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EFFECTIVE RURAL CREDIT DELIVERY IN SRI LANKA

© Submitted by Eric Bellows
in fulfillment of Thesis for
46.599

Norman Paterson School of International Affairs
Carleton University
November 1987

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The undersigned hereby recommend to the Faculty of Graduate Studies and Research acceptance of this thesis, submitted by Eric Bellows, in partial fulfilment of the requirements for the degree of Master of Arts.

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ABSTRACT

Lack of access to sufficient capital is a barrier to the poor being able to improve their production and therefore their incomes. Informal sources of funds are either insufficient or too costly. Formal sources, with their top-down approach, have rarely succeeded in reaching the poor. What is required is an effective local institution to solve the problem. Sri Lanka's Thrift and Credit Cooperative Societies provide a model of local savings mobilization, local lending, and democratic process which could be emulated elsewhere. Problems in the Sri Lankan societies include rapid expansion of membership, inadequate education and training resources and increasing governmental interference. Furthermore, the very poor are obstructed from borrowing by the requirements to purchase shares, hold sufficient savings and provide guarantors. A Grameen Bank (Bangladesh) type solution, involving group shares, group savings accounts and group loans (with group guarantees) is suggested to increase access to capital for the poor.

EFFECTIVE RURAL CREDIT DELIVERY IN SRI LANKA

0 1 Contents	i
0 2 List of Tables	iii
0 3 List of Acronyms	iv
0 4 Map Position of Matara District in Sri Lanka	v
0 5 Map Thrift and Credit Societies in Matara District	vi
Chapter One: The Role of Rural Financial Markets	1
1 1 Introduction	1
1 2 The Field Study	3
1 3 Definition and Major Functions of Rural Financial Markets (RFMs)	6
1 4 The Evolution of Development Thought on the Role of RFMs	8
Chapter Two: The Need for Rural Credit and Savings	14
2 1 Focus Groups	15
2 2 When Do Small Producers Need Credit?	21
2 3 Evaluating the Impact of Loans	24
2 4 Savings	27
Chapter Three: Institutional Viability	30
3 1 The Government	31
3 2 Lender Behavior in Credit Programmes	36
3 3 Interest Rates, Securities and Default	39
3 3 1 Interest Rates	39
3 3 2 Securities	45
3 3 3 Defaults	48
3 4 Savings Facilities	52
3 5 Performance Criteria for Financial Intermediaries	53
Chapter Four: Institutional Choice for Credit and Savings Delivery	58
4 1 Issues in Institutional Choice	58
4 2 Centralized Institutions	60
4 2 1 Government Agencies	61
4 2 2 Commercial Banks	66
4 3 Decentralized Institutions	68
4 3 1 Informal Lenders	69
4 3 2 Lending to Informal Groups	72
4 3 3 Informal Savings Mechanisms	74
4 4 Cooperatives, Credit Unions and Caisses Populaires	75
Chapter Five: The Poor in Sri Lanka and Their Need for Credit and Saving	79
5 1 The Sri Lankan Poor	79
5 2 Credit Needs of the Rural Poor in Sri Lanka	87
5 2 1 Farm Credit Requirements in Sri Lanka	89
5 2 2 Non-Agricultural Financing	97
5 3 Savings Facilities for the Poor in Sri Lanka	100
Chapter Six: Supply of Credit and Savings in Sri Lanka	103
6 1 Supply of Loans to the Rural Poor	103
6 1 1 Government Credit Schemes and Agencies	104
6 1 2 Informal Credit	107
6 2 Supply of Savings Facilities	111

6.3 Persistent Problems of Rural Credit and Savings in Sri Lanka	113
Chapter Seven: Setting of the Field Research: Matara District	117
7.1 Matara District	117
7.2 The Focus Group in Matara District	120
Chapter Eight: The Federation of Thrift and Credit Cooperatives (FTCCS)	129
8.1 A Brief History of the TCCS Movement	129
8.2 Functions and Problems of the FTCCS	132
8.2.1 National Organizational Activity	132
8.2.2 Banking and Financial Affairs	134
8.2.3 Training and Education	138
8.2.4 Village Development and Member Services	141
8.2.5 Conclusions on FTCCS Programmes	143
8.3 Relations with the Government of Sri Lanka	144
8.4 Overview of the TCCS Movement	150
Chapter Nine: The Matara District Union (DU)	153
9.1 Organization of the Matara DU	154
9.2 Functions of the District Union	159
9.3 Liaison and Political Matters	165
9.4 Conclusions	169
Chapter Ten: The Primary Societies (TCCSs) of Matara	171
10.1 Bylaws and Organization of Primary Societies	172
10.2 TCCSs in the Village: Descriptive Overview	177
10.3 Operational Aspects of Primary Societies	184
10.4 Education and Training	193
10.5 Primary Societies and the Poor	198
Chapter Eleven: Financial Profile of the Primary Societies	201
11.1 Savings	201
11.2 Loans	205
11.3 Interest Rates	218
11.4 Overdues and Defaults	219
11.5 The Focus Group	223
11.6 Conclusions on TCCS Finances	227
Chapter Twelve: The TCCSs - A Model for Rural Financial Intermediation?	228
12.1 The Cooperative Process in RFMs	229
12.2 The Rural Poor in the TCCS Model	230
12.3 Financial Functions and the TCCS Model	234
12.4 External Influence and Local Autonomy	237
12.5 Overview: The TCCS as Development Institution	240
Appendix: Methodological Notes	242
A. Field Placement and Components of the Work	242
B. Data Handling	246

LIST OF TABLES

Table 1 Mean Monthly Incomes of Rural Producers	81
Table 2 Daily Wages in Unorganized Agriculture: Gender Specific.	82
Table 3 Land Ownership by Economic Sub-Sector.....	85
Table 4 Categories of Loan Use in Rural Sri Lanka.....	88
Table 5: Average Seasonal Credit Needs of Paddy Farmers in Kurunegala District	89
Table 6. Financial Investments of the Poorest.....	101
Table 7 Means of Financing Paddy Production (Kurunegala District)	103
Table 8 Source and Amount of Loans: By Sector and Income Group	108
Table 9: Distribution of Loans by Rates of Interest and Sectors.....	109
Table 10 Average Monthly Borrowings and Repayments by Income Groups	110
Table 11 Volume of Deposits By Type of Institution.....	111
Table 11A: Share of Deposits by Type of Institution.....	111
Table 12 Real Interest Rates Paid by Commercial Banks on Savings	112
Table 13 Size of Operational Holdings in Matara.....	121
Table 14 Land Ownership in Rural Matara.....	122
Table 15 Size of Owned Plots in Matara	123
Table 16 TCCS National Lending Portfolio, 1984.....	152
Table 17 Comparison of Matara Education and Training Programme Projections.....	161
Table 18 Matara TCCS District Bank 1987 Capital Budget.....	163
Table 19 Year of Registration of Matara TCCSs.....	178
Table 20 Importance of Different Economic Activities in TCCS Villages	184
Table 21 Non-Financial Functions of Matara TCCSs.....	187
Table 22 Possible Future Functions of Matara TCCSs.....	188
Table 23 TCCS Participation in Government Programmes.....	189
Table 24 External Sources of Funding for Matara TCCSs, 1986	209
Table 25 Expected Sources and Amounts of External Funds, 1987.....	210
Table 26: Specific Crop Loan Averages, 1986.....	211
Table 27. 1986 Average Lending Summary.....	217
Table 28 Summary of Interest Rates, Matara TCCSs, 1986.....	218
Table 29 1986 Average Loans Due, Amounts Recovered and Overdues.....	220

ACRONYMS USED IN THE TEXT

BC	Bank of Ceylon
CB	Central Bank [of Sri Lanka]
CD	Department of Cooperative Development (GOSL)
DU	District Union (of the Matara TCCSs)
FTCCS	Federation of Thrift and Credit Cooperative Societies
GFA	Government Financial Agency
GOSL	Government of Sri Lanka
HYV	High Yielding Variety (of crop)
IRDP	Integrated Rural Development Project
MIRDP	Matara Integrated Rural Development Project
MLTCF	Medium and Long Term Credit Fund (GOSL)
MPCS	Multi-Purpose Cooperative Society
NCRCS	New Comprehensive Rural Credit Scheme (GOSL)
NHDA	National Housing Development Authority (Ministry of Housing, GOSL)
NSB	National Savings Bank
PB	People's Bank
RB	[Cooperative] Rural Bank (of an MPCS)
RFM	Rural Financial Market
RRDB	Regional Rural Development Bank
TCCS	Thrift and Credit Cooperative Society
USAID	United States Agency for International Development

Location of Matara District

Sri Lanka

MATARA DISTRICT

Thrift and Credit Cooperative Societies

- - SOCIETIES REGISTERED BEFORE APRIL, 1986
("ESTABLISHED SOCIETIES")
- △ - SOCIETIES REGISTERED BETWEEN APRIL AND
DECEMBER, 1986 ("NEW SOCIETIES")
- * - NO RESPONSE

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1 inch = 4 miles

CHAPTER ONE

THE ROLE OF RURAL FINANCIAL MARKETS

1.1. Introduction

If it is assumed that the needs of the rural poor in developing countries are best expressed by the poor themselves, then a primary means of development should be to remove the constraints they face in attempting to meet those needs themselves. This has been expressed in the development cliché, "helping the poor to help themselves."

The single most versatile tool required by the poor to meet their needs is money, since money is fungible;¹ it can be exchanged for food, clothing, shelter, health care, education *et al.* Employment and production are the main sources of funds for the poor,² therefore creation of employment and production opportunities yielding sustained income is a significant way to improve well-being.

The rural poor in developing countries face a formidable array of obstacles in gaining employment or improving existing productive enterprises. Assuming that asset-earning opportunities exist,³ the set of constraints to filling them can be widely variable on an extremely local, even individual basis. Problems may be physical, such as lack of water for crops; technical, such as poor quality seed stock; social, such as gender discrimination in many job categories; political, such as highly inequitable land tenure; economic, such as low prices for crops; or financial, such as inadequate

¹ "Fungible" is defined in Webster's as "1: of such a kind or nature that one specimen or part may be used in place of another specimen or equal part in the satisfaction of an obligation 2: INTERCHANGEABLE." Fungibility is an important concept in finance and will recur in the text.

² Other sources, such as welfare and inheritance, are rare or insignificant in most cases and cannot be included in a generalized model.

³ In all too many places there is a serious shortage of productive opportunities. In the case study district in Sri Lanka, finding a niche in the market can prove extremely difficult and returns to labour are very low (see 7.1.).

capital to start or improve an enterprise.⁴ This thesis deals with the last category, financial constraints to self-employment or improved production.

Increasing productivity of land and labour is one essential mechanism of rural development. Quite often, the means to increasing productivity involve investment beyond the financial capacity of the poor, farmers and landless alike. To bridge the shortfall, the rural poor need credit mechanisms which are available, affordable, responsive and flexible.

The "rural financial market" (RFM) is the focus of the theoretical investigation in this thesis. The major functions carried on the RFM are the lending and borrowing of assets, mainly cash (or productive inputs) and saving of assets, again mainly cash (though considerable savings are held in real goods). Perhaps the main obstacle to access to credit and savings for the rural poor is inadequate financial institutions in their RFM. Commercial banks and government agencies, where they exist at all, tend to serve the better-off strata of the rural populace. If an economy is to create and respond to demand, then liquidity and the financial intermediaries who handle it are essential. Yet in the rural sector of many developing countries access to affordable credit and reliable savings facilities is denied to the poor majority, mainly because they have no assets. Informal lenders may serve some of their needs, but their economic health is retarded by lack of choice and by the expense of those services which are available. A major constraint to rural development may be removed by provision of adequate financial services.

Several major questions arise:

- Who are the rural poor?
- Why do they need credit and savings mechanisms?

⁴ Of course, these categories often overlap. For example, the low price for food crops may be dictated by the government to assuage urban consumers, who inevitably have a greater political voice than rural people.

- How can a balance be struck between creating access to services for the poor and maintaining institutional viability?
- What institutional delivery mechanism is best suited to serve the poor?

These questions are at the root of the problem of inadequate financial services and this thesis shall address them, using a field study from southern Sri Lanka.

1.2. The Field Study

In rural Sri Lanka the demand for financial services comes from the rural populace in general, including a defined group of the poor who comprise the focus group in this thesis.⁵ Supply comes mostly from informal sources. Informal savings mechanisms include the widespread *cheetu* groups,⁶ trusted members of the community who will hold deposits, jewellery passed through female inheritance, and local variants of the sock-under-the-pillow. Informal credit is sought from family and friends, shopkeepers, and professional moneylenders. The informal financial systems of Sri Lanka, especially informal lenders (family, friends, shopkeepers and professional moneylenders) have not been thoroughly studied and there is no claim to comprehensive treatment herein.

Formal credit and savings institutions have been making inroads into rural markets. Currently the two state-owned "commercial banks", People's Bank and Bank of Ceylon, are major suppliers of

⁵ Roughly, all households eligible for government food stamps, meaning all households earning Rs.700 (C\$35) per month or less. For a more complete description, see Chapter 5.

⁶ The *cheetus* a group of neighbours who all contribute an equal monthly amount to a fund, which is dispersed by lot or by auction until every contributor collects a pot. The main advantages are the forced saving of the monthly contribution and the collection of a large lump sum. Unfortunately, the jackpot is often used on major consumer items and marriages, not on improving income. F.J.A. Bouman, "Informal Saving and Credit Arrangements in Developing Countries: Observations from Sri Lanka," in Dale W. Adams, Douglas H. Graham and J.D. Von Pischke (eds.), Undermining Rural Development With Cheap Credit (Boulder, Co.: Westview Press, 1984), p. 232-247. Also Edgar Fernando, "Informal Credit and Savings Organizations in Sri Lanka: The Cheetu System," Savings and Development, 10(3), 1986: p. 253-262.

government agricultural credit, very little of which goes to the poor.⁷ They collect a considerable amount in savings deposits, almost all of which is funnelled into high-yielding markets in Colombo.⁸ Many of the government-sponsored Multi-Purpose Cooperatives have Rural Banks, resulting in good penetration into the countryside, but their main function and moneymaker is acting as agents for the People's Bank pawnbroking system. Recently, the Central Bank initiated Regional Rural Development Banks, which have a wide mandate to serve the poor and to get involved in local development projects. Their performance to date has been an improvement on the commercial banks, but still bypasses most of the poor. Several private and foreign banks have been bit players in rural Sri Lanka.

Finally, there are the Thrift and Credit Cooperative Societies (TCCSs), a private cooperative movement which involves villagers themselves in institution building. The volume of funds handled by the over 4000 primary societies is not significant compared with the other institutions. However, members of the focus group of poor have much better access to credit and savings facilities.

It is the purpose of the field portion of this thesis to analyze the TCCSs of Matara District, the TCCS District Union, and, to a lesser extent, the national Federation of the TCCSs. The specific questions are:

- How capable are the primary societies of undertaking credit and savings functions for the poor?

There must be money to lend and capable people to lend it. The lenders (mostly middle-class people) must feel secure although the poor lack conventional securities. Obstacles, such as

⁷ Derived from Central Bank of Sri Lanka, Department of Rural Credit, New Comprehensive Rural Credit Scheme: Cultivation Loan Statistics (Colombo: Central Bank, November 1986 and April 1987... separate volumes from *Yala* 1986 and *Maha* 1986-87 seasons).

⁸ This can easily be confirmed by comparing the figures for mobilization of rural savings in G.M.P. de Silva, "Rural Savings Mobilization in Sri Lanka," in Mobilization of Rural Savings in Selected Countries in Asia and the Pacific (Bangkok: APRACA, 1985) with rural lending figures for the banks for the same years, published in S.M.P. Senanayake, "Chapter 10: Sri Lanka," in Asian Productivity Organization, Farm Credit Situation in Asia (Tokyo: APO, 1984).

loans tied to share purchase and savings deposits, need to be lowered or removed. If any of these conditions are not met, the society will not fulfill the needs of the poor.

