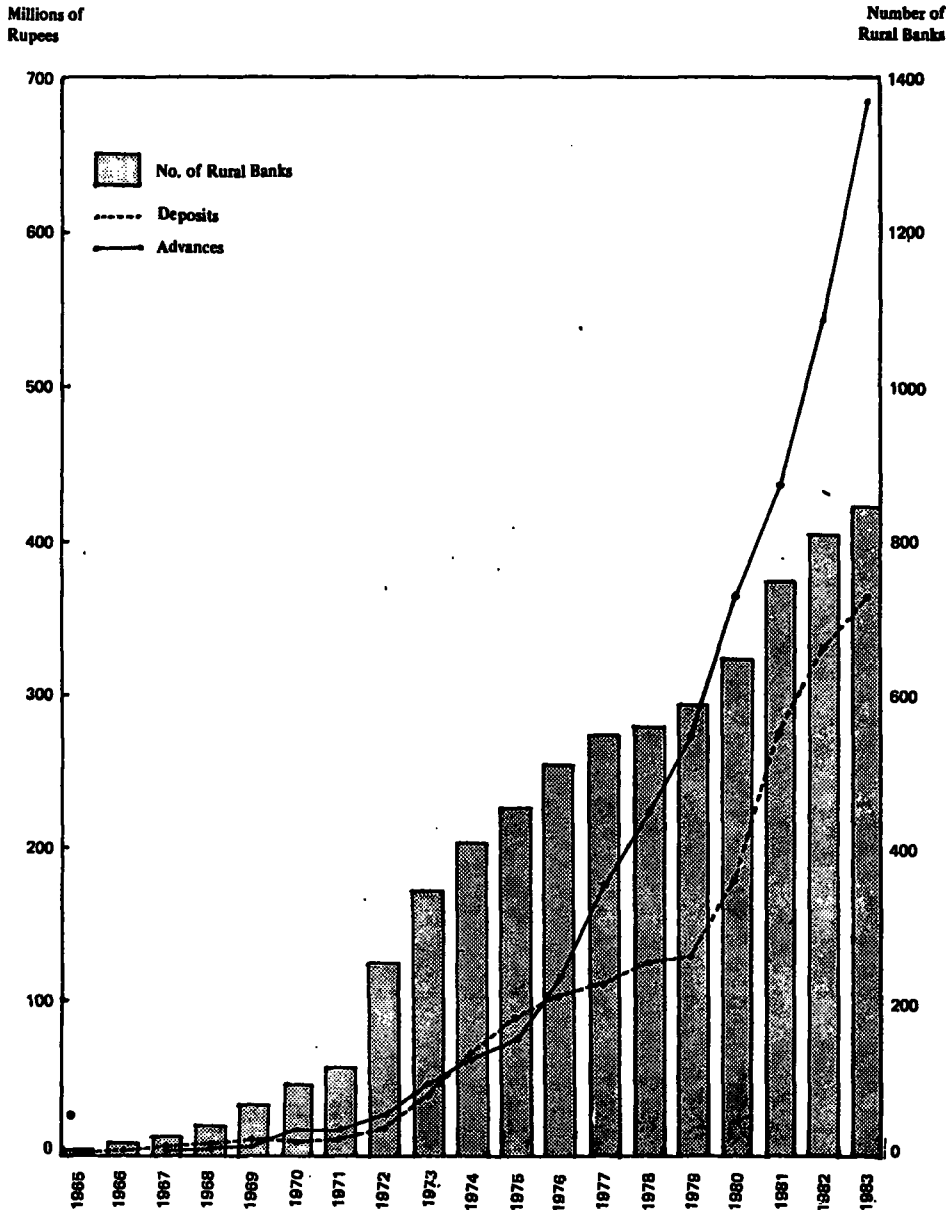


GROWTH OF RURAL BANKS AND THEIR DEPOSITS AND ADVANCES



the Central province. This was followed by another important step of the colonial government, namely, the appointment of an Agricultural Banking Committee in 1909, which highlighted the gravity of the problem of rural indebtedness in the traditional sector as against the enclave sector of the economy. The committee further advocated the establishment of Co-operative Credit Societies, which would enable the small farmer to borrow at a reasonable rate of interest for his agricultural needs while offering him an inducement to invest money in his lands, in manure, in providing agricultural machinery etc., all of which could bring the farmer a return more than commensurate with expenditure he incurred. Consequently the Co-operative Societies Ordinance was enacted in 1911, and this is considered the beginning of organised credit for small farmers in the traditional sector of the economy.

The first Co-operative Credit Society, registered under this Ordinance, was an unlimited liability society modelled on Raiffeisan lines where members were individually and jointly liable for the debts of the society.

Credit societies of limited liability and Co-operative Thrift and Savings Societies were two other types of Co-operatives founded in the early period. However, these two types had a considerable urban-middle class bias both in their outlook and formation. Even the credit societies of limited liability were of numerous types although they had a fundamental advantage of having an explicit rural-small farmer orientation.

In later years there was a trend for the co-operative thrift and savings societies of public servants to be transformed into societies of limited liability so that they could expand their loan business by removing the restriction of loans to a percentage of the savings held.

RURAL BANKS IN SRI LANKA

Rural Banks in Sri Lanka mark their 20th anniversary of operations in March this year. In the last two decades, and especially since the re-organisation of the Co-operative sector in 1972, the Rural Banks have grown rapidly. This special report describes the history of the Rural Banks, their growth, as well as the degree to which they

have achieved their stated purpose of mobilising rural resources for development.

CO-OPERATIVE CREDIT BEFORE 1964

The history of co-operative credit societies extends as far back as 1906, in which year the first co-operative credit society was established in Dumbara in

CO-OPERATIVE CREDIT SOCIETIES

In the early decades co-operative credit societies of unlimited liability were the most numerous type and they catered to the rural population. Apart from introducing organised credit for the first time to the farmer, they also signalled the entry of a new institution to encourage thrift and savings at the Village level. Up to that time the only institutions available to the small saver were offices of the Post Office Savings Bank.

In the years following 1930 and upto the 1950s these credit co-operatives continued to increase in number, membership, shares, deposits, resources and assets. It was observed of the credit societies of the unlimited liability type that throughout their active life-span of over forty years they embodied in a very real sense the basic co-operative philosophy of self help and mutual help. It is unrealistic to expect a comprehensive coverage of credit by these societies, based on their own funds, owing to the impoverished nature of the rural economy. Therefore, funds were drawn from external sources, such as the state owned 'Local Loans and Development Fund', to meet short term liquidity problems. It should, however, be noted that the resources of the Co-operative Societies that came in the form of share capital, deposits and resources consistently supported a substantial proportion of their own lendings. The figures on the percentage share capital and member

deposits to total loan outstanding between 1953 and 1967 illustrate this position.

The prime intention of having co-operative credit societies was to solve at least part of the problems associated with rural credit and indebtedness. The societies were composed of small groups of persons known to each other and the loans issued were generally in the region of Rs. 100/- for a duration of one year on the average. The loans were chiefly for agricultural or non agricultural production and the farmers' essential consumption and other needs were not provided for. Besides, the societies were not geared to provide short term and medium term credit needs for the farmers.