- What is the profile of membership of the District Union? How many societies are financially strong and are presently or potentially able to carry out additional functions? There are new societies and old societies, societies with very large lending pools and societies with almost nothing, societies with competent management and some very dubious societies indeed. Creating a profile of societies can illustrate where improvements are required. Strong, mature societies can serve as examples and sources of expertise, even as they take on other development functions.
- How strong is the District Union itself? What is its relationship to its members and to the government? The DU must have a high profile in order to build its influence among the members. It needs the ability to reach out to the villages in order to educate and train people where they live. The people in the villages need to have confidence in the financial abilities of their District Union, something the DU must earn in cautious steps.
- What are the problems of rapid growth and increased governmental interference and what strategies are being developed to handle them? Costs are difficult to control, but must be. Increasing the capacity to deliver services and maintaining the quality of service are daunting tasks. Political sensitivity is also required, as Sri Lankan society is highly politicized. Use of any financial intermediary for implementing government policies can result in reduced access for the poor, even if the stated intention of the government was to help the poor. Lender independence from government may be compromised if the government becomes too closely involved.

It is hoped that by answering these questions, a model based on the Thrift and Credit Cooperative Societies may emerge, offering lessons which could be transferred to other situations.

1.3. Definition and Major Functions of Rural Financial Markets (RFMs)

An RFM can be broadly defined as "...the set of arrangements by which a nation's [rural] citizens exchange current funds or commitments against future funds or commitments."⁹ That set of arrangements includes:

- Provision of Media of Exchange:

In simple RFMs, currency and real goods are the only media of exchange, severely limiting commerce. Developed RFMs add debt claims, including demand deposits, overdraft facilities, loans, and lines of credit. Types of tradeable paper increase as the RFM becomes more sophisticated.

- Provision of a System for the Mobilization and Allocation of Capital:

Individual savers are not necessarily the most efficient investors or may simply possess few opportunities for productive investment. Since savers are not willing or able to make their assets directly available to the most efficient investors, the latter often do not have access to the funds they require. The resulting sub-optimum investment process is known as "fragmentation" of the RFM. The financial intermediaries in an RFM should ideally provide deposit facilities for savers, perform the search for efficient investors, and allocate available resources to higher-yielding investments. This process includes the transformation of maturities, offering savers short-term liquid deposits while providing investors with longer-term loans better coordinated to the cash flows of the investment. Generally, small amounts are collected from many savers and lent in larger amounts to fewer borrowers, thereby transforming the size of financial transactions. This is especially crucial for indivisible or "lumpy" investments and makes possible a scale of borrowing impossible in person to person transactions. With improved allocation of liquidity, there should be increased yield on capital and increased output of goods and services. Assuming that savings are

⁹ Edward J. Kane, "The Political Economy of Subsidizing Agricultural Credit in Developing Countries," in Adams, Graham, and Von Pischke, Undermining Rural Development, p. 168.

sensitive to the yield on capital (sometimes not the case among the poor),¹⁰ such improvements should raise the economic savings rate. Assuming that savings equals domestic investment, those countries which have shown marked progress in economic development have all had high savings rates (most of these countries are now "Middle Income").

- Provision of a Mechanism for the Distribution of Risk Associated with Saving:

Pooling of the funds of many savers and channelling them into a wide variety of investments reduces variations in return to savings. This spreading of risk is extremely valuable to small producers, who tend to be highly risk averse.¹¹ For the borrower in a competitive market, the lender of choice will be the one with the lowest interest rate, all other terms and conditions being equal. In other words, the system allocates risk to those charging the least to bear it. Eventually, a properly functioning RFM can reduce risk substantially as investment opportunities become more varied and therefore more stable than markets for physical assets. Most RFMs in developing countries have relatively poor distribution of savings risk. Few have deposit guarantees.

- Provision of a Tool for Implementation of Government Policy:

In virtually all developing countries, governments manipulate and regulate financial markets for a variety of reasons. A mature RFM is much more accessible to government, often to the detriment of the rural economy (analyzed in 3.1).

¹⁰ Dale W. Adams, "Are the Arguments for Cheap Credit Sound?", in Adams, Graham and Von Pischke Undermining Rural Credit, p. 70.

¹¹ Analysis of risk aversion among marginalized people was broached in the 1960s by Michael Lipton, "The Theory of the Optimizing Peasant", Journal of Development Studies 4(3), 1968, p. 327-351 and by Clifton R. Wharton Jr., "Risk, Uncertainty and the Subsistence Farmer", Development Digest, 3(2), 1969. There have been numerous corroborating studies since, including Hans P. Binswanger and Donald A. Sillers, "Risk Aversion and Credit Constraints in Farmers' Decision-Making: A Reinterpretation", Journal of Development Studies 20(1), 1983, p. 5-21.

Operationally, the major roles of RFMs are provision of credit and savings facilities. Credit has been the largest concern by far, frequently appearing alone in governmental or foreign-sponsored development projects. The neglect of savings has contributed to the weakness of many financial programmes, yet that neglect persists. This thesis also gives more attention to credit, but it should be borne in mind that saving is the obverse of the credit coin and should always be considered when credit projects are designed or analyzed.

1.4. The Evolution of Development Thought on the Role of RFMs

Most early development thinkers believed a "vicious circle" theory of income for the poor: low income meant inability to save, no savings meant inability to invest, no investment meant inability to raise productivity, and, closing the circle, static low productivity meant continued low income.¹² The way to break this circle was to inject investment funds, like millions of micro-Marshall Plans, thereby increasing productivity and enhancing income. Simply put, credit was an input which could stimulate growth. A minority, including J.K. Galbraith and J.W. Mellor, disagreed.¹³ They stated that credit could not itself lead development, that a substantial degree of development had to be underway before credit was introduced. Although this minority view seems correct in retrospect, it was not the one followed at the time.

The result of the majority view was "supply-leading" finance in the rural sector. Supply-leading finance is "the creation of financial institutions and supply of their financial assets, liabilities,

¹² H.W. Singer, "Economic Progress in Underdeveloped Countries," Social Research 16 (March 1949), p. 5. Much later, the "vicious circle" theory was eloquently expressed by Gunnar Myrdal, Asian Drama (New York: Pantheon, 1968), Appendix 4.

¹³ J.K. Galbraith, in E.K. Bauer (ed.), Proceedings of the International Conference on Agricultural and Co-operative Credit, Vol. 1 (Berkeley, Ca.: Univ. of California, 1952). J.W. Mellor, The Economics of Agricultural Development (Ithaca, N.Y.: Cornell University Press, 1966).

and related financial services in advance of demand for them...¹⁴ and was more often applied to the modern industrial sector, since the industrial sector was seen as the leading sector. In the rural sector, governments created specialized agencies, often development banks, through which large sums of money were made available to agricultural borrowers at concessional, even negative real rates of interest. The supply was to lead demand in the new techniques of "green revolution" farming.

To the extent that conservative attitudes to new techniques were broken by virtually paying producers to adopt innovations, this policy was useful. However, the financial results of such programmes are well known: huge sums were poured into rural lending and never seen again due to programme expenses, negative real interest, and default.¹⁵ Target groups of the poor occasionally received the credit and some of them may have experienced measurable improvements in their standard of living, but more often the money was captured by better-off farmers.¹⁶ Cheap capital replaced labour, eliminating jobs and driving down real wages, thereby harming landless agricultural labourers.¹⁷ The institutions created to operate the programmes did not survive as financially viable entities. The whole idea of "rural credit" began to draw a wary response among development practitioners.¹⁸

The year 1973 was a watershed year in thought about rural savings and credit. USAID published the massive AID Spring Review of Small Farmer Credit, in which policy and practice from all

¹⁴ H.T. Patrick, "Financial Development and Economic Growth in Underdeveloped Countries", Economic Development and Cultural Change 14 (1966), p. 175.

¹⁵ For examples, see Appendix G of Joseph M. Lieberman, A Synthesis of AID Experience: Small Farmer Credit 1973-1985 (Washington: USAID, 1985).

¹⁶ Claudio Gonzalez-Vega, "Cheap Agricultural Credit: Redistribution in Reverse", in Adams, Graham and Von Pischke, Undermining Rural Development, p. 120-132.

¹⁷ Most notably in Punjab. See Clifton R. Wharton Jr., "The Green Revolution: Cornucopia or Pandora's Box?" in Foreign Affairs 47(3), April 1969; Wolf Ladejinsky, "The Green Revolution in Punjab: A Field Trip," in Economic and Political Weekly 4(26), June 28 1969; A. Rudra, "The Green and Greedy Revolution," in South Asian Review 4(4), 1971; T.J. Byres, "The Dialectics of India's Green Revolution," in South Asian Review 5(2), 1972.

¹⁸ Personal communication with several officers at CIDA, June-July 1986.

over the developing world were gathered into twenty volumes.¹⁹ It was also the year of Ronald I. McKinnon's Money and Capital in Economic Development and Edward S. Shaw's Financial Deepening in Economic Development.²⁰ In the briefest possible terms, the most significant contribution of all these works was to move the focus of thinking from effects of credit upon the borrower to effects of government policies upon financial intermediaries (i.e. lenders). They concluded that financial markets are constrained by government policies, especially low commodity prices and low interest rates. In order for these markets to function effectively and grow, governments should loosen restrictions and allow market forces to determine prices and interest rates. This "commercial" argument holds true for a lender's internal policies as well; the policies which ensure continuing viability are those which bring the best returns, namely those which govern the operations of commercial banks (see 3.2.).

The critical assumption, that a viable financial institution is the best assurance of access to credit for all, is far from clear. The common consequence of strictly market policies has been that the rural poor (and women in particular), whose loans are less secured, higher risk, and more expensive to administer per unit lent will tend to be "rationed"²¹ out of the market.²² In order for the poor to retain access to credit, commercial policies must be tempered with mechanisms which deliberately target them. Yet these mechanisms reduce efficiency by adding to the cost of lending. In other words, the developmental objective of serving the poor may be sacrificed for the imperative of lender viability. Clearly, an ideal balance would ensure that the poor have access to

¹⁹ United States Agency for International Development, AID Spring Review of Small Farmer Credit (Washington, D.C.: USAID, 1973).

²⁰ Ronald I. McKinnon, Money and Capital in Economic Development (Washington, D.C.: Brookings Institute, 1973). Edward S. Shaw, Financial Deepening in Economic Development (New York: Oxford University Press, 1973).

²¹ The notion of "rationing" is frequently encountered in the literature. It simply means that a decision is made to ration a scarce resource, so if a group is "rationed out" it simply means that it was not allocated any of the resource because, for some reason, another group was preferred. Equitable distribution is not a consideration of market forces, though governments may, on rare occasions, attempt it.

²² Dennis Anderson and Farida Khambata, "Financing Small-Scale Industry and Agriculture in Developing Countries: The Merits of Limitations of 'Commercial' Policies", Economic Development and Cultural Change 33(2), 1985, p. 349-371.

services, with the drop in financial efficiency which that entails, while maintaining at least enough financial efficiency to ensure institutional viability and eventual independence from external infusions of cash.

Another lesson learned from hard experience is that credit is not in itself a major bridge on the development road; rather, credit is a vital cable in the bridge. It is now acknowledged that credit plays "only an ancillary role following the establishment of some basis for new investment, probably new technical knowledge and possibly also a degree of structural change in rural society."²³ Credit programmes are support systems, not engines for pushing economic growth. This is not to conclude that they are inessential, but that they are not usually as important to producers as product prices, output yield, and cost of production. The importance of credit must be weighed alongside other factors to see how they relate to each other. In many situations (outlined in Chapter Two) credit for the poor is critical to their improved production and welfare.

Saving plays a low-profile but key role, yet it was long neglected on the assumption that the poor had no margin over consumption and therefore no capacity to save.²⁴ It is now clear that there is an enormous pool of capital in the rural sector, most of it held in real goods.²⁵ Further, the rural poor *do* have need of savings facilities, even the truly marginalized who have no surplus. While early credit institutions had no provision for accepting deposits, the push to institutional viability has encouraged savings mobilization by rural lenders. The rural people receive the services they need and the financial intermediary mobilizes loan funds on its own instead of relying exclusively

²³ A. Bottrell and J. Howell, "Small Farmer Credit Delivery and Institutional Choice", in John Howell (ed.), Borrowers and Lenders: Rural Financial Markets and Institutions in Developing Countries (London: Overseas Development Council, 1980), p. 145.

²⁴ Yet another "vicious circle": "There is small capacity to save resulting from a low level of real income. The low real income is a reflection of low productivity, which in its turn is due largely to the lack of capital. The lack of capital is the result of the small capacity to save." Ragnar Nurkse, Problems of Capital Formation in Under-developed Countries (New York: Oxford University Press, 1963), p. 5.

²⁵ For example, Marcia L. Ong, Dale W. Adams, and I.J. Singh, "Voluntary Rural Savings Capacities in Taiwan, 1960-70," in American Journal of Agricultural Economics 58(3), 1976, p. 578-581. Also Arnaldo Mauri, "A Policy to Mobilize Rural Savings in Developing Countries", in J.D. Von Pischke, Dale W. Adams and Donald Gordon (eds.), Rural Financial Markets in Developing Countries: Their Use and Abuse (Baltimore and London: Johns Hopkins University Press, 1983), p. 408-413.

on external sources of funds. In a macroeconomic view, the previously untapped rural capital pool could contribute substantially to increasing the national savings rate.

Governments and financial intermediaries both damage RFMs through the common practice of siphoning capital from the rural sector via deliberately depressed commodity prices and other measures in order to subsidize urban investment and consumption. The flow of savings deposits collected in rural areas to urban capital markets is a major drain on the rural economy. The greater the difference in growth rates between the rural and urban economies, the more pronounced will be the flow, since lenders with commercial policies will get better returns on investment in the modern urban sector. Of course, lack of investment in the rural sector only exacerbates the low-productivity problem, resulting in continued low returns and continued disincentive to invest... the whole sector experiences a "vicious circle" effect.

If all the functions of RFMs are taken together, finance may be considered a service sector in its own right, employing inputs to produce outputs.²⁶ Seen as an intermediate input in the entire production process, producing more of these services should spur the growth of real output. Due to the costs involved in a full range and penetration of services, the optimum size and complexity of the financial market in a developing country need not compare to that of a developed economy; as an economy develops, its financial system matures. RFM development is typically slow and evolutionary.

It has been argued that in many developing countries the size of the financial market has been "repressed" by inflation and government intervention, notably by selective interest rate regulation and credit allocation.²⁷ The supply response of the financial system to demand for services is assumed to be automatic and highly elastic unless governments create distortions in the RFMs or regulations inhibiting intermediaries. This assumption oversimplifies the constraints

²⁶ After E. Shaw, Economic Deepening.

²⁷ Ibid. and McKinnon, Money and Capital.

and incentives to fulfilling demand for services in RFMs. It is possible that, even with no government "repression", formal suppliers of financial services would not arise in many RFMs. The lender perception of unprofitability, real or imagined, remains the major constraint. Governments are left with three responses: 1) try to improve the financial environment through policy moves, 2) form a governmental financial agency to service unfulfilled demand, or 3) ignore the problem entirely. The net result is that the rural poor are rarely served.

Since the early 1950s, thinking on the role of RFMs in the development process has changed radically in response to experience. Like so many other aspects of development, credit and savings turned out to be more complex than originally assumed. While credit is not an engine of growth by itself, it can be essential to successful expansion in the rural sector. Savings mobilization, ignored as impractical in the early days, is currently seen as vital. It is now acknowledged that finance acts as an important component in the production process and, like any other part, must function efficiently if the entire process is to be efficient and growth-oriented. If the financial sector is ignored or repressed it can become a bottleneck in development. Inadequate or non-existent financial services dampen the ability of the rural economy to grow. Consequently, the other aspects of development, such as equitable distribution of benefits and participation in the economic, political and cultural spheres are constrained.

CHAPTER TWO

THE NEED FOR RURAL CREDIT AND SAVINGS

There are no current estimates of demand for rural credit in Sri Lanka, but the flood of applications for formal credit schemes and the fact that many rural people, especially the poor, continue to borrow from informal sources, sometimes at 180% or more per annum, would certainly indicate an inadequate supply for a large, if unmeasured demand. Coupled with the findings of microeconomic studies which have been performed for similar economies elsewhere,¹ it is assumed that a substantial portion of the rural poor can make productive use of credit and savings mechanisms. Although some producers are so small and risk averse that they will not take credit, while others who do take a loan will not use it for productive purposes, experience (especially Grameen Bank in Bangladesh) suggests that very poor borrowers can make substantial gains with access to very modest amounts.

With regard to credit, this assumption has a simple theoretical base. Small producers tend to maximize labour (especially unpaid family labour) and other factors of production in their possession, such as land and simple tools, while minimizing use of scarce capital. Returns on labour may be very low indeed. The injection of even a small amount of capital can substantially increase output because the amount of labour applied will not likely be reduced. Where large, "commercial" enterprises will tend to substitute capital for labour if the price of capital is low enough, household enterprises will not substitute for labour. Capital is never cheaper than unpaid family labour and a household would never willingly create unemployment among its members in

¹ For example, Iqbal Farrukh, "The Demands for Funds by Agricultural Households: Evidence from Rural India", Journal of Development Studies 20(1), 1983, p. 68-83.

any event.² (In cases of near zero returns to labour, capital may be substituted to create leisure time.) Instead, capital is applied to improving returns through other means, such as irrigation repair, fertilizer, better tools, increased trading stock *et al.* These improvements increase the return to a unit of labour and therefore meet the development criteria of increasing household income.

Productive use of savings facilities is simply using those facilities for conservation of capital. As explained in 2.4., the very poorest can still make good use of savings accounts for this purpose.

2.1. Focus Groups

Who needs credit and what do they need it for? Most groups in an RFM, rich and poor, claim that they can use credit productively. While it is quite possible that the rich and middle-class could use credit to make themselves still better-off, the focus of development must remain on the poor.

In absolute terms, the rural poor are those farming or landless households which do not produce or earn a surplus over bare consumption needs. In relative terms, the rural poor are those whose living conditions are considered substandard by their cultural standards yet do not earn enough of a secure surplus to make substantive improvements. These definitions are somewhat amorphous and there needs to be a measurable standard for identifying the focus group.

The better-off households of rural society are not proportionately numerous and can only rarely be called "rich", but they do produce a substantial economic surplus, usually from farming, trading or transport. Possession of this surplus makes them net lenders in their communities. The

² Alexander Schejtman, "The Peasant Economy: Internal Logic, Articulation, and Persistence," in Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment, 3rd Edition (New York: Random House, 1984), p. 277f.

next stratum is that of small and medium producers, those with a modest surplus to sell. They are usually net borrowers only during periods of change due to introduction of new technology or expansion of operations and do not find it necessary to borrow on a seasonal basis. Should they suffer temporary moderate shortfalls, they can convert household assets, usually held in real goods. The bottom stratum is composed of chronic deficit enterprises, often those with little or no good land. They are almost always net borrowers, unable to produce enough to meet consumption and production needs (much less hold adequate reserves) and forced to seek credit on a seasonal basis. It is people in this stratum that find themselves in the famous "vicious circle" of low income and irredeemable debt and it is they who form the focus group of most rural development projects.

There are several special measures and considerations useful for defining the focus group of a credit and savings programme.

- Income:

Annual per capita income has for decades been a favorite yardstick for measuring poverty. Yet it is not easy to compile good statistics on income in developing countries, much less collect information fine enough to determine whether one household should receive benefits while the neighbour next door should not. Nonetheless, governments and multilateral agencies continue to collect income statistics and use them to determine social and economic policy.

It is difficult to say whether a given rural household income is enough to provide a given standard of living. Unlike urban incomes, where rent, food, clothing and everything else must usually be purchased and may therefore be priced, rural people often provide many items of their own consumption from their own production or from barter. Food is the obvious example. However, where there is a wide array of possible sources of income for different members of the urban household, rural people are severely constrained in their sources of income. In balance it must be pointed out that farming families generally provide employment for the very young, the old and the

handicapped, though the returns to this added labour are often extremely low or even zero. The conclusion to be drawn is that income figures may look more authoritative than they actually are.

• Gender:

In most countries women have more difficulty gaining access to credit, despite being heavily involved in small-scale production and services. This lack of access can have severe consequences. For example, in sub-Saharan Africa, women produce most of the food crops and a lack of access to credit means they may be unable to improve food crop productivity. Informal trading and cottage industry are other rural activities with strong women's participation. Because these activities are often not visible and the women themselves not represented in dialogues with government and aid agencies, women's needs are often not recognized.

There are several reasons why women have difficulty getting credit. First and foremost, their economic activity in small farms and the informal sector puts them in a group where all borrowers, female or male, are rationed out of the market (see 3.2.2.). Lenders perceive them as high-cost and high-risk. But even inside this disadvantaged group, women are further discriminated against. In countries with a patriarchal social hierarchy, women are stereotyped as homemakers, not producers, and therefore incompetent to handle finances. Women are not seen as "hard-headed" in business dealings; they would rather feed their children than pay the bank. In some countries there are entrenched social customs which circumscribe what types of activity are "proper" for women. In some cases there are legal barriers limiting their property rights, denying them collateral. Yet in even the most stifling patriarchies women are involved in micro-level production and trading.

Regardless of the lender's perception of women's roles, women are assessed as higher financial risks than men. Few women have had access to credit before, so most have no credit rating. The profit margins on many women's activities (such as food stalls and petty agricultural sales) are so low that they may be seen as not having adequate repayment capacity. Higher illiteracy among

women means they have less opportunity to learn bookkeeping and management skills that lenders like to see. Collateral is a problem, especially in those countries where women are not usually the legal owners of land or chattel. A woman may have to rely on her father or husband, if she has one, to cosign a loan. This is especially serious in the case of a food producer whose husband migrates looking for work, leaving the woman unable to establish her relationship to the land she tills.

Since the smaller and more labour-intensive the enterprise, the higher the returns to a given small amount of capital tend to be, women's enterprises should be efficient users of loan funds. This may not be the case in places where women's economic activity is limited to a few overcrowded, low-return activities, but otherwise even tiny infusions of money could make significant improvements in productivity. Women, especially single mothers and widows, are often closer to the margin than anyone else in the adult population, making them extremely risk averse. Their use of investment funds will tend to be frugal and efficient.

The chances of a woman getting formal credit are so low in most countries that they do not even try to get it and remain trapped in the vicious circle of low productivity and low income. Women very rarely have access to credit unless they are specifically focussed upon. Targeting credit to "the rural poor" is inadequate because women form a disadvantaged substratum within the rural poor. Programme design must create clear avenues for women. The degree of resistance to such changes depends mostly upon cultural constraints and institutional practices and may not be clear at the design stage, so flexibility should be built in to allow targeting mechanisms to be refined.

Apart from making funds available to women, it is important not to neglect investment counselling and savings facilities. Although women do much of the physical work in the rural areas of many countries, they may still be relatively inexperienced at making productive investment decisions. Loans officers in credit programmes need to be aware of this and may require special training. In some countries, especially those with orthodox Islamic cultures, female savings and credit officers need to be recruited and trained. Otherwise social restrictions alone will prevent women from

gaining access to services. Women in many cultures tend to be more frugal than men, but lack formal means of saving. Interest bearing accounts which do not place limits on minimum deposits or balances need to be widely available.

● Size of Farm Holding:

When is a farm sub-economic? This is usually answered by combining size, physical conditions, and technique. Some very small farms may be highly productive and produce a substantial surplus. Still others may be quite extensive yet not produce enough for the consumption needs of the farming household. The rural poor could fall under a wide range of farm sizes, depending upon climate, soil, water, use of improved techniques, and social obligations (which are too complex to deal with here). It is therefore difficult to determine just how small a holding must be in order to declare it "sub-economic" and the farming household poor. Clearly, if the farm does not produce a marketable surplus, it is subeconomic under existing conditions.

Unfortunately, formal lenders do not often take the time to determine the productivity of an individual plot when determining capacity to repay. The usual criteria, apart from simple area, is how much of the area is irrigated (if necessary), and, less frequently, whether improved varieties of seed are used. Many credit schemes set minimum farm areas which are eligible for loans, despite evidence of high productivity for smaller plots. This may leave the tiller of a small plot without sufficient capital to use improved technology, resulting in reliance on traditional, lower-yielding techniques which exacerbate the income problem.

● Landlessness:

Even worse than sub-economic farm size, landlessness in the rural areas of developing countries is almost a guarantee of poverty. Of course, some of the landless are well-to-do traders or government employees, so the "landless" are not poor *ipso facto*, though most of them indeed are. Many of the landless were once small landowners who were forced off the land by various economic and physical pressures. Yet the social bonds of the rural community tend to keep the

landless from moving away as long as there is any opportunity for earning a living in the home village. The problem, especially in densely populated parts of Asia, is that there are too many landless labourers for the amount of employment available (mostly seasonal agricultural work) so wages are bid down to subsistence levels. Many developing countries also have displaced persons who swell the numbers of the landless. They may be internal refugees, displaced by civil strife or natural calamity, or they may have fled from a neighbouring state for similar reasons. Refugees often arrive with no physical assets at all.

The landless suffer from income insecurity which is interpreted by lenders as a tendency to use loans for consumption or as inadequate capacity to repay. Indeed, without land or other assets, the landless are the very last people any banker would lend to. Generation of steady employment opportunities with the assistance of credit is one avenue of escape for the landless. Purchase of a few simple tools can allow a landless person to begin a non-agricultural enterprise, most likely in service or petty trading occupations. Saving is also important, partly for the conservation of seasonal income and partly to demonstrate financial discipline. The Grameen Bank of Bangladesh is perhaps the best known effort to provide savings and credit facilities to the landless.³

Each developing country will have its own "portrait of poverty", depending upon its resource base, economic and political systems, population pressures, refugee problems, and susceptibility to natural calamities.

³ Muhammad Yunus, Grameen Bank Project in Bangladesh - A Poverty Focused Rural Development Programme, Workshop Papers from Comilla (Dhaka: Government of Bangladesh, 1982).

2.2. When Do Small Producers Need Credit?

Credit becomes a need when a profitable investment opportunity exists which requires working capital or purchase of fixed assets which the producer cannot afford from liquid savings plus whatever can be raised from friends and family. Of course, obtaining a loan is not the only response to the situations described below. Households can reallocate resources from one activity to another or sell assets to obtain necessary funds. Often a family member will seek wage labour to bring in needed cash. In almost all cases, producers perceive financing from internal resources as preferable to borrowing. The exceptions to this rule tend to occur when "credit" is in fact a net transfer payment to the borrower, through either negative real interest or repeated debt forgiveness.

There is a school of thought which insists on the "irrational peasant" constraint, wherein small producers do not lack for access to capital but, rather, lack motivation to use the capital at hand for development purposes.⁴ The proponents of this view do not seem to have a clear understanding of markets and risk aversion strategy. While there may be truth to the allegation that small producers are not aware of all the investment options open to them (a job for extension services), the "irrational peasant" view seems to be a product of cultural and economic misunderstanding. There is plentiful research and experience which suggests that the rural poor are willing and able to take any opportunity for improving their situation, provided risk aversion guidelines are met.⁵

There are three types of situations in productive enterprise (that is, excluding consumptive use) which may call for taking a loan:

⁴ A general analysis of "irrational" peasant behavior is Everett M. Rogers, "Motivations, Values and Attitudes of Subsistence Farmers: Toward a Subculture of Peasantry", in Clifton R. Wharton Jr., Subsistence Agriculture and Economic Development (Chicago: Aldine, 1969), p. 111-135. With specific regard to the "irrational" use of credit, see David H. Penny, "Farm Credit Policy in the Early Stages of Agricultural Development", Australian Journal of Agricultural Development, 12(1), 1968, p. 32-45.

⁵ Theodore W. Schultz, Transforming Traditional Agriculture (New Haven, Cn.: Yale University Press, 1964); John W. Mellor, "The Subsistence Farmer in Traditional Economies." In Wharton (ed.), Subsistence Agriculture; Samuel L. Popkin, The Rational Peasant (Berkeley, Ca.: University of California Press, 1979); and Schejtman, "The Peasant Economy".

● Dealing with Seasonality:

The most predictable reason for borrowing in rural enterprise is the seasonality of production and income. This is most common among those "net-deficit" producers who do not produce enough surplus to carry themselves through the cycle. Not only farmers face a regular cycle of input expenses and harvest receipts. Many fisheries are also seasonal due to weather or fish migration. Secondary and service activities, such as shopkeeping, which are dependent upon the primary local activity, also follow the cycle.

● Reducing Production Risk:

Less predictable is risk encountered in the production process. Producers at the margin are highly risk averse since survival depends upon keeping income (after potential losses) above the local subsistence level. For this reason minimum variation in income, often the result of specifically adapted traditional methods, is preferred to the potentially greater rewards or greater losses of new techniques. Borrowing adds risk to the enterprise in that failure can mean greater losses than would occur without a loan. Borrowing at interest rates that are lower than market, even negative in real terms, will make the risk of new techniques more attractive. Some new techniques do not require much capital and what little is needed can be provided from savings or informal loans. Some purchased inputs (seed, fertilizer) are highly divisible and the small producer may purchase only the quantity he or she can afford without borrowing. Only when the new technology requires greatly increased working capital or large new fixed investment is a loan necessary. The experience of some lenders is that producers at very low levels of development will not use credit at all.⁶ They are simply too risk averse and do not see the new technology as falling within their limits of risk.

⁶ C.J. Howse, "Agricultural Development Without Credit," Agricultural Administration 1, 1974, p. 259-62. Supporting field results for Sri Lanka can be found in Ananda Wanesinghe, Small Rice Farms in the Wet Zone of Sri Lanka (Armidale, Aust.: Dept. of Geography, Univ. of New England, 1982).

● Responding to Business Growth Trends:

There are trends over the life of an enterprise which may induce credit use. Start-up almost always requires some investment, however minimal. In productive (as opposed to service) activity there is a lag until sale of output brings income flow. Depending upon the type of enterprise, other trends may induce credit use. For example, should a farmer wish to expand into double-cropping, a relatively large initial expenditure for a tube well may be required. Such lumpy investments require medium or long-term credit, rarely available in informal markets, to smooth the financial impact of the transition to a new growth situation.

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Credit is not usually the most binding constraint to small producers. Many inputs, new technologies, or business expansions are divisible and can be acquired in small increments. Savings and informal loans are probably adequate for many producers' investment needs. Input supply, price incentives, and marketing facilities are usually more important, yet small producers themselves often note lack of capital as a major constraint.⁷ Whether this is a ploy for concessional loans providing net income transfer to the borrower or a genuine felt need is certainly worth investigating in the field.

Credit programme planners must be aware of the full range of income-generating options available to rural people in a given area. It is necessary to weigh the importance of each activity, especially because some non-agricultural enterprises will be more critical to the poorest groups than any other group. The landless and near-landless are forced to look for non-agricultural options. Inclusion of financial services for these activities could well have excellent results among the poor.

⁷ For farmers' demand, see Philip E. Church and Gary D. Adams, "Experimental Approaches to Rural Credit in Bangladesh," in Bangladesh Bank, Problems and Issues of Agricultural Credit and Rural Finance (Dhaka: Bangladesh Bank, 1979). For non-farm demand, see Peter Kilby, Carl Liedholm, and Richard L. Meyer, "Working Capital and Non-Farm Rural Enterprises," in Adams, Graham and Von Pischke, Undermining Rural Development, p. 277.

2.3. Evaluating the Impact of Loans

Much effort has been spent trying to determine the effect of loans at the producer level. However, there are a number of problems with quantifying effects. The general conclusion is that "it is very costly, if not impossible, to determine the impact of credit" at the producer level.⁸

Gauging the effectiveness of credit programmes by one of the various "impact assessment" approaches (described below) also contributes to the problem of perceiving credit solely as an "input" in the production process, instead of a component of the financial service sector. It therefore diverts attention from the lender's behavior, understanding of which is critical to the effective targeting of credit and the long-term viability of any credit programme. Given the problems of determining impact on producers, it is suggested here that analysis of lending institutions would be a more constructive contribution. This is the direction of the field research described in later chapters.

Fungibility in credit programmes means that additional liquidity may be used for whatever money will buy in the open market. The fungibility of loan funds yields several effects.

- Diversion:

This occurs when loan funds are used for purposes other than that for which the funds were lent. Loan funds should be viewed as additional liquidity rather than as an input to a specific activity, raising the question of relative profitability of alternative uses for the additional liquidity.

Alternative uses include consumption, retirement of outstanding debts, or productive purposes perceived by the borrower to be more profitable than the activity intended by the lender. Most small producers have several activities with potential need for extra liquidity and only if the activity targeted by the lender is the most profitable for the borrower will the loan be used for it

⁸ J.D. Von Pischke and Dale W. Adams, "Fungibility and the Design and Evaluation of Agricultural Credit Projects," in Von Pischke, Adams, and Donald, Rural Financial Markets, p. 82.