CO-OPERATIVE BANKING SYSTEM

The co-operative structure of the country entered a new era in the early 1930's with the commencement of the co-operative banking system, formed by affiliating the primary credit societies to Co-operative Central Banks. The first one of this kind was established in Jaffna in 1929; which marked a turning point in co-operative credit history, as it enhanced the consolidation of credit societies and strengthened the financial base of the entire movement. These banks in practice accepted time and savings deposits both from co-operatives and the public although demand deposits were accepted only from the co-operatives. In

the meantime their credit lines indicated a conscious bias towards credit societies in granting advances.

The Banking Commission of 1934 revealed that the British based Exchange Banks were catering exclusively for the enclave economy, having a partiality for British nationals. Therefore the only institutional form of credit available for Sri Lankans was the Co-operative Credit system although it catered to a very small strata of society. The Banking Commission appreciated the overall performance of the co-operative credit system, particularly its growth rate and area of coverage. A noteworthy observation of the Commission was that the Co-operatives had liberally accommodated their members and the system on the whole was ideally suited for the land owning cultivators. This observation highlights the selective approach of these societies in delivering credit and banking services only to the land owning class of the rural economy.

The year 1949 marked another turning point in the history of co-operative credit with the establishment of the Co-operative Federal Bank of Ceylon Ltd which was the apex body for all co-operative banks and credit societies. The co-operative banks and the other co-operative societies were eligible to be share holders of their apex bank. Along with the Co-operative Federal Bank there came the Co-operative Agricultural Production and Sales Societies (CAPS) which were basically a state creation rather than a spontaneous co-operative development.

A prime responsibility of this organization was to act as a commission agent of the government for purchase of commodities coming under the guaranteed price scheme (GPS). Besides functioning as marketing agencies these societies were also used by government as a medium for channelling loans to farmers for cultivation. Des-

Years	Total Loans Outstanding Amount Rs. '000	Share Capital (Members Deposits)	Percentage of Share Capital and Members Deposits to Total Loans Outstanding
1953-57	38,250	18,382	47.92
1958-62	50,513	28,864	56.15
1963-67	50,923	30,521	59.93

pite the very ambitious programmes drawn up the CAP Societies too succeeded in reaching only a limited segment of the small farmer population. Another drawback was that the classical co-operative concepts of mutual help and self-reliance were hardly evident in the new CAP Societies.

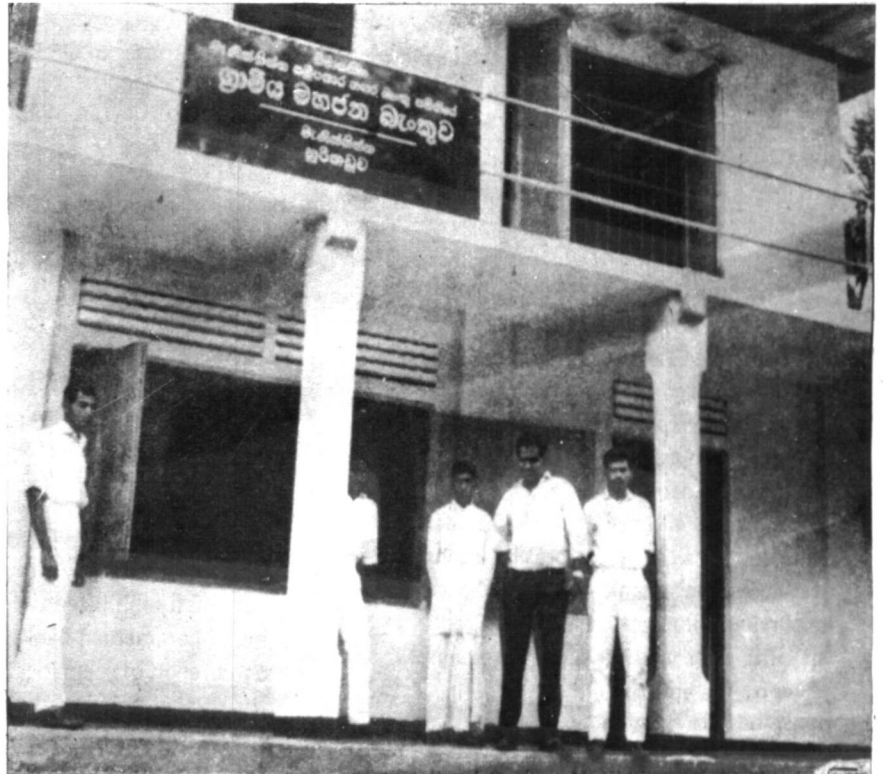
On the basis of the findings of the survey on 'Rural Indebtedness in Ceylon' 1957, the Co-operative structure was organised by establishing an islandwide network of Multi-Purpose Co-operative Society's (MPCS) with the object of promoting inter alia rural credit on a comprehensive basis. An established view at this time was that the multipurpose form of society where credit, marketing, provision of consumer goods and other services were combined was superior to the single purpose form of co-operative. The scheme was a multi objective one, where the MPCS's were expected to operate as a village bank providing credit, mobilising savings, and playing a catalytic role in stimulating the overall development of the village.

The objectives of the MPCS movement were laudable, although in practice the then-existing co-operative banking structure, representing the apex Co-operative Federal Bank on the one hand and the Provincial and District Co-operative banks on the other, was ill-equipped to meet the increasing financial commitments of the new structure. The self-imposed restriction arising out of the insufficient financial base, and the limits created by the unit banking approach appeared to be counter productive in the context of increasingly high financial requirements. Thus, setting up of a specialized bank possessing the much needed structural strength to supply the co-operative movement with adequate finance and absorb the risks became a dire need in this period. In 1961 the People's Bank was established to fulfill this need and the objectives of this new bank, as spelt out in the People's Bank Act,

were as follows "The purpose of the Bank shall be to develop the Co-operative Movement of Ceylon, Rural Banking and Agricultural Credit by furnishing financial and other assistance to co-operative societies, cultivation committees and other persons"

Bank. Thus capital of the People's Bank was owned equally by the government and the co-operatives.

The People's Bank in a very short period of its operation realized the high cost of extending 'banking and



Bank officials at the opening of the first Rural Bank at Manikhinna in the Kandy District, on March 26, 1964.

It was envisaged that it would acquire the necessary structural strength by providing it

- (1) Government participation in the share capital.
- (2) Provision to engage in all aspects of commercial banking
- (3) Provision to establish a branch network
- (4) Statutory requirement that all co-operatives should bank with the new bank so that the limited resources of the movement could be concentrated in one financial institution.

Accordingly all the 17 Co-operative Provincial and District Banks merged with the newly established People's

agricultural credit' to remote rural areas particularly where there was limited banking business. The difficulties involved in servicing loans, of a small size to a large number of small farmers on a direct banker-borrower basis, compelled the bank to channel credit through the co-operative network. However, the year 1963 witnessed the introduction of a People's Bank sponsored Extended Credit scheme which provided credit through the multipurpose co-operative network. This network was composed of over 14,858 co-operative societies by the end of 1964, which made it the prime source of institutional credit to the rural sector.