(depending upon the level of supervision). Even if the loan is given in kind, such as seed or fertilizer, the goods can be sold and the proceeds directed to other activities, though the borrower usually incurs a loss in this process. Given the large number of small producers taking loans in any credit programme targeted to them, it is almost impossible to comprehensively monitor the end use of credit when the funds are being invested, though careful sampling techniques can yield fairly accurate profiles of end use after the fact.

- Substitution:

When credit is used in place of resources that would have been committed anyway, substitution has occurred. Given a profitable investment opportunity, the producer may be willing to invest from savings or informal loans (largely low or no-interest loans from relatives or friends).

Alternatively, she or he may be willing to forego some consumption to invest. If credit is available, especially at concessional rates, then it may well substitute for these existing resources and, subsequently, not contribute to new investment. Since cash credit is fungible, it can substitute for almost anything.

- Additionality:

This effect is gauged by a "with or without" comparison. What is the credit adding at the producer level, at the credit programme level, or at the national level that would not otherwise be there?

These are difficult measurements to make and are totally different at each level. At the producer level, if the interest rates are concessional, credit may provide borrowing (and investment) incentives to producers as well as drive down informal interest rates. The result should be some genuine additional investment. If credit funds come from a foreign donor, there is a foreign exchange effect at the national level only... what additional activity is the government undertaking with fungible foreign exchange it would not otherwise possess?

The lender must try to assess and control all three of these effects, minimizing the first two and maximizing the last one at the producer level.

The impact of credit schemes on borrowers has been tested from a variety of angles but all are subject to problems which cast their findings into doubt.⁹

Descriptive studies compare effects of different variables on the production process. There is a problem of attribution; factors other than credit can explain differences in before/after or with/without samples, yielding a likely overestimation of the effect of credit. Which input or mix of inputs shifts the production function? It could be technique, technological information, irrigation, weather and other variables more difficult to quantify, or it could be credit. There are different factors explaining non-optimal input allocation, including yield and price uncertainty and management ability. There are differences in input and output prices. Where extension services or input subsidies are involved, their effect needs to be separated from that of credit. Concessionary interest rates also confuse the picture (see 3.3.). They create an excess demand for loans, with rationing favoring larger producers who have larger factor endowments, better access to technological information, and better management. Thus any results of analysis would not only be subject to the same set of problems described above, but would be only for a small, more modern stratum of the potential borrower population. Finally, there are differences in the producer's own financial constraints and savings which cannot be accounted for. Studies of this type are therefore subject to considerable inaccuracy.

There have been econometric studies, using a Cobb-Douglas production function, an input demand function, or an efficiency gap function. There have also been programming studies, using single or multi-period models, recursive models, and quadratic models. All of these have methodological problems. The studies have failed to capture the full complexity of the rural household's

⁹ The criticism of effect-on-borrower techniques follows Christina C. David and Richard L. Meyer, "Measuring the Farm Level Impact of Agricultural Loans," in John Howell, Borrowers and Lenders, p. 201-234. See also E.P. Rice, "Problems and Results in Evaluating Agricultural Credit Projects," in ADC Conference on Rural Financial Research (San Diego: ADC, 1977).

economically heterogeneous activity, focussing almost exclusively on farming. Since loan funds are fungible and will be used for the most profitable activity, quite often *not* farming, it is necessary to capture the full range of activity. There is also no certainty that the credit measured is the only source of liquidity. In situations where long-term credit is scarce, short-term loans may be used to finance long-term investment (the "roll-over" effect), but this is not accounted for. The cost of borrowing may not be accurately reflected in the interest rate and borrowing limits, but these measures are often taken as benchmarks. Risk and uncertainty may not be accurately reflected. If the credit system were fully functional on a market basis, optimal borrowing could be less than estimated. Mathematical models are difficult to check with statistical goodness-of-fit tests, so it is unclear how much borrower behavior has been captured. The result is substantial overestimation or underestimation of the demand for loans and the impact of borrowing. Finally, even if the models worked, their applicability is limited due to the shortage of data from the RFMs of developing countries.

The sum of all this is that attempts to measure the impact of loans on rural producers are not very useful, either from a theoretical or a practical point of view. This lends weight to the view that lenders are more worthy of study, even if such studies do not verify the assumption that a healthy lender will provide optimum service to a full range of borrowers.

2.4. Savings

There are three forms in which rural savings are held: cash, real goods, and debt claims. Since most RFMs are not as monetized as other financial markets in a developing country, a large proportion of those savings will be in the form of agricultural produce and livestock, tools, housewares, and informal debt obligations. (For clarity, "savings" shall herein refer to deposited funds.) Such cash as there is, which is still considerable, is often hidden at home. This lack of

visibility has contributed to the old assumption of development theorists that the rural poor have no surplus over their consumption and therefore no capacity to save.¹⁰ Consequently, it was concluded that there was no need to provide savings facilities for them in RFM projects. Even though there is now considerable evidence that most of the rural poor do save,¹¹ savings mobilization is still not given any consideration in most credit programmes.

A more accurate definition of savings among the rural poor is funds not immediately spent upon receipt. There are, then, two patterns of saving. First is savings of a surplus beyond consumption, the eventual use of which may not be known. Second is postponed consumption, saved to protect assets from premature or alternative use. The latter type is a form of financial discipline especially important to marginal producers after harvest. Actual savings levels depend upon affordability and personal values.

The major reasons for saving are: requirements of predictable periodical needs (e.g. seed, pre-harvest food), predictable extraordinary or lumpy requirements (e.g. weddings, tubewells), and unexpected or emergency requirements (e.g. recovery from drought, fall in output prices). These bear a striking resemblance to the reasons for borrowing and indeed there is competition between the two responses. Potential for saving does not equal willingness to save. If savings are perceived as a deprivation of consumption before the need for them arises, then the small producer may gamble with time and probability by consuming, borrowing should the need actually arise. If savings is to be the preferred choice, then other benefits must be obvious. These include protection from premature or alternative use (as above), protection from theft, protection from the claims of family and friends, provision of a status symbol, provision of interest on savings, provision of assets for lending, and provision of eligibility for loans. It should be noted that rural savers do not

¹⁰ Ragnar Nurkse, Problems of Capital Formation, p. 5. Quotation in Chapter One, footnote 23 of this paper.

¹¹ For example, M.L. Ong, D.W. Adams, and I.J. Singh, "Rural Savings Capacities".

tend to be very sensitive to interest rates,¹² though they will tend to hoard real goods as hedges against inflation if the real interest rate on savings is negative.

Developmentally, savings facilities serve the poor more than credit facilities because there are potentially far more poor savers than borrowers. Even though the benefits of a savings account seem modest relative to the gains in productivity possible with a loan, those modest benefits can at least be experienced by the poor majority. If positive real interest is paid on deposits there is even an income redistribution effect, from borrowers (mostly better-off) to savers (mostly poor). Savings also reallocate resources away from unproductive use, such as inflation hedges, towards productive investment. There is, of course, the problem of capital flows out of the rural sector towards higher return urban industrial and commercial investment, but with most institutional forms this cannot be helped due to the fungibility of credit. The only realistic way of keeping savings in the area where they are raised is by mobilizing them through local level institutions such as credit unions, which lend to members.

Savings facilities, then, are essential to the health of RFMs. It may even be said that savings should be encouraged before credit in order to create an ethic of saving in the local population, a base of local capital for lending purposes, and lender responsibility to local people. Development benefits may not be as visible as those of credit schemes, but they are not less substantial to the poor majority. Savings are inseparable from credit if a lender is expected to be self-sustaining, yet savings facilities are rarely promoted as much as credit facilities (see 3.4.).

¹² Dale W. Adams, "Are the Arguments for Cheap Credit Sound?" in Adams, Graham and Von Pischke, Undermining Rural Credit, p. 70.

CHAPTER THREE

INSTITUTIONAL VIABILITY

This chapter analyzes the economic environment, the responses of different financial intermediaries to a range of policies, and the effect on the rural poor.

Since demand for credit and savings facilities is assumed to exist (and is corroborated for the Sri Lankan case study in Chapter 5) and since measurement of effects of credit on borrowers is so difficult to measure accurately (Chapter 2), the best way to check performance of credit and savings programmes is by analysis of the lender. Formal lenders invariably keep reasonably good records of who they lend to, how much, for what purpose, and under what terms and conditions. They also monitor the progress of repayment and, in most cases, are quick to identify problems. This creates a substantial paper trail for analytical purposes.

Caution must be exercised in order that the very poor and women are properly identified as subgroups of borrowers. Some credit programmes appear as though they are serving "the poor" when in fact the group in question is not the poorest stratum and are overwhelmingly male. Furthermore non-agricultural productive activities are frequently neglected in rural credit programmes although such activities are a sizeable form of rural employment, especially for the landless and women. The point here is that analysis of the lender may seem straightforward because policies and records are available for examination, but the analyst must first profile the focus group (see 2.1. and 5.1.) and end uses of credit (see 2.2. and 5.2.).

The counterpoint to access for the focus group is the viability of the lender itself. An independent lender, such as a commercial bank, will always consider its own survival first and foremost.

Extension of access to services down the socio-economic ladder only extends as far as the lender must go to operate at maximum profitability inside the constraints of the economic environment. In other words, the poor are excluded due to perceived risk and cost of administration. The poor hamper efficiency and lower profitability.

Government policy bears heavily on the economic environment, especially in small countries with poorly developed markets. Policies can push financial intermediaries towards opening access for the poor or can bar the poor with a policy of laissez-faire. Governments often create their own financial intermediary in order to carry out financial policies and economic programmes. Unfortunately, unless the mandate of such an institution includes emphasis on its own financial viability, it will be a cripple, constantly begging the treasury for more funds. Sometimes these agencies are able to give better access to the poor, but often benefits are captured by more politically influential groups.

The lesson here is that, if the poor are to be served, it must be in the interest of the financial intermediary to serve them. If not, the intermediary must be coerced into serving them.

Regardless, the intermediary must still break-even at least or it will fail, depriving the RFM and the poor of an essential institution or burdening the government with continual expenditures.

3.1. The Government

The first institution to be considered in the context of RFMs in general and credit and savings programmes in particular is the government of the developing country. In most developing countries the government is a major sponsor of credit programmes through state owned banks, through a specialized state agency set up for the purpose of financing the agricultural sector, or through provision of loan funds channelled via commercial banks and/or cooperatives. The economic policies of the government always have a strong influence on the financial health of lenders and borrowers alike.

Governments of developing countries must intervene in the financial system in order to carry out their monetary policy and assure the stability of the financial sector. Controls on the marketing of money and other financial instruments are therefore more comprehensive than on the marketing of any other commodity. Manipulations of the financial markets are used to offset distortions in the economy such as overvalued foreign exchange, product price controls, high-priced inputs, various taxes, and lack of government investment in rural areas, all of which can depress incentives, yields, and incomes. Regardless, cheap credit will not make unprofitable enterprise profitable; the credit will often be diverted to consumption or more profitable uses. Concessional credit programmes have also been used to try to transfer income to the rural poor, to allocate patronage to political supporters, or to induce rural people to join government-sponsored programmes. Schemes of agricultural credit, almost always without a complementary savings scheme, have been quick ways for governments to enter RFMs. Such programmes are usually progressive on the surface and therefore politically popular, though the costs are often regressive but diffused. It is imperative to understand the policies and objectives of government intervention in RFMs and the financial sector in general. Failure to do so may result in misunderstanding of the context in which a credit (and savings) programme is to operate and the resulting programme may not perform up to expectations.

Credit controls are justified on the grounds that the private profitability to the banks and the social profitability to the nation differ with respect to which sector or focus group receives credit. The social benefits to small producers receiving credit are neglected by commercial lenders who view this group as high risk and high cost. Governments try to promote particular sectors or subsectors through their own credit programmes. Cash crops which earn foreign exchange are a favorite. Long-term investment which other lenders are unwilling to supply is sometimes supplied by the government. Credit is also used as a tool for disaster relief, though the funds are heavily directed to consumption. The effect of all this manipulation is that "by reallocating credit

to alter the market-determined allocation of real resources, credit controls become implicit tax-cum-subsidy schemes."¹

And what are those controls? There are a number of them which the government can mix to try and ensure that its objectives are met:

- Limitations on Institutional Participation in the Market:

The government has charter granting authority to determine just who will be able to participate in the formal market. It can also set limitations on the range of financial activities which an institution can undertake.

- Portfolio Ceiling Devices and Quotas:

Here ceilings may be set on loans for specified purposes or to specified sectors. This tends to promote evasion on the part of lenders and increases their costs. A related regulation is ceilings on increments, specifying the maximum increase allowed on loans for certain purposes. Lending quotas force lenders to direct a certain percentage of their loan funds to a specific sector or group. This also is subject to evasion.

- Discount Mechanism Alteration:

The central bank may offer to rediscount loans to a specific sector at preferential rates, creating a spread for lenders which offers them better returns. There are weaknesses to this though. The banks may indeed rediscount small producer loans but use the additional funds they collect in the process for more loans to traditionally preferred customers. The incentive to raise loan funds from savings will be inhibited if the rediscount rate is less than the interest to be paid on deposits. Finally, the net effect of this practice is to increase the money supply, allowing the preferred sectors to bid away resources from other sectors, leading to rising prices and inflation.

¹ Omolunde E.G. Johnson, "Credit Controls as Instruments of Development Policy in the Light of Economic Theory," in Von Pischke, Adams, and Donald (1983), p. 326. Original publication in the Journal of Money, Credit, and Banking 6(1), 1974, p. 85-99.

- Reserve Requirements:

The government may link the reserve requirements of a lender to the composition of its loan portfolio. Lenders which maintain a certain minimum portion of their portfolio in a preferred sector are allowed to maintain lower liquid reserves than otherwise. An alternative is to maintain the reserve levels at high rates, allowing the lender to invest some of those reserves in preferred sectors. The government can change the reserve levels and targeted sectors at will

- Direct State Participation in the Market:

The government can create its own financial agency or nationalize private sector banks. It also may attempt to control credit and savings schemes in the cooperative movement (if the cooperatives were not government-sponsored to begin with). Unfortunately, the performance of these institutions leaves much to be desired.²

- Interest Rate Manipulation:

A major tool in many developing countries, interest rate policy is the cause of many distortions and inefficiencies, especially when low ceilings are set. This complex issue is dealt with in greater detail below in 3.3.1.

Regardless of the method used, alteration of the profits of banks is an implicit tax on their earnings and diverts loan fund suppliers to the open market, away from the banks. The banks' traditional clients are also forced to the open market if preference in bank lending is redirected to new client groups. The interest rate in the market is bid up, causing a net redistribution of wealth from borrowers to lenders. Taxing banks reduces the supply of financial instruments, lowers interest on savings, increases it for loans, and increases the transaction costs for everyone.

"Country experience has shown that a reduction or removal of controls produces growth, both in

² Compton Bourne and Douglas H. Graham, "Problems with Specialized Agricultural Lenders," in Adams, Graham and Von Pischke, Undermining Rural Development, p. 36-48. See also 4.2.1.

the financial system and in the economy, but it may be accompanied by a loss of power some governments would like to exercise over the changing shape of their economies."³

In the face of government regulations, financial intermediaries are quick to find ways to avoid the intended consequences, since there are strong economic incentives to do so.

It is becoming increasingly clear, nevertheless, that the control politicians have over financial systems is more shadow than reality. By nature, financial intermediaries are innovative. They are able to mine loopholes that exist in virtually every regulation. The net result of this mining is that the original intent of the policymaker is often evaded by the intermediary, and the social costs of financial intermediation are increased through evasion. Because of the diffused nature of financial intermediation, it is difficult for anyone, especially the harried policymaker, to know exactly what intermediaries are doing. It is easier for policymakers to assume that financial mandates are largely followed. ⁴

Then there is an interminable lag until the government realizes what is going on and reregulates to close the loophole. This adversarial relationship assumes that the government is ~~not~~ in cahoots with the financial institutions. In some cases, it may well be that regulations are intended to be cosmetic while the government (or influential members of it) and financial intermediaries all benefit behind the scenes at the expense of borrowers or the public in general.⁵

Can RFMs be depoliticized? They probably cannot be since "scarce things of value cannot be depoliticized or removed from the political arena. Any effort to do so is really an attempt to substitute one political solution for another - to change the rules."⁶ The best approach is to look at the government's real objectives, which do not usually include among their high priorities the maximizing of social welfare for the poor. Since the government wants to stay in power, it can maintain stability by retaining the support of those groups which could disrupt it. In rural areas,

³ Millard Long, "A Note on Financial Theory and Economic Development," in Von Pischke, Adams, and Donald, Rural Financial Markets, p. 20.

⁴ Dale W. Adams, Douglas H. Graham and J.D. Von Pischke, "Overview of Relationships Between Politics and Finance," in same authors Undermining Rural Development, p. 163.

⁵ Kane, "Subsidizing Agricultural Credit".

⁶ Harry W. Blair, "Agricultural Credit, Political Economy, and Patronage," in Adams, Graham and Von Pischke, Undermining Rural Development, p. 185.

it is usually the wealthy that maintain order, so the government buys their loyalty with protection of their property and dispensation of patronage, the latter often in the form of subsidized credit.⁷ If subsidized credit is used as patronage, interest rates cannot be raised and access to the credit itself cannot be denied to the wealthier stratum of rural producers unless the government has something of equal value to replace it with, can build the support of an alternative power base in the countryside, or is willing to give up rural support altogether. It is far easier to maintain the status quo.

In the case study to follow, it will be worthwhile to analyze the power relationships which may be linked through existing credit schemes. This will suggest whether the rural power brokers are involved in credit programmes, whether the government has a hidden agenda, and whether the real benefits of the schemes are being captured by those who do not need them.

3.2. Lender Behavior in Credit Programmes

The principal determinant of lender behavior in RFMs is whether or not financial viability is one of the objective functions of the institution. Obvious examples are commercial banks, which count their financial viability above all else and, conversely, some government financial agencies which are mandated to serve certain welfare or political functions and are not expected to be financially self-sustaining. The former must earn enough revenue to cover their lending costs, protect their assets from inflation, and earn a profit; the latter do not necessarily work under this restriction as long as they enjoy continuous financial support from government treasuries or from foreign donors.

Given increasing pressure on governments to lessen spending, the desire of donor agencies to assist institutions towards self-reliance, and the merits to the RFM of financially viable lenders, the

⁷ Ibid., p. 186.

discussion in this section will consider how a lender striving for financial viability will respond to various government policies and RFM conditions.

Interest rates, securities on loans, and response to default are critical to all lenders. If the poor are to have access to credit, any lender whose objective is financial viability must make a sufficient spread between costs and returns (the interest rate) to maintain the value of the capital pool, must have a reasonable guarantee that someone will repay the loans, and must have legal recourse to pursue defaulters. If any one of these is missing, the poor will tend to be rationed out of the credit market as cost of lending rises and supply consequently falls.

Where there is not enough credit to meet demand or when lending conditions are not conducive to recovering costs, lenders will adopt a policy of "credit rationing." This will leave them with the best combination of low risk and high returns. There are three ways in which this is accomplished:

- Interest Rates (see 3.3.1. for full discussion):

Differential interest rates are quite common, with small borrowers generally paying higher rates. If there is an interest rate ceiling, a very common policy in developing countries, then lenders must ration using the next two methods.

- Non-Interest Terms of Contract:

Lenders may discourage certain borrowers, small rural producers first and foremost, through contract restrictions which make borrowing too expensive. In more restrictive cases, some borrowers are categorically disqualified.

- Transaction costs: Although transaction costs per unit lent is already higher for small loans, lenders often transfer a disproportionate percentage of that to smaller borrowers in order to discourage them.
- Collateral: Borrowers with the most collateral, always the larger ones, will receive loans in a rationed market.

- Term of loan: Lenders may make shorter-term loans to reduce risk and to protect themselves from inflation. This restricts the ability of borrowers to invest in lumpy fixed capital which could produce long-term benefits.
- Sectoral preference: Lenders also prefer certain sectors of the economy, those with lower risks and higher returns. Agriculture, especially food crop agriculture, is avoided because of the risk of crop failure and the low prices often set for food crops. Artesanal fisheries, smallholder forestry, cottage crafts, and micro-level rural services are all shunned. Cash crops, commerce and industry are much preferred.
- Simple exclusion: Lenders may reject new borrowers out of hand on account of the cost of information gathering and risk assessment.

- Size of Loans:

Should the borrower be able to afford the cost of a loan and meet contractual obligations, the lender may set a ceiling on the size of the loan in order to restrict risk. This is especially prevalent for small rural borrowers whose reliance on conditions of nature (after the loan is taken) and potentially small capacity to repay make them high risk. Thus, there may be a credit limit per hectare of a certain crop. These are almost always below the borrower's optimum requirements and are especially low for food crops.

3.3. Interest Rates, Securities and Default

3.3.1. Interest Rates

It used to be that subsidized interest on loans was an article of faith when focussing on the rural poor for credit.⁸ Not so any more; subsidized interest can be blamed for several serious distortions in RFMs which continue to deny access to credit for the rural poor. Successful credit schemes now tend to have market or near-market interest rates.

There are three determinants of the cost of lending, which set market interest rate:

- Opportunity Cost:

This is an exogenous variable, depending upon returns for competing uses in the economy. It is independent of loan size and therefore identical for all classes of borrowers. It can be local or national, depending upon the source of the loan funds. Locally it is the supply price of money in the community or the value to the rural saver of parting with liquidity and forgoing his or her own investment. The national supply price would be the cost to the lender of getting external funds from the central bank, commercial banks or wherever. Opportunity cost is rarely less than 10% in real terms.⁹

- Administrative Premium:

This covers the cost of handling a loan (recording, disbursing funds, accepting repayment) and the cost of risk reduction (information gathering, end use monitoring, collection efforts). The handling cost as a portion of interest depends upon the size of the loan; as loan size goes up, cost per unit lent goes down. Larger borrowers are therefore favored. Administration cost for

⁸ This was an extension of the "supply-leading" philosophy of H.T. Patrick (1966) and others (see 1.4.).

⁹ Joseph M. Lieberman, A Synthesis of AID Experience, p. 32.

commercial lenders is usually about 3%, but for efficient lenders to small producers it rises to 5-10%.¹⁰

• Risk Premium:

Since uncertainty about loan repayment is impossible to eliminate, a risk premium must be attached to each loan beforehand. Probability of default (and risk premium) depend upon the borrower's willingness and ability to repay. These, in turn, are a function of the productivity of the activity for which the loan was made and the value of collateral offered. The premium is calculated as principal plus lending costs summed and multiplied by the expected default rate, all divided by the proportion of principal repaid by the borrower the previous time. Assumed default rate is largely speculative, since willingness to repay exemplified by borrowers in previous rounds of lending does not account for exogenous variables like weather and output prices. Commercial lenders tend to err on the side of overestimation on this.

It is in the lender's interest to distinguish between as many different classes of borrowers as possible, but the cost of information gathering increases dramatically the more numerous and accurate these distinctions become. Lenders must find the optimum combination of information cost and residual risk acceptable. The minimum is attained when the marginal cost of additional information equals the marginal return of that information in reduced losses. Since small producers are often economically heterogeneous and therefore difficult to classify, they are often lumped together in a high-risk group with a corresponding high-risk premium attached. If a ceiling on interest rates exists and the cost of optimum information gathering cannot be retrieved, small lenders may be excluded entirely through non-interest rationing. Efficient lenders can keep this premium down to about 2-5%, but in a poorly run programme it can be much more.¹¹

¹⁰ Ibid.

¹¹ Ibid.

When all these determinants, plus whatever margin is left for profit, are brought together, a market interest rate is set. An efficient top-down programme should run at 7 - 15% plus inflation. Two safety-valve policies may be used to cover changes in the inflation rate. Loans may be indexed to inflation, but that creates insecurity for borrowers and makes them reluctant to borrow. In some economies, of course, there is nothing which can compensate for huge inflation except indexing, making borrowing extremely risky. Under moderate inflation, an alternative sometimes used by some informal lenders is to receive repayment in real goods. This is easier on the borrower, but most formal lenders are totally unable and unwilling to handle goods. The most frequent tack taken by lenders is to keep the lending period short, usually less than one year. This leaves a large demand for medium and long-term credit unfulfilled and is a serious shortcoming since many capital improvements leading to long-term development benefits require long-term credit. One solution is for the government or a foreign development agency to offer partial guarantees for long-term loans only, though this could be extremely costly in countries with mounting inflation and depressed agricultural prices.

There has often been a failure to distinguish between nominal and real interest rates. Nominal rates for rural credit programmes are usually inflexibly set by the government or parastatal financial agency and are not adjusted with changes in the market rate. Even though they are invariably lower than the market rate, implicit interest rates, legal or illegal, will tend to cover the difference.¹² Implicit interest includes "service charges", "administration fees", kick-backs to loans officers, and other charges. Real interest rates adjust the nominal rate for changes in prices over the term of the loan. In countries with double (triple!) digit inflation, real interest, even on a short-term loan originally set at market, can easily become negative. Subsidized interest rates are negative to start with and usually get more so while the loan is outstanding.

¹² Kane, "Subsidizing Agricultural Credit".

Under such circumstances it is difficult for financial intermediaries to mobilize voluntary savings, forcing them to rely on government or foreign donors for loan funds. It is also difficult for them to recover their loan costs, compelling them to seek subsidies themselves from the same sources. The alternative is decapitalization, a shift of loan transaction costs to the borrower, or loans to large, well-secured borrowers. In any event, the lender will be internally unstable.

There have been a number of arguments in favor of concessional interest rates in RFMs, but each may be refuted:

- "Informal moneylenders charge usurious interest rates which permanently indebted the poor, so they should be cleared out of the market through cheap formal loans." ...Although there are indeed usurious moneylenders in some RFMs, most moneylenders perform valuable services that would otherwise not be available. Further, their rates are often competitive and reflect the real cost of lending in the RFM.¹³ This argument is pursued in more detail in section 4.2.

- "The formal lenders get the money cheaply, rediscounted through the central bank or other facility, so they should lend it cheaply." ...This ignores the opportunity cost of the money, the foreign exchange risk if money was borrowed by the central bank, the loan default risks to the lender, and the real costs of administration.

- "If interest rates are raised, lenders holding long-term low-interest loans will be at risk." ...Actually, most loans in the rural sector are short-term production loans. Most lenders hold only a tiny part of their portfolios in medium or long-term loans, so governments are often the major long-term lender and may be best suited to absorb a loss.

¹³ D.W. Adams and G.J. Nehman, "Borrowing Costs and the Demand for Rural Credit." Journal of Development Studies 15 (1979), 165-176.

• "Producers need low-cost loans to persuade them to adopt new technology." ...Proven high rates of return and low incidence of failure are what it takes to accomplish this. Small producers are often relatively insensitive to interest rates in any event, since interest forms only a small part of cash expenses.¹⁴ This is substantiated by the continued use of higher interest informal lenders.

• "Low interest rates transfer income to the poor." ...In fact, the opposite occurs. The income effects are: 1) net returns from using the extra resources purchased with the loan, 2) income transferred from negative real interest rates, and 3) income transferred from loan defaults. Since lenders cannot make back their costs on negative real interest rate loans, they tend to lend to large, well-secured borrowers. Therefore the income effects of loans will accrue proportionate to the size of loan, large benefits to large borrowers and no benefits to the small producers who get no loans at all. This can be summarized by the "The Iron Law of Interest Rate Restrictions", which states that the lower the real rate of interest, the more heavily concentrated the loans will be in the hands of relatively fewer people.¹⁵ Low interest on loans also forces low interest on savings, which does more damage to the poor because more of them are deposit savers than borrowers, while the better-off tend to invest in non-financial savings.

• "Higher interest rates will spur inflation." ...Inflation leads interest rates, not the other way around, since borrowed money is only one of many inputs subject to price increases. Also, this assertion assumes that higher interest rates will be passed along in the prices of the output (cost-push) when in fact rural producers are price takers, having little control over the price of their output and most frequently are forced to absorb the increase in cost of production. In fact, for several reasons, higher, more flexible interest rates would tend to lower inflation.¹⁶

¹⁴ Dale W. Adams, "Cheap Credit".

¹⁵ Carlos Gonzalez-Vega, "Credit-Rationing Behavior of Agricultural Lenders: The Iron Law of Interest-Rate Restrictions," in Adams, Graham, and Von Pischke, Undermining Rural Development, p. 78-95.

¹⁶ Shaw, Economic Deepening.

• "Cheap credit offsets policies with negative effects on rural producers." ...The problem here is that all those who produce are taxed by regressive policies while only those who borrow benefit from the loan subsidy. Fungibility means that the loan will not necessarily be used to directly compensate for a taxed output anyway. An unprofitable investment will remain unprofitable and only adjustment of the regressive policies will solve the problems those policies create.

The common effects of subsidized interest may then be summarized: taxation of savers, reduction in size of total loan portfolio, reduction in the proportion of portfolio in loans, low profitability of lending institutions, inefficient allocation of resources, high transaction costs for lenders and borrowers, politicization of financial institutions, patronal relationships in the financial system, corruption, and negative income distribution effects.

Is there any condition which might call for subsidized interest rates? Where interest rates are very high, the only borrowers who may be able to pay the interest are those with high-risk but high-return investment plans.¹⁷ Should the lender skew its loan portfolio with too many of these high-risk borrowers, the lender's viability could be at risk while the less-risky but lower-return investments go wanting. Many enterprises might fail. The other side of this argument is that informal lenders charge higher rates and are still lending and being repaid. Clearly, there is no call for subsidized interest unless the market rate itself is highly distorted, in which case a temporary subsidy may be necessary to prevent serious damage to small producers. A case may also be made for moderate subsidization of the very poor who would otherwise shun credit (and therefore miss the benefits of improved production), provided the targeting is very precise, other supports are in place, and supervision is adequate.

¹⁷ Anderson and Khambatta, "Commercial Policies".

Otherwise, one should be very wary of calls for subsidized interest in loan schemes. Thorough investigation of such a proposal should reveal at least one, and likely several major drawbacks. The political pressures in favor of subsidized interest may be difficult to repulse, but in most cases taking a strong stand against subsidized interest will serve long-term development goals.

3.3.2. Securities

- Small producers cannot compete with larger ones when offering collateral or securities to lenders.

This is one of the major reasons that small producers lack access to institutional credit.

Ironically, lenders of funds from external sources rarely try to collect collateral when a loan is defaulted. The motivation is simply not there. When the lender itself has something to lose, more effort at collection will be expended. Reluctance to seize collateral may be politically difficult or it may saddle the lender with assets it cannot easily sell, locking-up its liquidity. The most practical alternative would be to seek some kind of rescheduling of repayment from delinquent borrowers.

There are many types of security which may be arranged:

- Land:

The more rigid lenders accept only the most secure collateral, land titles, which the rural poor either cannot offer because they do not own real estate or will not offer because they are too cautious to risk losing it (and justifiably so). Nonetheless, land is the normal security for long-term loans.

- Chattel Mortgages:

In this case, some non-real estate asset, often a durable item purchased with the loan is security of payment and will be seized upon non-payment. They are not common in RFMs since most loans are used for production inputs, not durables.

- Crop Liens:

Here the lender has first rights against the harvest of the borrower. They are less risky for cash crops and in areas where crops are not subject to serious loss. This form of security is often the only kind that a poor producer can offer and should not be overlooked in credit programme design.

- Guarantors:

The borrower must provide one or two cosignatories on his or her loan, people who promise to repay if the borrower does not. Of course, the poorer the borrower the less likely he or she is to find guarantors.

These options may still not suffice, in which case there are alternatives to conventional securities.

- Group Guarantees:

In this case, a group loan is taken and divided among the members of the group. The group as a whole is responsible for the repayment of its loan, putting the burden of default upon them. They provide such strong social sanction that they usually prevent any of the individuals from defaulting. Of course, there are numerous cases of the entire group defaulting!¹⁸

- External Partial Guarantees:

The government, the development bank, or a foreign donor may offer to guarantee part of a loan portfolio. Each individual loan may then be covered for, say, 20% of its value. The lender takes some of the risk and charges the borrower a premium for the rest. High percentage guarantees tempt default because the lender will not be too diligent about collection. The best use of guarantees seems to be as an inducement to the lending institution to take on lending of a new type (agriculture? cottage industry? petty trade?) or to a new group (small producers? women?