The Extended Rural Credit Scheme, introduced by the People's Bank

in 1963, is considered the forerunner of the Co-operative Rural Banks. So much so that the new scheme was intended to be an effective vehicle to eliminate the discrepancies created by the middlemen and money lenders, while at the same time mobilising the savings in the rural sector. However, the scheme did not perform in the expected manner which led to the setting up of a specialised institution called the Co-operative Rural Bank (CRB) to cater to the overall financial needs of the rural sector.

The functions of CRBs include acceptance of savings and fixed deposits from members and non members in a better organized manner and its line of financing covers agricultural production, animal husbandry, cottage industries, debt redemption, electrification, consumption and relief of distress. It also functions as a pawn broking agent of the People's Bank and a media of disbursing Comprehensive Rural Credit for cultivation and other purposes specified by the government. The People's Bank had to play a crucial role by way of providing financial, managerial, supervisory and technical assistance to enable the rural banks to overcome their shortcomings, and function as viable-self sufficient units. The People's Bank in turn gains knowledge of conditions in the rural areas which helps to build up effective contact with the rural clientele. The functions of CRB may be summarized as follows:

- (1) Mobilization of deposits from members and non-members
- (2) Provision of loans and other accommodation to members for production and consumption purposes.
- (3) Provision of pawn-broking facilities to members and non-members
- (4) Provision of money payment and transfer

The CRBs operating in a limited area have the advantage of intimate knowledge of the local individuals.

This has significance in a situation where there is difficulty in finding conventional forms of security to satisfy the procedural needs of the lending institutions, contributing to the perpetuation of poverty and indebtedness.

These advantages of CRBs were summarized in the annual report of the Central Bank of Ceylon in 1965 as follows:

"Rural Banks, as operated in Ceylon, incorporate a blend of the advantages of unit banking and branch banking. They are :

- i) The decentralization of the lending decision through the use of local knowledge available to the committee of management of each co-operative. Such knowledge has proved useful in solving the problem of security which has greatly inhibited the lending of commercial banks through branch officers located in the rural areas.
- ii) Access to overdraft facilities with the People's Bank which mobilizes resources from surplus areas through the system of branches.
- iii) The lower cost of operation made possible by the economies resulting from the minimising of centralised management and also by the local recruitment of staff.

At the time of setting up of the Rural Banks it was clear that the very nature of the rural economy provided the basis for the establishment of banks of this type. The bearing of economy on these was well analysed in a paper by two economists of the Central Bank who showed that the rural economy was almost entirely dependent on agricultural activity and was characterised by income flows only at harvest times while expenditure for production and consumption needed to be fairly continuous and

regular. At harvest time the surplus of funds over immediate needs could be mobilised for use in other areas where the production-consumption cycle is at a different stage. Such mobilization of funds and their transmission to deficit areas is of mutual benefit to both savers and borrowers. The link between the rural banks and the People's Bank enables this type of mobilization and transmission of funds. Funds in a rural bank area may also be utilized within the area itself in the deficit sector

However, the mobilization and use of funds within a 'rural bank sector' may be limited by the low level of income in the area. In such circumstances, it is necessary to provide these deficit areas with supplementary resources, mobilized elsewhere in the more developed and prosperous sectors of the economy. Here again, the rural bank's link with the overall resources of the People's Bank provided a means of credit to deficit areas.

The period 1964 to 1972 should be considered largely an experimental phase in the evolution of rural banks. The period after 1972, coinciding with the re-organisation of the Co-operative Societies, saw a period of rapid expansion of the Rural Banks. In the period 1964 to 1972 there were only a few Rural Banks in selected Co-operative Societies. The expansion was then relatively slow, as seen from the following statistics in table 1. An important aspect of lending policy during this period was that loans were restricted to purposes other than paddy production. (Also see figure 1). • • •

A period of increased growth emerges after the re-organisation of the Multi Purpose Co-operative Societies in 1972. In this reorganisation, a large number of small and uneconomic Multi Purpose Co-operative Societies were brought together to form larger units. The idea was to reduce the number of societies and increase the standard of management. Each such

THE ROLE OF RURAL BANKS

A characteristic of agricultural activity is the periodic failure of crops. The availability of credit from rural banks at reasonable rates of interest could minimize hardships at such times and redeem farmers from indebtedness caused by such calamities. In fact a significant proportion of the funds lent by rural banks has been for debt redemption. The release of farmers from high-interest lenders could relieve farmers of chronic indebtedness. This often reduces the profitability of agricultural production owing to both, the increase in production costs and reduced prices due, to the commitment of produce to lenders at below market prices.

For several reasons a rural bank is in a better position to perform the lending functions in a rural area than a branch of a commercial bank. A rural bank operates in a limited area and therefore, has the advantages of an intimate knowledge of both local conditions and of persons served by the bank. This is particularly significant in a context where the customarily acceptable forms of security are very limited. The continued insistence on these therefore tends to perpetuate conditions of poverty, the fundamental reason for which is the lack of adequate capital. A greater intimate knowledge of the borrower permits a rural bank to give credit on personal security and on the security of guarantors rather than on real assets or collateral.

A rural bank is much less costly to operate than a branch of a commercial bank. The limited operations in a rural bank area necessitates the provisions

of banking facilities at lower costs than those of operating a branch bank. In terms solely of the cost of operating a branch bank, rural bank areas may not be served with any commercial bank branches. A rural bank is often housed in the co-operative society building and engages persons on its staff who are paid lower salaries than regular People's Bank staff members. The choice in these areas is between limited banking facilities as provided by rural banks or no facilities at all.

From the point of view of the rural clientele the provision of even limited banking facilities by a local and familiar institution may be preferable to a more imposing but less comprehensible, type of institution. The personal acquaintance of bank personnel and the operation of the bank at times convenient to the clientele are advantages of particular significance in a context of non-familiarity with institutional savings and credit organisations.

The scheme of rural banks could be looked upon as a means of extending even limited banking and credit facilities to areas whose conditions do not justify the extension of the branch banking system. It is also a means of combining the advantages of a unit banking system such, as personalised knowledge of the clientele and local conditions, with the advantages of a branch banking system, which enables the transfer of resources between different areas and a greater security and stability of funds.

Source: *The role and performance of Co-operative Rural Banks in Sri Lanka 1964-1976.* Sumanaratne Kahagalle and Nimal Sanderatne.

re-organised large Co-operative Society had a Rural Bank. The number of rural banks rose rapidly as a result. By the end of 1973, there were 341 rural banks corresponding to each of the 341 Multi Purpose Banks which were opened in the sub-branches of the Multi Purpose Co-operative Societies or *Pradeshikas*. This resulted in a

further expansion of the number of branches as seen in the following Table 2. The decrease in the number of Rural Banks since 1973 was due to that amalgamation of multi-purpose co-operative societies. As a result of this amalgamation, a number of rural banks were converted into special branches. By 1983 the number of

Table 1
Expansion of Rural Banks
(1964 - 1971)

Year	No. of Rural Banks
1964	3
1965	8
1966	13
1967	27
1968	44
1969	68
1970	70
1971	111

rural banks was over 825; a strong contrast to the 112 branches of 1971, before the re-organisation. Table 2 together with figure 1, indicates the relatively slow growth upto 1972 and the uniform rapid expansion thereafter. (Table 2).