¹⁸ In Sri Lanka, some of the village Rural Development Societies, which are mainly vehicles for the ruling party, have taken loans and deliberately defaulted. Tightening of the lending system in recent years has reduced such occurrences considerably.

landless labourers?) and gradually withdraw the guarantee once the lender has developed information systems and capacity to handle the new portfolio.

● Incremental Lending:

Here loans are doled out a bit at a time, with repayments on the first installment starting well before the whole loan is disbursed. The borrower is thus gently coerced into making regular payments in order that he or she can receive the balance of the loan. However, the lender must be able to deliver the increments on time. Small intermediaries may not have the physical ability to manage this system.

● Customer Orders:

If a small producer, usually non-agricultural, can produce a batch of orders for his or her product which demonstrates that the enterprise will be receiving a strong income, the lender may feel confident to proceed. For agricultural produce a guaranteed price or, better still, a guaranteed purchase agreement, preferably from a government agency, may serve the same purpose.

● Character Assessment:

This is not a real "security", but a personal evaluation. If the borrower is known to the loans officer and especially if she or he has repaid a previous loan, then formal security may be waived. Character guarantors are used by some cooperative credit schemes. In this case a well-known and trustworthy village person vouches for the suitability of the borrower without putting up a repayment guarantee.

● Qualitative Measures and Familiarity with the Enterprise:

This depends entirely on the knowledge of the loans officer. If he or she can evaluate the enterprise in question and make a personal judgement that the loan is viable, then security may be waived.

However, lack of personnel with appraisal experience is a very common shortcoming of lending institutions in developing countries.

When all efforts to collect or reschedule a loan fail, it is imperative that the lender use legal sanction, including the seizing of securities. If action is not taken, other borrowers will take note and defaults will increase. While it is more constructive to be flexible with a borrower in arrears, the lender and the whole RFM cannot afford the chaos of failing to be firm.

3.3.3. Defaults¹⁹

Defaults are the bane of credit programmes. A lender to rural enterprises in a developing country is doing very well to keep defaults under 5% of the value of its loan portfolio.²⁰ Many credit schemes, notably those offering external funds, suffer default rates of 50% and more.²¹ Reducing the default rate to a size which can be absorbed by the risk premium in the interest of loans which are repaid is the goal of any institution which must protect its financial viability.

Default rate is measured in a variety of ways: the collection ratio for an accounting period, percentage of the portfolio in arrears at a given time, the proportion of borrowers who repay, or other methods. It is difficult to determine just when a loan ceases to be delinquent (overdue) and

¹⁹ For a more detailed discussion of reasons and remedies for default, see Gordon Donald, Credit for Small Farmers in Developing Countries (Boulder, Co.: Westview Press, 1976), Chapter 11. With specific reference to Sri Lanka, see Nimal Sanderatne, "An Analytical Approach to Small Farmer Loan Defaults," in Savings and Development, 4 (1978), p. 290-303.

²⁰ Lieberman, in AID Synthesis, reviewing USAID credit projects for the period 1976-85 says, "Unsuccessful projects had delinquency rates that ranged from 10 percent to 75 percent, with most falling between 25 percent and 50 percent. The successful projects had delinquency rates from 0 percent to 15 percent, with most below 5 percent. The rates in partially successful projects were around 20 percent. Although comprehensive default data are not available, it appears that successful projects had rates of 2 percent to 3 percent." By "successful", Lieberman means that the credit project was executed as planned and the lending institution is viable.

²¹ There is no better example than our case study country, Sri Lanka, which has suffered chronic high default rates on its government agricultural loan schemes.

may be classed as a true default, so a more comprehensive, if more discouraging measure includes all overdue loans. Even these may be hidden by rolling the loan over or by simply extending the repayment period. Good bookkeeping is required so that delinquency may be detected and acted upon quickly. Project designers should look closely at bookkeeping methods, drawing a balance between simplicity and completeness. Implementors and evaluators should check to see that the books are being properly kept and that defaults are not being hidden.

There are a range of reasons why defaults occur; pinpointing the causes of defaults is the first step to reducing them. The World Bank has identified three categories: failure of the borrower to use borrowed funds for production, failure of the investment, and refusal to pay.²² There are a number of individual points which fit variously in these three categories.

- Diversion: (see 2.2.)

The borrower may not use the loan for the productive purpose for which it was intended. Consumption and repayment of informal debts are frequent alternatives which can lead to default. Weak supervision of the loan also contributes.

- Loan Size:

The larger the loan size relative to productive capacity, the more difficult it will be for the borrower to repay.

- Defects in the Production Process:

The producer may not realize enough surplus after consumption to repay the loan. There are a number of reasons, some of them exogenous such as a drop in price for output. The producer cannot be blamed for many of these problems. Default in this case is compounded by large loan size, though even small loans are vulnerable to serious defects.

²² World Bank, Agricultural Credit Sector Policy Paper (Washington: WB, 1975).

- Net Income of the Borrower:

This is closely related to the last one. The greater the borrower's income, the greater his or her ability to repay.

- Debt-Equity Ratio:

This ratio is closely related to loan size and net income (above) and is usually lower for better-off producers. It is difficult to know for certain how much is owed to informal lenders, who are the first to be paid.

- Value of Collateral:

The more collateral put forward, provided the threat to seize it is serious, the less likely is default.

- Income Variance of the Economic Activity:

Farmers, for example, are subject to wide variation in income year to year. A poor year, due to drought perhaps, can mean many defaults in the area affected.

- Administration Costs in Collection:

If a lender spends little on pursuing repayment, defaults will increase.

- Enforcement:

If lenders are lax in taking legal measures against defaulters, other borrowers will tend to follow suit.

- Real Rate of Interest:

Ironically, negative real interest can promote repayment if the borrower thinks he or she can get further loans which transfer income. This effect is lost, however, if the lender *appears* unable or unwilling to offer further loans.

- Type of Lender:

Local lenders, especially informal lenders and producer groups, are much less likely to suffer default than large, centralized institutions due to superior local knowledge and effort expended in pursuing repayment.

- Source of Funds:

Borrowers are much more likely to default on government or foreign donor funds, which are often regarded as welfare, than on funds raised from savings in their own community.

These causes or indicators of high probability of default are interrelated and lowering the default rate for any particular lender may demand a broad approach. In some cases where lender viability is in doubt due to problems in the production process, wide-ranging policy changes may be called for, including price adjustment, land reform, and infrastructural development. One-time variations in income may be cushioned by rescheduling repayments, introducing crop insurance, or providing temporary price supports. Willingness to repay is another matter. There is a strong tendency for a borrower to default if he sees another borrower getting away with it. In some cases, rich and influential people deliberately milk credit programmes.²³ Deliberate default can be curbed by halting political decrees of loan forgiveness, which plant the expectation of further such decrees, and by following through on threats of legal action against defaulters. Weaknesses in the lending institution demand improved management, higher pay for some positions to keep

²³ Gordon Donald, Credit for Small Farmers, p. 146.

qualified personnel, more rigorous systems of loan supervision, better enterprise management data on borrowers, and improved accounting and bookkeeping.

The clear trend which emerges in commercial loan policies is that the smaller the producer, the less likely he or she is to get a loan. If a loan is obtained, it is likely to be more costly per unit borrowed and more restricted in its contract obligations than loans to larger, more secure borrowers. Special mechanisms, such as loan guarantees, must be put in place which counteract the tendency to ration the poor out of the market. While guarantees do distort pure market allocation of credit, the effect is beneficial, whereas the many distortions of interest subsidies are not.

3.4. Savings Facilities

Savings facilities benefit both the saver and the deposit taking institution. The institution can collect funds which it can lend, thereby reducing dependency upon external sources and levelling the feast or famine effect of injections of funds from those sources (4.2.1.). Price discipline is imposed when interest rates charged for loans must exceed those paid for deposits by at least enough to cover costs. Since savers will be reluctant to keep funds at negative real interest rates, both rates should be positive. The lender will also have more information about borrowers, should they also be depositors, making information gathering and loan assessment less costly. They will be more diligent about collecting loans than if the funds came from an external source.

When facilities first become available in a locality, savers tend to be more responsive to service and the savings environment than interest rates. Conditions are optimum when...²⁴

- cash flows of the depositors are growing
- depositor income is lumpy, not spread evenly over time
- deposit-taking facilities are conveniently located and open at convenient times
- the deposit-taker offers other facilities, such as money transfer services or credit
- minimum transaction and balance limits are not set or are not too large
- fees, charges, and other costs of access are reasonable
- paperwork is minimal
- deposit services are capable of planning, promotion, implementation, and control
- the deposit-taker enjoys the confidence of savers, who are protected against fraud and bankruptcy
- inflation is not so high as to induce savers to put their assets in real goods or
- the savings mechanism is indexed to cover inflation

While very few deposit-taking institutions anywhere provide the full array above, all of them must be sensitive to the mix of services desired by the potential clientele in a specific area and economic activity. If so, a large proportion of the poor can benefit from savings facilities.

3.5. Performance Criteria for Financial Intermediaries

Performance of credit and savings operations may be quantitatively measured provided good bookkeeping and accounting practices have been followed. The measures listed below are indicators of the health of the lender and efficiency of the delivery system. The list does not include day-to-

²⁴ After J.D. Von Pischke, "Toward an Operational Approach to Savings for Rural Developers," Savings and Development, 2(1), 1978.

day functional measures, nor does any single financial intermediary have to collect data for or attempt to calculate all of them. Several baseline measures should be regularly monitored over time, while problems or potential problems may call for other specific measures.

- **Nominal and Real Rates of Interest:**

The lender should always be aware of the difference between these, though the inflation rate for many countries may be difficult to determine with accuracy.

- **Percentage of Value of Overdue Loans to Value of Loan Portfolio:**

This is the critical measure of delinquency (and pessimist's default rate), which should be under 10%. If the rate goes over 15%, corrective measures should be taken immediately.

- **Amount of Voluntary Savings Mobilized:**

This is a gross figure which, over time, should show steady increases. It is a strong indicator of both penetration into unserved RFMs and institutional viability.

- **Percentage of Savings to Loans:**

A lender who depends upon external funds will have a low rate here. Strong, independent institutions usually have a high percentage.

- **Percentage of Funds Lent to Funds Available for Lending:**

This usage rate shows how well the lender is utilizing resources. If the rate is low, there may be powerful disincentives to lending or borrowing, most of which originate in government policy, which should be investigated.

- **Borrower Profile:**

If the information has been compiled, it is instructive to know how much has gone to which income and gender groups and which economic activities. Unserved segments of the population may be

identified this way. Lenders collect much of this information in gross form during the loan evaluation and approval process.

- **Percentage of Agricultural Credit to Total Credit:**

This is closely related to the last one, but is critical for rural lenders. Some lenders are reluctant to make agricultural loans and there may be unsatisfied demand. Too much of a portfolio in agricultural production credit (particularly in a single major crop, such as paddy) can be very risky if the crop fails in a region. A good mix of activities is healthiest.

- **Percentage of Production Credit to the Value of Production:**

If this rate is too high, there may be inadequate capacity to repay. If it is very low, it might indicate lender reluctance to meet demand for production credit (often expressed as credit ceilings for a given crop and cultivated area). Should the latter condition exist, optimum input requirements may not be purchased and, therefore, maximum yields may not be forthcoming. This, in turn, inhibits capacity to repay.

- **Costs Imposed on Users for Various Services:**

What is the breakdown of transaction fees? Are there different costs for different classes of borrowers? This can reveal loan rationing on the part of the lender or bias against certain services or types of credit.

- **Term Structure of Loan Portfolio:**

Too large a percentage in long-term loans is risking serious losses due to inflation. A very low percentage may indicate lender uncertainty about the future of the economy and probably leaves unsatisfied demand for long-term credit.

- **Intersectoral and Interregional Flows of Financial Claims:**

This can be obtained by comparing deposits (though just who is making the deposits must be estimated) with the intermediary and local lending from the same source. There is often severe leakage of capital out of the agriculture sector and out of the rural regions.

- **Percentage of Cost of Credit to Amount of Credit Disbursed:**

This is a time comparison ratio with which the lender can try to lower the cost of lending. Both direct and indirect costs must be included. If broken down for different borrower groups, figures can be used to justify or deny credit to poorer strata of borrowers.

- **Percentage of Cost of Credit to Income from Credit Operations:**

A viable lender should show more income than cost. Consistent failure to do so leads inexorably to collapse or dependence on external finance and controls.

- **Direct Cost Analysis:**

The administrative expenses are broken down into components such as salaries, information services, rent, utilities, office equipment, etc. Trends in proportions for each are analyzed over time to attempt to control costs.

- **Information Cost per Application Processed:**

This may assist in determining the optimum combination of information quality versus residual risk (3.3.1.). It may suggest more or less use of interviews, references, and other information sources or it may suggest better training of loans officers.

- **Time Required for Application Approval and Authorization:**

Long periods here should spur the lender to streamline operations. Chances are that a lengthy approval process is also costly. Furthermore, if a loan is not timely it can be worse than useless,

yet approval and disbursement delays are common in formal credit systems in the developing world.

The quantity and quality of data for determining any of the above measures must be considered. Quality data is simply not available in many developing countries, from the central bank or anywhere else. Although there is a cost involved in data gathering, some basic forms of measurement is mandatory.

Many of the above indicators can point the way to solutions for the same problems they illustrate. Quite often internal changes in the lending institution can bring about improvement, but there are exogenous influences as well, especially on institutions that are not independent of government. A variety of internal and external corrective measures are suggested throughout the text of this thesis.

CHAPTER FOUR

INSTITUTIONAL CHOICE FOR CREDIT AND SAVINGS DELIVERY

4.1. Issues in Institutional Choice

The choice of which institution to work with depends upon the ends being sought. If a development agency or government simply wants to supply credit for a few years as an input to support the introduction of a new technology, then whichever competent institution has the deepest penetration into the target area could well suffice. If the objective is to create a permanent, self-sustaining institution which will give access to the poor, then the demands upon the institution and on the sponsor (if there is one) are much greater. It is quite likely that no such institution will exist, so the question becomes whether an existing one can be altered or strengthened to serve adequately or whether a completely new organization must be built. The former is always preferable, both for political reasons and to take advantage of the existing pool of human resources and physical infrastructure. In either case, building a financially viable institution which is accessible to all is a long-term process. Creating one from scratch, should it even be possible, may take twenty years or more.¹

When determining institutional suitability for rural credit programmes, the following factors should be considered:

- level of development of enterprise and commercial awareness of the community

¹ For example, the Société de Développement International Desjardins, the overseas cooperative development arm of the Québec caisses populaires movement, has been working for over 20 years building caisses from scratch in Zaïre.

- distribution of income within the community and desire of government and/or development agency to alter it
- type of enterprise the government and/or development agency wishes to encourage (food production, non-agricultural small enterprise...)
- strength and potential of private lending and government policy towards it
- cooperative law and restrictions on cooperative activity
- penetration and flexibility of existing government financial agencies
- potential degree of cooperation from line ministries
- existing producer or other local organizations and their capacity to undertake new functions
- information needs of the lender
- availability of staff resources and existence of physical infrastructure
- savings capacity and needs of the savers

Choice of a credit and savings institution depends on the mix of objectives and working environment. Each country or region of a country will have a unique situation which will bear close scrutiny in the design stage of an RFM programme. Flexibility must be built into the design since only during implementation will the institutional abilities of the financial intermediary be tested.

There is no one type of institution best suited to offering access to credit to the rural poor. Each situation depends upon an array of factors including physical penetration of the intermediary into rural areas, skills of intermediary personnel, government policy towards RFMs, and intermediary lending policy.

- Government financial agencies may be very good, but are more often highly inefficient and subject to considerable destructive government interference. Most depend upon the government for regular infusions of cash and do not make any effort to mobilize savings.

- Government Integrated Rural Development Projects, if they function as intended, can coordinate many of the rural producer's needs, including credit. However, they tend to treat credit as an input (unaccompanied by a savings mechanism), may be subject to government interference, and often do not have the full cooperation of line ministries.

- Commercial banks (either state or privately owned) suffer from over-centralization, high operating costs, and commercial policies which exclude the poor from loan eligibility. Most savings mobilized by commercial banks are transferred out of the RFM into the urban market.

- Informal lenders supply most of the credit in RFMs. There is a strong debate about whether they are "exploitative" or "essential", depending upon the profits they make and the demand which would remain unfulfilled without them. In a few cases, there are possibilities of channelling formal credit through them.

- Village level institutions are better situated for appraisal, disbursement, and recovery of loans. However, unlike banks, they often have few trained people to operate their programmes. Although they can efficiently mobilize previously untapped local savings, they tend to have small capital bases and are unable to meet the demand for credit in their communities.

4.2. Centralized Institutions

Centralized institutions share an urban bias because top management and, therefore, policy emanates from major urban centres, most often the national capital. Institutional policy makers lack close contact with potential savers and borrowers or even with their institution's own branches in rural areas. Hence policy will often not reflect the real needs and conditions of the RFM.

4.2.1. Government Agencies

Governments get involved in RFMs either because they wish to exert full control over some aspect of rural policy or because there is simply no other institution providing adequate services in the countryside. There are two main types: the Government Financial Agency (GFA), which is created expressly for credit delivery on a national basis, and the Integrated Rural Development Project (IRDP), which is locally or regionally based and may have a credit component.

Governments are notorious for creating rural GFAs that are not financially self-reliant.² Because GFAs are used to implement government policy, financial viability is not the most pressing demand, at least at first. The GFA model which emerges below is not a universal one; rather, it is a composite compiled from the sorry history of many rural GFAs created in the last few decades.³ Governments are perfectly able, if seldom willing, to reverse this trend and create strong, viable institutions.

When forming a GFA, many governments operate under a set of assumptions that guarantee a poor programme. The supply-leading philosophy (see 1.4.), which many governments ascribe to, instructs them to try and induce adoption of new technologies by providing a financial carrot, subsidized credit, but no stick. Credit is viewed as a necessary input for adoption of new technology which can be measured, delivered, and supervised. By underestimating the fungibility of credit and the problems of supervision, such an assumption is bound to unravel. If the government attempts to target the rural poor with a subsidized credit programme, better-off borrowers often take most of the benefits (see 3.3.1.). Long-term credit is also a preserve of government agencies, since all other lenders are reluctant to commit liquidity for long periods when inflation may outstrip a fixed interest rate. Under such circumstances the capital pool constantly erodes and must be

² J.D. Von Pischke, "The Pitfalls of Specialized Farm Credit Institutions in Low Income Countries," in Von Pischke, Adams and Donald, Rural Financial Markets, p. 175-182.

³ For a brief overview, see Compton Bourne and Douglas H. Graham, "Problems with Specialized Agricultural Lenders," p. 36-48.

periodically replenished from the treasury. The overall effect is socially regressive since, while larger producers are often able to capture the benefits, funds from the treasury are largely raised through regressive taxation.

The lending approach of GFAs tends to be conservative. The demand for securities is often just as stringent as that of a commercial bank, biasing loans towards larger producers. The loan appraisal period is long, entangled in red-tape, and often followed by disbursement lags, the sum of which may make funds available too late for optimum use. Supervision is cumbersome, costly, and ineffective. For the borrowers, the inconvenience and cost simply may not be worth it, making local informal sources of credit competitive.⁴

Internal institutional problems also affect performance. The process of loan approval is so diffuse, with so many managers involved, that individual accountability is weak. Problems in long-term loans may appear years after the responsible officials have transferred. As with commercial banks, there is often a shortage of expertise in the technicalities of rural production. Lending costs may not be documented. Internal indicators of efficiency (see 3.5.) may be improperly calculated to make performance look better than it is.

Since many of these programmes operate under the assumption that small producers are too poor to save, little effort is expended trying to mobilize savings. Consequently, GFAs seldom hold savings deposits, thereby failing to build a source of information on potential borrowers.

Arguments may be made that small savings mobilization is too costly, an echo of the commercial banks' position. In fact, GFAs would have to pay an interest rate marginally higher than inflation, which would necessitate charging still higher rates for loans, leaving them with a spread to meet transaction costs. In other words, creation of a scheme which could successfully attract deposits would force the GFA to have more financial discipline, specifically positive real interest rates on loans. Of course, this would undermine the government's attempt to garner political capital with

⁴ D.W. Adams and G.I. Nehman, "Borrowing Costs."

subsidized rates. The result of not accepting deposits, coupled with limited use of bond issues to the private sector and heavy reliance on loans or grants from government or foreign donors, yields a distinctive liability structure not at all conducive to self-reliance.

Governments (and occasionally supporting donor agencies) are often driven to interfere in the policies and operations of the GFA, creating an uncertain institutional environment. GFAs are notorious for their role as patronage machines of the governing party (or as the vehicle for donor agency development philosophy). Its highly centralized structure and dependence upon external funds make it accessible and pliant to influence from above.

- Portfolio Preferences:

These limit lending to certain income groups or enterprises. It is very tempting for a government to get political mileage from credit programmes targeted for the rural poor, despite the all too common fact that larger producers tend to capture most of the credit due to lender rationing. Of course, reduced portfolio diversification increases risk and reduces net revenue.

- Interest Rate Ceilings:

Again, political benefit can be gained by the apparent benevolence of concessional rates, but it creates a host of problems (see 3.3.1.), not the least of which is credit rationing by the GFA which channels funds to larger producers. Once the better-off producer group is accustomed to this *de facto* purchase of loyalty, it is very difficult to reverse the policy.

- Discontinuous Inflow of Funds:

For many GFAs, it is either ~~fact~~ famine in the supply of loanable funds. If the capacity is built for peak periods but maintained at full capacity, there will be prolonged periods of excess capacity. Yet loan recoveries, especially with substantially negative real interest rates, may be too small to create significant amounts of revolving funds. If the government does not replenish the

pool of loan funds at critical junctures, then the GFA may not be able to offer much either, encouraging delinquency or default and seriously damaging the operations it was meant to support.

• Different Performance Criteria than Commercial Banks:

GFAs typically suffer a two-stage cycle of existence. When formed they are judged by their governments on how well they fulfill their political ends and how well they adhere to the bureaucratic process. Once they get into serious financial trouble and economic costs start to exceed political benefits, financial discipline becomes important. Commercial methods and lending biases may well prevail until political pressures once again rise to the point where financial health is again sacrificed (especially common before elections or just after a change in government).

Closing down one scheme or institution in trouble and raising a new one from the ashes, with a clean slate and fresh funding, is a common government practice.⁵ Indeed, if borrowers think the lender is not long for this world and will not be around to pursue repayment or make further loans, then they may be strongly tempted to default deliberately, regardless of negative real interest.

It is unfortunate that GFAs have had such a sullied history, but it once again points to the necessity of building responsible, self-reliant institutions that operate at least at arm's length from government. With the legal support of and seed programme funding from the national government,

⁵ For example, in India, the Agricultural Refinance and Development Corporation was terminated after suffering high defaults in many states and consequent loss of bilateral and multilateral donor support. The phoenix which arose shortly thereafter is called the National Bank for Agriculture and Rural Development. Sri Lankan government schemes provide another example, though credit was run through state-owned banks and cooperatives, not through a specialized GFA. The New Agricultural Credit Scheme of 1967 was dropped in 1973 in favor of the Comprehensive Rural Credit Scheme, itself dropped in 1985 in favor of the New Comprehensive Rural Credit Scheme. The first two suffered horrendous default rates of more than 50% on some years.

a multi-functional OFA could offer outstanding, accessible services to the rural population, while building itself into a financially self-reliant institution.

Another form of government agency is the Integrated Rural Development Project (IRDP), which may function under one or more line ministries. It has the advantage of being able to coordinate different inputs and services for production in a given area (that is, if the agency functions as intended with the full cooperation of line ministries... all too often not the case). The IRDP often has its own foreign sources of funding, its own staff and loan procedures, and even control over interest rates. IRDP staff should have a good idea of local investment opportunities and, through control or influence on inputs, extension, and marketing, be able to reduce both cost and risk of loans. The multi-functional role of the IRDP allows the security of the loan to be established at certain points in the production process (planting, harvesting, marketing). Operationally, functions of the loan officer would be shared among those responsible for different aspects of production.

There are of course a number of disadvantages to IRDP credit programmes. Credit is simply another input and savings facilities are rarely included. Cost of administration, often quite high in such a scheme, is usually buried in the general project costs, so borrowers are subsidized for it⁶ and efficiency is difficult to measure. Extension officers can end up spending much of their time collecting loans instead of educating producers. Credit rationing favoring large producers is also a common occurrence. Finally, all too often there is no serious attempt to build a permanent credit institution and services stagnate or decline over time. USAID has found that single-purpose credit agencies tend to work better than IRDPs, but either will do if all constraints are addressed.⁶

⁶ Joseph Lieberman, AID Synthesis, p. 25ff.

In general, government agencies suffer from political interference and bureaucratic inertia which damage their financial viability and operational efficiency.⁷ Yet there are merits to government programmes and they cannot be rejected out of hand. After all, governments and their agencies have a large human resource base and, usually, deep physical infrastructure. This allows them to carry out programmes on a scale much more massive than any other institution. At least, it is necessary to determine whether a government agency is flexible enough to adapt its policies and operations to suit a credit and savings programme for the poor.

4.2.2. Commercial Banks

In many countries, particularly in Africa, commercial banks have barely scratched the rural areas. In others, such as Bangladesh, they have the best penetration into the countryside of any formal financial intermediary. In yet others, such as India, what were private commercial banks have been nationalized and mandated by government to open rural branches. (In the case of nationalized commercial banks, the blend of commercial and governmental policy is unique to each country and cannot be generalized upon.)

When commercial banks are involved in RFMs, their participation is strictly limited to low-risk lending and large savings deposits unless they are legally forced to do otherwise. In other words, they play by the commercial rules described in 3.2. The cycle of government regulation, bank avoidance of the intent of the regulation, and government reregulation is an ongoing game in which the banks' response time is much faster than the government's ability to plug loopholes (see 3.1.). Since there is almost always a loophole, it is difficult for governments to implement their policies through commercial banks unless those policies are beneficial for the bank. An example of this is the channelling of development funds from the government or donor agencies through commercial

⁷ One need only compare the Rural Poor Program and Proshika schemes in Bangladesh to see the difference between government and NGO credit programmes. With the same target group, the RPP (government) is fraught with inefficiencies and delivery problems, whereas the modest Proshika projects (two indigenous NGOs) are relatively efficient and effective. Sources: CIDA documents, Bangladesh Desk.

banks to focus group individuals or to organizations, such as cooperatives, who then lend to members. The success of this depends upon the spread between the rate charged the bank by the government and the rate charged the borrower by the bank. If it is insufficient to meet costs, then the bank may well fail to transfer the funds or, if it can, divert those funds to more profitable investments. Commercial institutions are less susceptible to political interference than government agencies, but they are still subject to changes in regulations and, in some countries, to nationalization.

The urban bias of commercial bankers may mean that they are unfamiliar with the technicalities of rural production, which makes them less able accurately to assess risk and therefore more reluctant to lend to rural enterprises. When they do lend, they demand strong security, most often land titles, which discourages or disqualifies many small producers. If loans are made to small producers, it is often only with a government or donor agency guarantee. Though commercial banks often limit themselves to short-term or medium-term loans to large producers, this may at least free government funds for small producers (though government credit agencies are often just as conservative in their lending policies). The solution would seem to be an increase in the number of bank staff trained in rural finance, though few banks seem motivated to take this initiative.

Cost-effective small-scale savings generation in rural areas is problematic for commercial banks, mostly because of the lack of physical facilities close to potential savers. They are also reluctant to handle a myriad of tiny accounts due to the administrative cost. There is potential for making links between commercial banks and better situated organizations, such as cooperatives, wherein the local organization could gather small deposits and make large deposits at the commercial bank. Again, the local organization would have to realize a large enough spread to cover costs.

There are possibilities for governments and development agencies to share risk in rural finance with commercial banks, but it is necessary to involve the banks from the planning stage onwards

In order to ensure that both parties can be clear about what is required and what is expected. Since the banks have moderately good human resources and, in some countries, fair penetration into the countryside, they may be the best-equipped institution available. Furthermore, as long as the commercial benefits for the bank are obvious, its behavior should be predictable. Given the commercial orientation of savings and credit projects in recent times, it makes sense to engage commercial operators, provided they are professional, flexible, and not wedded to profit maximization when dealing with small producers.

4.3. Decentralized Institutions

Decentralized institutions have immediate advantages over commercial banks or GFAs. To begin with, the local financial intermediary is accessible when needed. Loan assessment should be superior, since the lender is local, should know the individual borrowers quite well, and should have good knowledge of local production conditions. Loan disbursement, especially from informal lenders, is very quick compared to a centralized institution. The local financial intermediary will be able to pursue repayment directly and, in the case of cooperative groups as opposed to moneylenders, have considerable social pressure to wield. If there is a problem, local lenders are much more flexible in arranging agreeable terms. If savings facilities are offered, they are nearby for both deposits and withdrawals and are much more likely to use the accumulated funds near to where they were raised instead of siphoning them off to urban areas. In short, a local financial intermediary designed and operated with the participation of the people it serves (i.e. not one of the infamous usurious moneylenders) can be made into a self-reliant institution. More than any other institution, such a local intermediary can be financially viable while serving the needs of the rural poor.

There are two major limitations to decentralized institutions. One is the shortage of skilled personnel. Qualified people from outside a locality are usually reluctant to take up residence in a strange place lacking in social links and amenities. The obvious solution is the training of local people to work in their own villages. The second major limitation is the relatively small scale of operations. Very few decentralized institutions have national scope. Indeed, success in many countries depends upon not becoming big enough to attract government attention! Thus decentralized institutions may not be suited to a "national solution" and may be bypassed when regulations are made and resources dispensed.

4.3.1. Informal Lenders

The vast majority of loans to rural producers come from informal sources. These can be non-commercial, such as friends and relatives who charge little or no interest, relying on other forms of reciprocity instead. Alternatively, the informal lender can be commercial, from the small shop-owner extending credit to his or her customers, to the local patron binding the dependence of his clients, from a middleman offering advances to his suppliers, to the professional moneylender exploiting the unfortunates who have no other recourse. Friends and relatives are the very first option explored by any small producer in search of a loan, but it is impossible to say how much of the demand is met in this fashion. The discussion below will concentrate on the commercial informal lenders.

The informal lender has lower transaction costs than a centralized institution, often running at 3-5%.⁸ This is because there is little or no overhead, few written records, and no appraisal fee since local production conditions and borrowers are so well known already. The informal lender is not bound by interest rate ceilings, credit allocation guidelines, or liquidity ratios. Service is quick; a

⁸ Juergen U. Holst, "The Mobilization of Personal Savings in Developing Countries," in Asia and Pacific Regional Agricultural Credit Association, Mobilization of Rural Savings in Selected Countries in Asia and the Pacific (Bangkok: APRACA [FAO], 1985).

loan can often be had in one visit. Repayment is flexible and easily scheduled to match periods of the borrower's expected income.

There has been considerable debate about the "exploitative" versus the "essential" nature of informal commercial lenders. The stereotype of the usurious moneylender is a strong one in some parts of the world, especially Asia, and has led some governments to mount moral crusades to eliminate moneylenders through formal programmes of cheap credit. In some countries usury is undoubtedly a problem, with moneylender interest rates up to 240% per annum, but the median seems to be in the range of 40-50% per annum.⁹ This rate may not be at all unreasonable depending upon the risk incurred (collateral is often not demanded) and the national inflation rate. Further, the opportunity cost of money in RFMs may be quite high. There are other ways in which some informal lenders add to nominal interest, however. Interest may be charged on the entire original amount as long as any portion remains outstanding and not on the balance owing. Lending may be against the security of standing crops which are valued far below market prices. If the lender is a provider of goods on credit, those goods may be overpriced. The one recurring theme in high-interest informal lending is long-term, even permanent debt for many poor borrowers. Debt can create long-term social obligations for the borrower toward the lender, including "debt bondage" still found in some RFMs. Often, a deceased borrower's survivors will inherit his or her debt. Relief from parasitic moneylenders is an early step towards improved welfare for the poor.

The competitiveness of informal credit markets is open to question, with one possibility being that anyone with surplus cash can play the game and the other possibility being that knowledge of the borrowers and the strong local interaction necessary for informal lenders create barriers to entry. Usurious interest rates are often blamed on the monopoly of individual moneylenders in a given area. While this is likely the case for small loans in some markets, larger loans may be more open to competition from a formal lender since formal loan costs decline as the amount

⁹ J.D. Von Pischke, D.W. Adams, and G. Donald, "Local Financial Institutions," in same authors, Rural Financial Markets, p. 228.

increases.¹⁰ Of course, there is no guarantee that a commercial bank, given the opportunity, will not mirror the monopolistic behavior of the moneylender.