After the reorganisation the Rural Banks were re-designated Co-operative Rural Banks. A survey conducted by the People's Bank of Co-operative Societies, in the latter part of 1983, to assess the need for any further expansion of branches has revealed that according to the perception of the Co-operative Societies managements over 80 percent of the need for rural banks has already been met.

With the increase in the number of branches, there has been a corresponding increase in the number of deposit account holders. A pattern of steady growth from 1964 to 1972 with a rapid growth thereafter, since the re-organisation, is indicated. The growth of deposits also follows the trends described above. Deposits grew at a slow and steady pace upto 1972 when the amount of deposits was Rs. 23 million. However, after 1972 an almost exponential growth is shown in the deposits. In 1976 the deposits stood at Rs. 116 million, in 1980 it was at Rs 334 million. It further increased to Rs. 683 million by the end of 1983. (See figure on Page 10.)

Table 2
Expansion of Rural Banks
(1972 - 1983)

Year	No. of Rural Banks	No. of Special Banks	Total
1972	242	—	242
1973	341		341
1974	332	71	403
1975	338	109	447
1976	345	158	503
1977	285	259	544
1978	284	275	559
1979	284	303	587
1980	284	357	641
1981	284	459	743
1982	286	518	804
1983			840

Under the rules of the rural banks any member of the public, whether a member of the Multi Purpose Co-operative Society or not, could deposit money in the rural bank. However, they could obtain loans only if they were members. The conditions for membership are liberal. For example,

FIGURE I

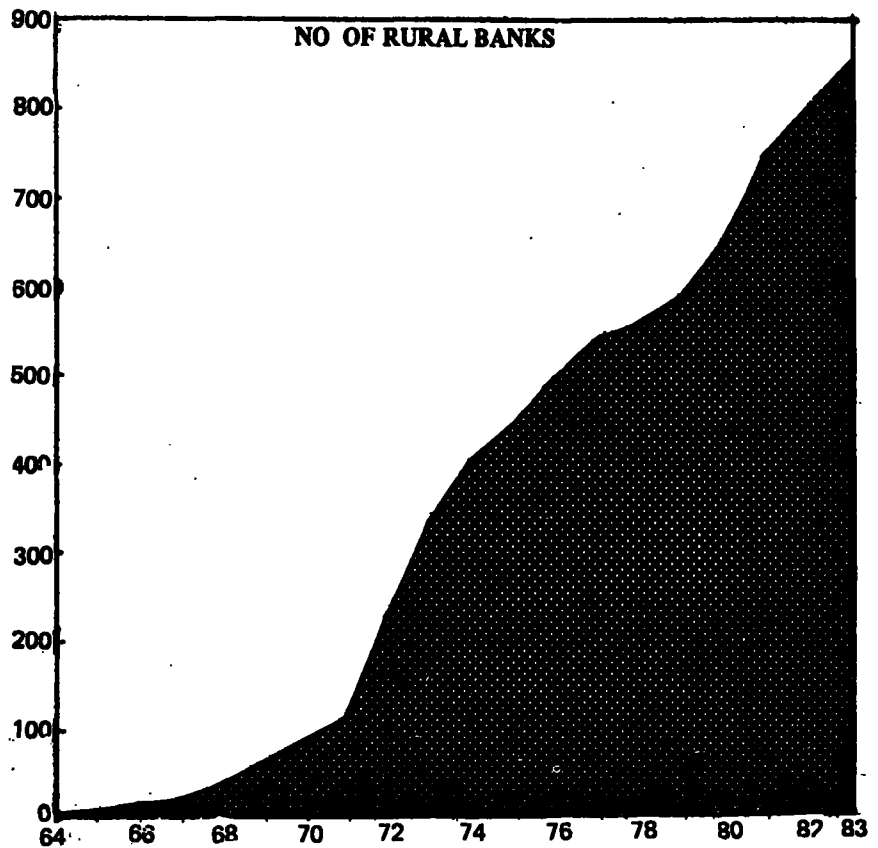
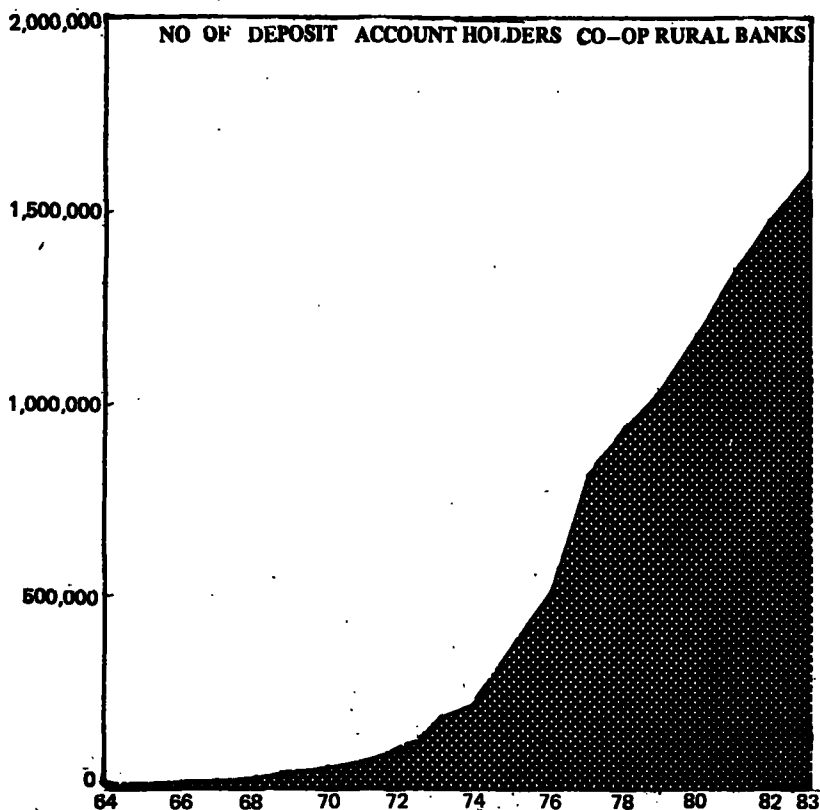


Figure II



a membership fee of only Rs. 1/- is charged once and for all, a contrast to the situation before the re-organisation, where a membership fee of Rs. 50/- was charged, in effect shutting off large sections of the population. As at 1972 the number of deposit holders stood at 97,000, at 1978 942,000, and in 1983 there were 1,595,000 deposit holders. This dramatically indicates the effectiveness of the reorganisation. (See figure II) A study carried out by the People's in 1978 covering a specific sample, showed that, after 13 years of service, as much as 39 percent of the total membership within the sample area had opened savings accounts in the rural banks which is by no means an insignificant achievement.

Those eligible for loans from rural banks are those who are members of the Co-operative Society and those who already have deposit accounts in the rural banks. However, under recent amendments to the rules (in 1983) even non-members with a deposit account with the Bank could withdraw money by pawning articles.

**The Recovery Position of Rural Banks in Relation
to Short Term Loans by People's Bank Administrative Regions
as at 30.9.1983**

Region	Short-term Loans	Defaults
Anuradhapura	Rs. 7,835,459/-	Rs. 4,433,050/-
Badulla	Rs. 10,410,659/-	Rs. 3,633,162/-
Trincomalee	Rs. 872,907/-	Rs. 208,205/-
Colombo	Rs. 11,367,085/-	Rs. 1,822,805/-
Gampaha	Rs. 19,982,697/-	Rs. 3,847,117/-
Jaffna	Rs. 1,959,939/-	Rs. 769,647/-
Kandy	Rs. 11,035,315/-	Rs. 2,727,575/-
Matale	Rs. 3,159,965/-	Rs. 857,400/-
Nuwera Eliya	Rs. 4,699,318/-	Rs. 1,586,638/-
Kurunegala	Rs. 23,099,972/-	Rs. 2,024,489/-
Galle	Rs. 13,005,097/-	Rs. 1,359,496/-
Matara	Rs. 9,697,467/-	Rs. 950,080/-
Kalutara	Rs. 6,132,248/-	Rs. 1,119,321/-
Kegalle	Rs. 5,998,808/-	Rs. 988,974/-
Ratnapura	Rs. 7,886,241/-	Rs. 1,812,828/-
Total	Rs. 137,143,177/-	Rs. 28,140,787/-

Although there has been a dramatic increase in the number of deposit holders since the re-organisation, the same does not seem to have occurred as far as loan recipients are concerned. Thus in 1970 the number of persons making use of loan facilities in rural banks stood at 10,000. The corresponding figures for 1972, 1976, 1980, and 1983 are respectively 12,000, 43,000, 59,000, 65,000. This shows a very slow growth in comparison with the growth of the number of branches or with the growth of number of deposit holders. It indicates that the re-organisation has had no effect on the number of loans granted. In contrast to loans, pawn broking activities have increased very significantly in the two years following the re-organisation. In

1972 the number of persons who had pawned articles stood at 61,000 whereas this figure had increased to 235,000 by 1974. Two factors contributed to this increase.

Firstly, the expansion of rural bank branches, and secondly, the higher rate payable for gold which went up from Rs. 250/- to Rs. 500/- per sovereign in 1973. However, mid 1970's also saw a rapid rise in prices of gold worldwide but the value of gold was not put up by the rural banks to keep pace with this rise. Consequently, there was a drift away from rural banks to private pawn brokers during this period, as is evidenced by the drop in the number of persons obtaining pawning facilities from 1974 to 1978.

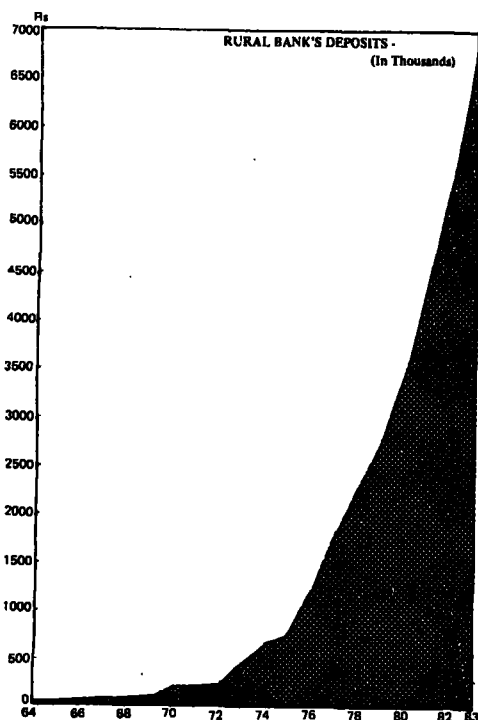
In 1979 the rate was again increased to Rs. 560/- per sovereign and the number of those seeking pawning facilities has shown a steady rise from the low figure of 1979 to the present. The 1983 figure of 315,000 persons making use of pawning facilities, however, is only slightly higher than the 1975 figure of 299,000.

Although the number of persons making use of loan facilities in the rural banks has not been commensurate with the rapid expansion of the system in 1972, the total number of loans granted by the system has increased significantly. Thus, after a steady growth, the total amount advanced at 1972 stood at Rs. 8 million and increased rapidly thereafter to Rs. 47 million in 1976, Rs. 79 million in 1980 and Rs. 137 million by 1983. (See figure) There was however a slight plateau in the period 1978-1979, coinciding with the withdrawal of Central Bank's guarantees for such loans.

The statistics indicate that a relatively few people have been making use of loan facilities, while a large number of those eligible have not obtained loans. In other words, the number of advances per person has increased at a faster rate than the number of persons served by the Banks. Detailed follow up studies also indicate other trends in this concentration of loans where there is evidence that sometimes persons close to rural bank decision making have been availing of loans more often than others.

The total volume of pawning advances also shows rapid increase from 1972. In 1970 the total amount of pawning advances which stood at Rs. 2 million and increased to Rs. 54 Million by 1976; they grew very slowly during the period 1976 to 1978 because of low rates paid for gold by the rural banks and increased rapidly after 1978. In 1978, the total amount of advances in pawning stood at Rs. 61 million increasing to Rs. 224 million in 1983. (See figure).

The graph on the growth of deposits and advances in rural banks since its inception also reveals many interesting features. Since of late, the



deposits have been increasing at a more rapid rate than advances. Upto about 1976 the deposits and advances had kept apace, but thereafter the two diverged significantly. The importance of this fact is that savings from the rural sector are not being fed back to the rural sector, but are being channelled elsewhere. The rural banks themselves make their major investments in deposit accounts in the People's Bank and thereafter rural savings find their way into the general financial activities of the People's Bank. The more significant of these activities generally belong to the growth areas of recent times, namely construction, and foreign and internal trade.

Although rural savings are not being mobilised (except in a few cases) within the rural areas themselves, this is not necessarily a bad thing. Most areas can still gain if the benefits from investment of these funds flow back in an indirect way. Rural savings and surpluses from the rural areas have often fed urban development and helped industrialisation in a wide variety of contexts. The industrialisation of the Soviet Union in the 1930's is an example of peasantry contributing to industrialisation.

However if rural savings are being used for activities which, in the long run, are not in the interest of the rural sector and the country, that naturally would be harmful. In a climate where pure market forces prevail, individual rural banks or the People's Bank itself could not be blamed for following strategies which in a sense pump rural savings into other sectors, because it is here that the maximum profits lie. Specially in a climate of competition among banks, profit becomes a priority consideration. Both the People's Bank Act and the by-laws of the Co-operative Department, under which the Rural Banks were formed, implicitly specify that the savings should be channelled to the rural sector itself. The economic climate for such channelling can however be created only by macro-governmental policy measures which will then skew returns of Bank investment towards the rural sector

There are also significant regional variations in utilisation of deposits. The activities of the People's Bank are divided into fifteen regions. The large-

st amount of deposits from Rural Banks are found in the Gampaha Region (Rs. 133.6 million) with the lowest in Batticaloa Region (Rs. 9.3 million). Similarly the largest advances (Rs. 61.6 million) are found in the Gampaha Region and the lowest in the Jaffna Region. This low figure in Jaffna is explained by the fact that pawning, because of security considerations, has been stopped in rural banks for quite sometime. Gampaha Region has the largest surplus over advances, amounting to Rs. 72 million; whilst Batticaloa Region has the least with advances being higher than deposits. The figure stood at a deficit of Rs. 4.7 million. It should, however, be noted that the quantum of both advances and deposits for Batticaloa Region are much smaller than the more densely populated Gampaha Region. If one were to examine the amount of deposits utilised within the region, we find that Batticaloa Region comes highest with (150 percent) more loans being given out than deposited. On the other hand, the lowest on this count is Jaffna Region with only 14 percent of that deposited being lent out.

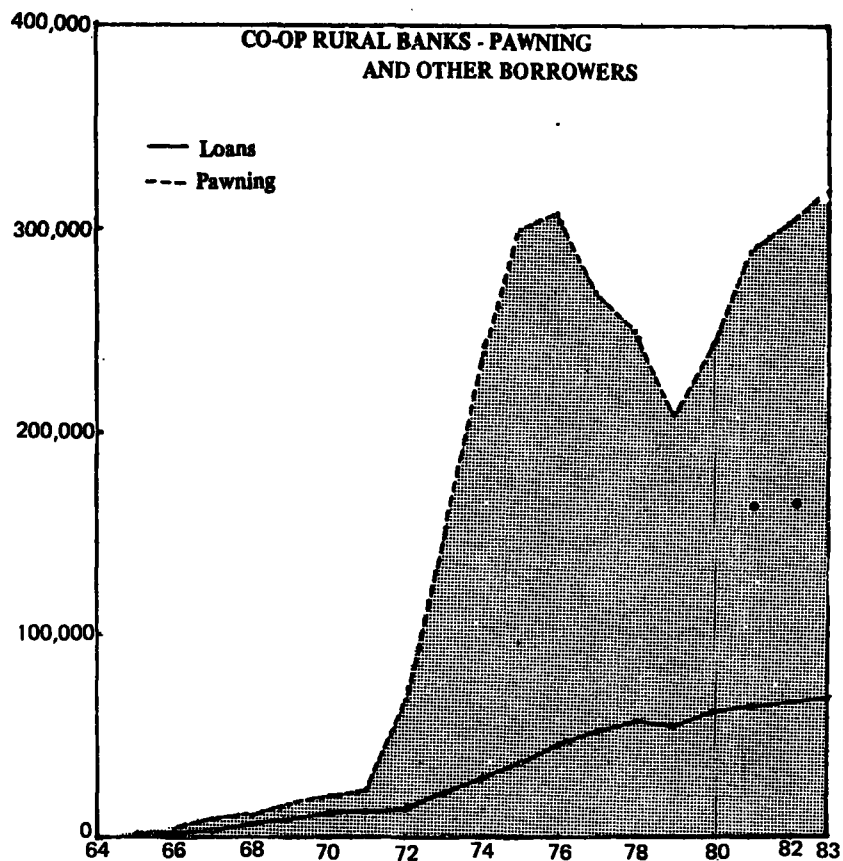
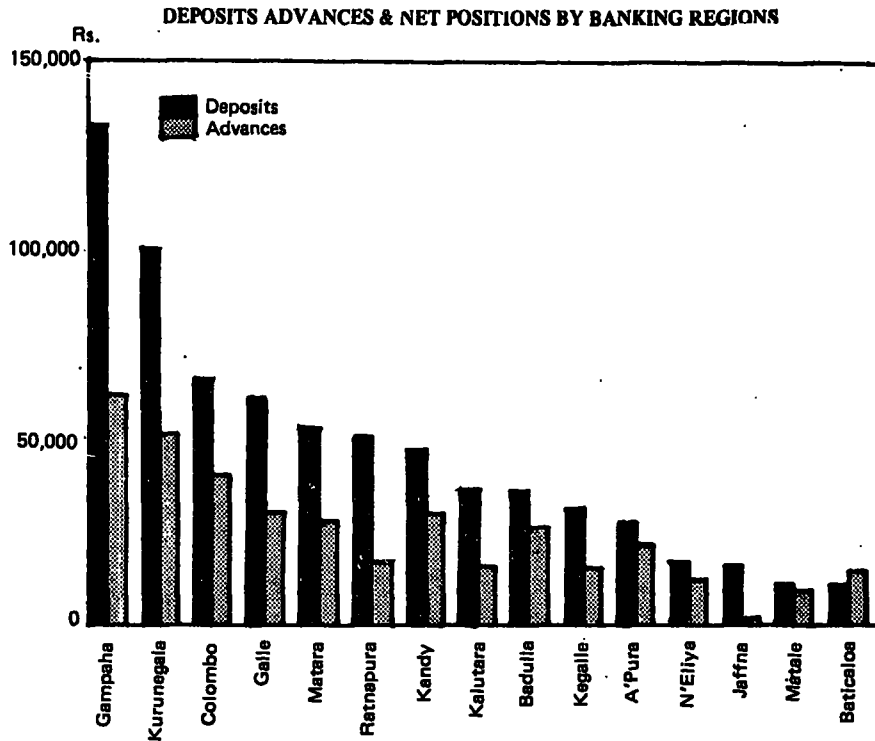


Figure III



which is about 7 times more than is being deposited in Jaffna Region. It should be noted that the Jaffna Region loan pattern is skewed by the security situation; with pawning being suspended in rural banks. The bar chart on this page illustrates these factors.

However, the concept of a rural to urban pump of financial resources, using only the figures from rural banks would be misleading. The People's Bank and other banks also operate in rural areas. When considering these factors, some of the general observations we have made above may have to be revised; especially as high income farmers tend to deposit more in the People's Bank than in commercial banks. A study by Chandra Fonseka has indicated that although Jaffna scores high on the rural to urban pump in the rural banks, when the People's Bank is included this position was almost reversed. To correct the picture therefore, one has to keep the activities of the commercial banks in mind, which aspect is not being covered in this report. There are no island wide studies which reveal who the major depositors are, and the main loan recipients of the rural banks. A few case studies conducted by the People's Bank, Research Department on certain selected areas however indicate inter-

FIGURE IV

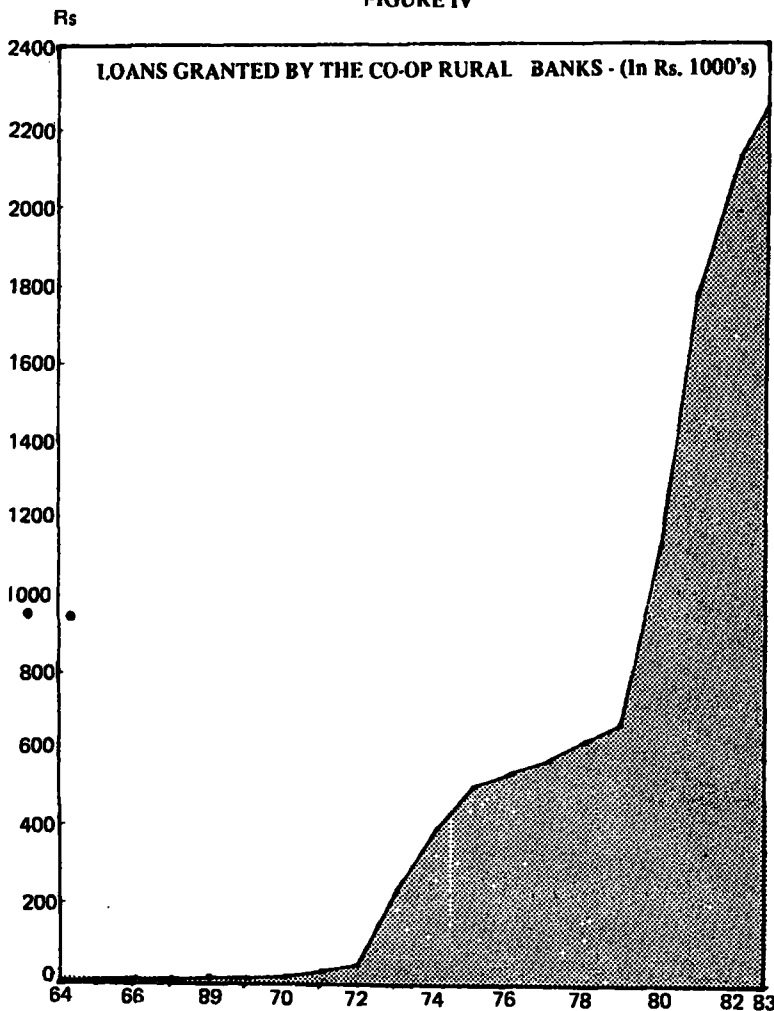
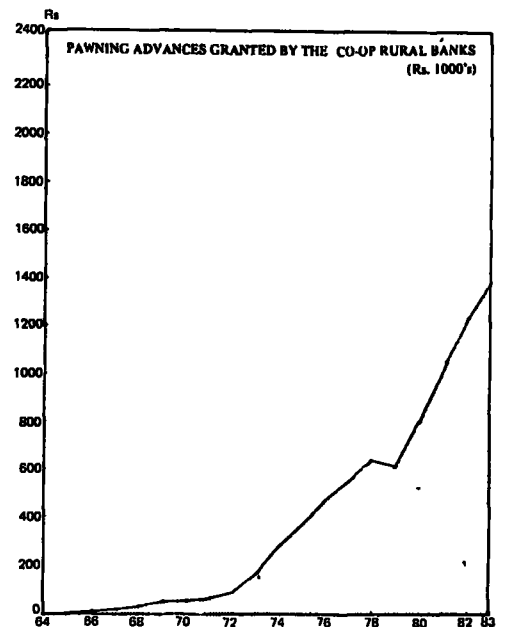
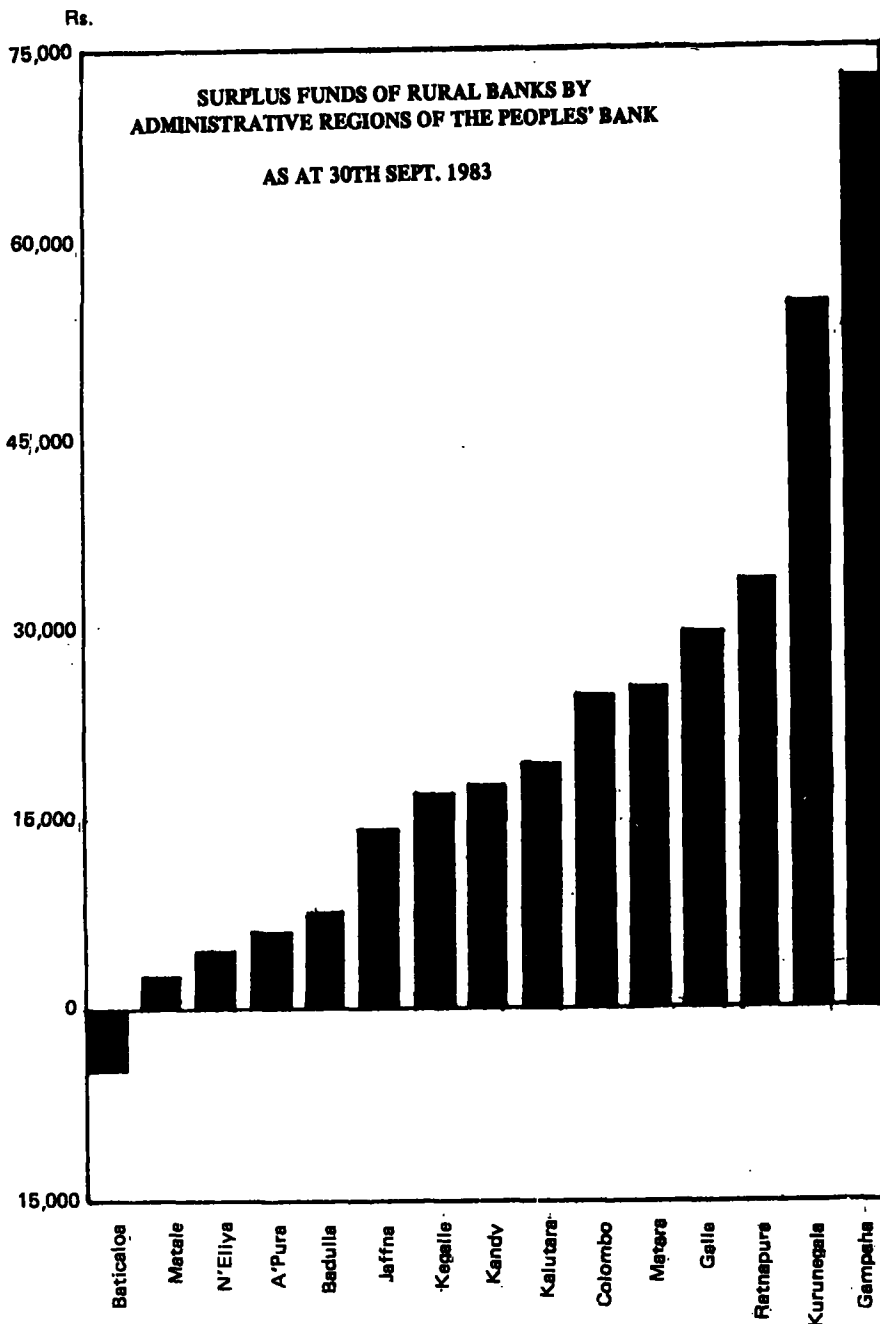


FIGURE V





esting trends. Thus a study done on Rural Banks in the Kandy District, indicates, the following:

"Highest amount of deposits in the rural banks seem to have been made by the middle income groups. Their share accounts for 93.36 percent of the total amount of deposits. Even in the amount deposited per account, this group is in the lead with a mean of Rs. 583,790 per account as against Rs. 26.5 and Rs. 63.28 for the lower and upper income groups respectively. Those of the lower income group amount to only 3.03 percent".

Of those who have made borrowings from all sources, only 38.26 percent have borrowed from the rural banks in the Kandy District. Almost all these persons are either farmers or salary earners. In terms of income groups 59.31 percent of the borrowings are made by the middle income groups.

This study shows that both the recipients, as well as depositors, seem to come from the same middle rural stratum. Very probably the higher rural income groups go to the Com-

mercial Banks directly, whilst the marginal farmers do not go to the banking sector at all, but have recourse to the informal sector. These broad results have also been borne out in several studies by the People's Bank, Research Department on access to credit through People's Bank branches in the Mahaweli area.

Default rates on short term loans also show a strong regional variation. This is contrasted with the overall rate of 48 percent for agricultural lending to the paddy sector by the commercial banks. The rural sector is considered a high risk lending area into which the rural banks, as well as the national banks, the People's Bank and the Bank of Ceylon have ventured. The 80 percent recovery rate for rural banks fares quite favourably with similar figures in neighbouring countries. For example, the All India recovery rate for agricultural loans is 54 percent for the rural sector. Region wise, the lowest recovery rate is in the Anuradhapura Region. (Anuradhapura Region under the People's Bank classification includes the districts of Polonnaruwa, Trincomalee and Anuradhapura). The next lowest recovery rate is in the Jaffna Region with 39 percent and Badulla and Nuwara Eliya being around 35 percent. The best recovery rate is recorded in the regions of Kurunegala, Galle and Matara with a default rate of only 10 percent. Others have intermediate positions.

Although the magnitude of default is comparatively low, it has posed a major threat to the expansion of credit to rural areas. A variety of reasons are attributed to the high defaults of which crop failures and low incomes play an important role. Two other commonly seen categories of defaults are of those farmers who defaulted wilfully and those farmers who defaulted at the instigation of politicians. However, studies conducted by the People's Bank suggest that the income levels of small farmers in the rural areas are insufficient to repay their loans. This is particularly true in cases where paddy farming is the sole income generating activity; here the farmers are often compelled to match all their escalating living expenses with

Table II

GROWTH OF RURAL BANKS IN SRI LANKA

Year	No. of Rural Banks	DEPOSITS			ADVANCES			Differences between deposits and advances Rs.	
		Savings Deposits Rs.	Fixed Deposits Rs.	Total Rs.	Short-term loans Rs.	Pawning Rs.	Total Rs.		
1965	8	491,626	4,734	496,360	914,669	252,596	1,167,295	- 670,935	
1966	13	703,011	22,737	725,748	1,326,475	427,129	1,733,586	-1,027,836	
1967	27	1,305,846	65,381	1,377,227	2,029,476	633,213	2,662,689	-1,291,462	
1968	44	3,110,576	222,614	3,333,196	3,360,731	1,085,613	4,716,344	-1,383,134	
1969	89	5,712,893	460,168	6,173,061	3,572,281	1,823,646	7,095,927	- 922,836	
1970	90	16,109,287	799,117	16,908,406	7,122,213	1,980,066	9,102,279	+7,806,126	
1971	111	17,188,297	676,106	17,864,403	7,144,913	2,171,734	9,316,647	+8,547,756	
1972	242	22,703,136	617,150	23,320,586	8,226,663	6,958,250	15,184,913	+8,135,673	
1973	341	44,281,601	872,935	45,154,536	16,177,708	22,734,438	38,912,146	+8,242,390	
1974	R.Bs. 332 S.Bs. 71	403	61,549,118	1,185,243	62,715,361	29,008,262	38,398,508	67,406,770	-4,671,409
1975	R. Bs 338 S.Bs 109	447	72,833,887	1,380,104	74,213,971	37,387,369	49,898,203	87,285,512	-19,071,601
1976	R.Bs. 345 S. BS. 158	503	114,495,097	1,793,923	116,289,020	47,624,595	54,167,951	101,792,546	+14,496,474
1977	R.Bs. 285 S.Bs. 259	544	170,514,871	4,947,329	175,462,200	55,034,180	55,849,120	110,883,300	+64,576,900
1978	R. Bs. 284 S.Bs. 275	559	209,608,000	12,538,000	222,146,000	63,763,000	61,315,000	125,078,000	+97,068,000
1979	R.Bs. 284 S.Bs. 302	586	250,043,000	20,960,000	271,018,000	62,558,000	66,693,000	129,251,000	+141,767,000
1980	R.Bs. 284 S.Bs. 357	641	309,184,000	59,170,000	368,354,000	79,677,000	97,022,000	176,699,000	+191,655,000
1981	R.Bs. 284 S.Bs. 459		356,798,000	77,250,00	434,048,000	100,899,000	170,697,000	271,596,000	+162,452,000
1982			441,997,000	99,488,000	541,483,000	122,470,000	206,807,000	329,271,000	+212,212,000
1983			562,125,367	121,319,323	683,444,690	137,143,117	224,117,890	361,261,009	+322,183,681

a meagre producer margin. In such a situation the farmer tends to give priority to feeding himself and his family members. Therefore, however honest he is he will not be able to settle his loans because he is too poor to meet his obligations.

As revealed by the Bank's study in the Kandy district, "In terms of income groups the repayment rate is most satisfactory in the upper 20 per cent income group. While for this group the repayment rate is 80 per cent, it is only 50 per cent for the lower income group. This finding also corroborates the view that the non repayment of bulk of the rural credit is due to the inability of the farmers to pay."

The findings of this case study on Rural Banks in the Kandy District were applicable to most other areas as well, and still hold. Among the study's conclusions were the observation that the Rural Banks in a developing country like Sri Lanka are closely connected with the process of national development; being primarily concerned with the mobilisation of savings and the provision of credit needed for the development of the rural areas. This study highlighted the scarcity of capital required specifically for development of land and labour resources in the rural areas. A major step to fulfill this need was taken in the 1960's when this programme was begun to mobilise rural savings for the purpose of meeting the capital needs of these areas. It was the recognition of such needs that led to the setting up of Rural Banks.

Considering the views of all respondents who expressed their opinions on the performance of Rural Banks over this 14 years period, the study concludes that the majority maintained that the Rural Banks had rendered a useful service. This was the general consensus in the first systematic evaluation of the activities of Rural Banks since they were originally set up. More recent views on the Rural Banks and the scheme in general are contained in the following pages

MAP SHOWING DEPOSITS AND ADVANCES BY ADMINISTRATIVE REGIONS OF THE PEOPLE'S BANK

The following schedule gives the districts amalgamated to form administrative regions.

- | | |
|---|----------------|
| 1. Anuradhapura, Polonnaruwa, Trincomalee | - Anuradhapura |
| 2. Kurunegala, Puttalam | - Kurunegala |
| 3. Moneragala, Badulla | - Badulla |
| 4. Amparai, Batticaloa | - Batticaloa |
| 5. Matara, Hambantota | - Matara |