Informal lenders are also accused of diverting personal savings into loans for consumption instead of productive investment or of funding productive investment that is either of low productivity or of low development priority. The evidence for these allegations is limited, but clearly a borrower must have adequate returns from some source to pay his or her debt, meaning that most informal borrowing should be for highly productive purposes. (If not, the reason must be extreme financial distress, such as purchase of food, or strong social pressure, such as paying for a marriage.) It appears that little informal lending is for agricultural production. The preferred sectors are trade, transport, and small industry, all of which usually bring higher returns than agriculture. Informal lenders tend to keep the funds in the locality, which has its merits despite the lack of optimal returns for investment.

The idea of using informal lenders as agents for formal credit is an intriguing one. It has been tried in Malaysia¹¹ and the Philippines¹² with moderate success. Since no-one else in a locality has as much experience in lending as the local moneylender, he or she would be uniquely qualified to undertake the local operations of a larger institution. Of course, local attitudes towards the moneylender are critical. Sometimes the moneylender is an important and respected person; in other cases the role of moneylender may render that person a social pariah, totally unfit to be an agent. In some communities, where the moneylender is so powerful that a competing local organization would be squeezed out or physically attacked, it may be necessary to co-opt the moneylender. Regardless of particulars, formal credit will displace some of the market for a moneylender's services, so strong incentives would be required to enlist support. One possibility

¹⁰ Anthony Bottomley, "Interest Rate Determination in Underdeveloped Rural Areas," American Journal of Agricultural Economics 57(2), 1975, p. 275-291.

¹¹ R.J.G. Wells, "An Input Credit Program for Small Farmers in West Malaysia," Journal of Administration Overseas 17(1), 1978, p. 4-16.

¹² Holst, "Mobilization of Personal Savings".

is a commission on loan repayments. A higher commission could be paid for loans to small producers or those using a new technology. Without an enforced legal stick against usurious lending (very difficult), the carrot of income for the moneylender-agent would have to be higher than potential income from lending his or her own resources, but, considering the high profits for informal lending in some places, this might not be practical. Other criticisms include the facts that no technical assistance would accompany loans through moneylenders, that their profits would give them more funds for private lending, and that they would face even less competition than they already do. Contrary opinion suggests that moneylenders be registered and regulated and that they be exposed to more competition from the formal sector.

Clearly, the role of moneylenders in each RFM must be considered as a unique case, worthy of study before formal financial intermediation is introduced, if only to assess the competition. These lenders, ranging in sophistication from the storekeeper to private indigenous (unregulated) banks, are the competition for any formal system. To this day, because formal sources are so inadequate, informal lenders supply a large majority of the credit taken in RFMs of the developing world.

4.3.2. Lending to Informal Groups

Less-formal groups can also act as financial intermediaries. They can be either spontaneous, formed around some common interest such as use of irrigation water or grazing land, or they can be government-sponsored, formed around any number of activities which the government and its agents are trying to introduce, such as pumpsets or extension classes. Using an existing group precludes the expense of forming a new one and, in the case of the spontaneous groups, there is already group cohesion around another theme. However, they can be very fragile once external forces start to push resources, structures, and processes at them. Due caution must be taken to ensure that a useful group is not overwhelmed.

These groups are quite open to such mechanisms as rotating savings and credit, but perhaps the single most effective financial mechanism for them is the group loan.¹³ A loan is made to the group as a whole, which then parcels out funds or inputs to individuals. The group itself is responsible for repayment. Such an arrangement can reduce transaction costs of both the lenders and borrowers, can create a focus group for technical assistance and extension, and can reduce the risk of default through peer pressure. There are a few techniques which improve the functioning of group lending programmes. Groups of 10-20 individuals from the same socio-economic stratum seem to be most cohesive. Loan eligibility for new groups can be delayed for a while (6 months is common) to allow for member education and for cohesiveness to gel. Paperwork must be simple and repayments scheduled to be frequent and small. Loan supervision is most critical for the first week after the loan is disbursed and the individual's peer group is uniquely situated to do this. Higher interest rates on larger loans discourage the participation of better-off producers. Group loans are a good method to persuade intermediaries to lend to previously rationed-out (high-risk) focus groups.

There are potential problems, too. There is evidence that repayment rates are not improved by lending to a group.¹⁴ Group members may jointly agree to default (more likely when no other service is offered), though this can be reduced by taking a deposit as a surety. The cost of identifying the groups and bringing them together may be high, though part of the cost may be transferred to the group itself. Demand may be dampened by lack of individual choice in the group and unwillingness to bear responsibility for others' defaults. Perceived benefits may not be enticing enough to maintain group solidarity once the loans are disbursed, especially if the group

¹³ Perhaps the most famous and successful of these has been the Grameen Bank of Bangladesh. For operational details, see Muhammad Yunus, Grameen Bank Project in Bangladesh. An update on progress is Syed Sadeque, "The Rural Financial Market and the Grameen Bank Project in Bangladesh: An Experiment in Involving Rural Poor and Women in Institutional Credit Operations," Savings and Development, 10(2), 1986, p. 181-195.

¹⁴ B.M. Desai, "Group Lending in Rural Areas," in Von Pischke, Adams, and Donald, Rural Financial Markets, p. 264-268.

has no other common interest. Other services, notably deposit taking, may be necessary to maintain the group.

4.3.3. Informal Savings Mechanisms

Saving has also been done through informal means. There are good reasons for even the very poor to save, but they rarely have access to formal facilities. The simplest form of saving, of course, is home saving of cash or goods. In this case, the assets are taken out of productive use. Cash in this situation is not protected against inflation, though some real goods are a strong hedge. When the savings are so near at hand the temptation to spend on consumption, the fear of theft, and the expectation that friends or relatives may make claims all induce either conversion to less-liquid goods or some less accessible form of liquid savings. A wide variety of schemes have been developed, many of them culturally distinct. Those described below are common types with local variations.

Funds can be saved by depositing them with a trustee. Since formal trustees such as banks are not available or can be socially distant even when near at hand, rural people will spread their assets among other villagers whom they trust. These include, for example, shopkeepers, merchant moneylenders, pawnbrokers, teachers, priests, or anyone of high repute. The saver not only receives no interest but may actually pay to have his or her money kept safe.

One basic type, especially popular with women, is the formation of a rotating savings and credit association. This is a small local group of rarely more than twenty participants (there may be several such groups in a village), where the individuals make equal regular installments. The lump sum collected each week or month is regularly disbursed by lot to one person, proceeding in rotation until everyone has had a turn. In some places this is made more fair by bidding down the allotment, wherein the people competing for the disbursement bid down its value until the person who bid least gets what he or she bid. The surplus remains in the pot for the next auction or is

divided among the members on the spot. Hopefully the increasing size of the pot in the former variation will buffer inflation over the period and compensate the last taker for waiting. In such groups there is some trusted person to handle the money. She or he may be rewarded by receiving the first disbursement or taking a fee from each disbursement. This person, with modest training, is a potential village functionary for a local institution.

Savings groups of various types can be encouraged to put their savings into bank accounts or productive investment. The latter is preferable for local development as bank deposits are largely siphoned to urban investment. It is helpful if there is a clear plan for the use of savings right from the start as it can assist group morale. Stopping of regular savings should be remedied immediately to prevent the whole thing crumbling. Corruption must be dealt with ruthlessly.

It is difficult to know all the variations and money volumes of informal mechanisms at work in an RFM, partly because some informal relationships are closely guarded and partly because every village has some type and level of informal activity. Nonetheless, it is vital to at least determine the informal interest rates and the potential effects of formal programmes on informal mechanisms. Underestimation of the pervasiveness and influence of informal systems can also lead to negative effects on the formal system. Yet, the informal and formal systems need not be adversarial in all cases.

4.4. Cooperatives, Credit Unions and Caisses Populaires

Much has been claimed for cooperatives in the field of development. When they work correctly, they are probably the best blend of equity, efficiency, and participation of all institutional options. This is as true for cooperatives which perform financial services as for those performing other functions. But like the other types, the financial service cooperatives are all too often financial

failures. The discussion below does not attempt to examine the dynamics of cooperation, but analyzes the cooperative and near-cooperative forms of financial intermediation with an eye to financial viability and access of the poor to services.

One basic distinction is whether the cooperative is single-purpose or multi-purpose. Single-purpose credit cooperatives (not credit unions or caisses populaires) appear to be more vulnerable to failure because there is little group cohesiveness. This means that individuals may join for short-term gains from credit, believing that credit should be taken while the getting is good. Such a person is not concerned about the adverse effects of his or her uncooperative behaviour, which, when multiplied, leads to sure failure of the cooperative. Such attitudes are especially prevalent when the loan money is clearly from an external source such as the government or a foreign donor. Credit will be seen as welfare and defaults will soar. Since all cooperatives are government created, government sponsored, or government regulated, the official reaction to signs of failure is often to send in more supervisors and burden the cooperative with bureaucracy.

Multi-purpose cooperatives, especially those performing a marketing function for their members, tend to be more successful. The idea is that there must be something other than access to credit which will promote cooperative behaviour among the members. Where ideology fails, benefits and balancing mechanisms may work. For example, a condition for taking a loan could be the obligation to market output through the cooperative. Repayment for loans may be taken by the cooperative from the proceeds of output sale before the balance is handed over to the borrower. Deductions from a member's marketing receipts can be used to buy share capital in the cooperative and, after that, to make regular deposits in a personal savings account.

The problem with multi-functional cooperatives is the complexity of running them, especially with the limited management skills which most cooperatives possess. The many linkages and infrastructural needs of multi-functional cooperatives are difficult to maintain, suggesting that

cooperatives should begin with a single function and take on others as necessary. The most practical arrangement for financial services could be linking cooperatives without financial services to a credit union. This would make the best use of available financial management talent while creating a larger, more stable financial intermediary. These cooperatives can be good intermediaries but it is necessary to analyze carefully the capacity and management skill of the cooperative in question and determine whether it is capable or can be made capable of the tasks at hand.

Credit unions and caisses populaires are particularly strong institutional forms in RFMs. They are dual-purpose in that they combine credit with savings facilities. They emphasize education of their members and saving is stressed above credit. Most credit unions and caisses have both a strong savings base and very high reserve rates, sometimes over 50%.

Lending policy tends to be conservative, in order to protect savings, but this is tempered by local knowledge and social pressure, which reduces risk and administration costs considerably. Thus, a borrower who is rejected by a commercial lender may succeed with his or her local credit union. Borrowers must find guarantors (sometimes only "character" guarantors) until more conventional collateral is available, though small producers may have difficulty providing guarantors or other securities. Borrowing against savings is common practice. There is some question about the appropriateness of credit unions for agricultural credit, since the demand for somewhat risky loans is large relative to the savings base which most credit unions possess.

The differences between caisses and credit unions in developing countries are slight, the main one being that caisses are open to anyone who wants to join, while credit unions are often restricted in membership to, say, employees of a certain industry, members of a certain cooperative, or inhabitants of a certain village. Even this distinction is not universal.

Governments and foreign donors have been impressed with the performance of some credit unions and have been tempted to channel loan funds through them, but this tends to undermine the self-reliance of the credit union. It has, on occasion, led to the insolvency of the credit union when external funds in excess of the credit union-owned resources have been defaulted.¹⁵ There must be in a reasonable ratio between external and internal funds, if external funds are to be used at all. An alternative idea is using the skilled personnel of the credit union to channel external funds, but without making the credit union take on all the risk.

Most countries have laws which pertain to the registration and operation of cooperatives and credit unions.¹⁶ Sometimes these laws can be quite restrictive concerning the activities which cooperatives and credit unions can undertake. Because most governments utilize financial instruments so frequently for their own ends, financial activities are especially circumscribed.

Despite their shortcomings, it must be stressed that cooperatives, credit unions, and caisses populaires can be extremely effective institutions for providing efficient and equitable financial services. The field portion of this thesis shall attempt to reinforce precisely that point.

¹⁵ B.J. Young Johns, "Agricultural Cooperatives and Credit," in John Howell, Borrowers and Lenders, p. 179-198.

¹⁶ Some countries do not have appropriate laws on the books; this usually has a restricting effect. In Indonesia, there is no official recognition or law regarding credit unions, leaving the Credit Union Coordination of Indonesia without a legally binding constitution or set of bylaws and without a legal understanding with the government or other financial institutions. There are obvious disadvantages, but lack of government attention can be a blessing in disguise, since regulations may well include a strong measure of government control.

CHAPTER FIVE

THE POOR IN SRI LANKA AND THEIR NEED FOR CREDIT AND SAVINGS

5.1. The Sri Lankan Poor

Despite Sri Lanka's strong performance in improving the welfare of its poor (when compared to other countries with similar economies and per capita incomes), there is still a sizeable portion of the populace which may be classed as relatively poor. Further, there are still some Sri Lankans who remain absolutely poor. Both groups, but particularly the latter, should be the target of development efforts. Provision of credit and savings facilities can benefit these people substantially if these services assist the poor to gain employment or to improve their production.

It is important to be able to identify specific subgroups of the poor so that benefits may be directed to them. Since Independence in 1948, the middle and upper classes of rural Sri Lankans have been very successful at gaining services and benefits from their government. They form a vocal and influential, though hardly unified political force which has been able to make successful claims for state resources.¹ Included in these successful claims is the major portion of benefits from subsidized government credit and positive real interest rates on fixed deposits.

The poor have only rarely gained government credit and their (standard) savings deposits often earn negative real interest. There must be a practical set of criteria for identifying the poor, and especially disadvantaged subgroups among them, so that they may be targeted for services and so that the better-off may be excluded to the greatest degree possible.

¹ These relationships are dealt with in detail in Mick P. Moore, The State and Peasant Politics in Sri Lanka (Cambridge, U.K.: Cambridge University Press, 1985).

● Income:

Sri Lanka is well within the low-income group of countries, though it has been lauded for its efforts towards equitable distribution of services and resources. However, since the United National Party came to power in 1977, a right-wing agenda, including an "open economy" and scaling down of welfare expenditures, has reversed longstanding efforts towards more equitable income distribution. The Gini co-efficient for household income has risen from 0.35 in 1973 to 0.44 in 1978/79 and to 0.45 in 1981/82.² Therefore, the proportion of the population which could be classed as relatively poor is growing.

The Government of Sri Lanka (GOSL) uses income figures to determine eligibility for programmes of assistance, the largest of which is the Food Stamp Scheme.³ The current household gross income ceiling for food stamps is Rs. 700 (C\$35) per month, a somewhat arbitrary figure which has been decreased in real terms by the current government, in order to reduce the eligible number of recipients and lower government expenditure. It is probable that some underestimation of declared income occurs, especially just above the maximum income eligible for food stamps because survey respondents will wish to declare themselves eligible for benefits.⁴ In all sectors (urban, rural, and estate), food stamp recipients would include about a quarter of all the households in Sri Lanka (rural and urban).⁵ The allocation of benefits is a strongly political process, however, and an even larger proportion of households receive food stamps.⁶ Whether or not Rs. 700 per month is

² Central Bank of Sri Lanka, Statistics Dept., Report on Consumer Finances and Socio-Economic Survey: 1981/82, Part I (Colombo: Central Bank, 1984), p. 187.

³ Sri Lanka has inherited the British compunction for censuses, surveys, and other such data gathering, so it possesses relatively good information for a developing country. Nevertheless, caution should be exercised in interpreting many of the statistics herein for "although there is a vast amount of statistics on conditions in Sri Lanka, figures on income-related changes are rare and unreliable." Gabriele W. Ström, Rural Development Strategy in Sri Lanka (n.p.: Swedish International Development Authority, 1980), p. 5.

⁴ G.M.P. de Silva, "Rural Savings Mobilization in Sri Lanka," in Mobilization of Rural Savings in Selected Countries in Asia and the Pacific (Bangkok: APRACA, 1985), p. 395.

⁵ Central Bank, Economic Survey: 1981/82, Table 5.5, p. 180.

⁶ At one point during the 1970s, a full 60% of the population received food stamps. The reason was not so much that 60% of the population were without adequate food as that the governments of Sri Lanka would use food stamps for political benefit. A comparison with the Canadian Family Allowance system would not be out of order.

an accurate reflection of poverty, data collection and allocation of eligibility has already been performed by GOSL and the figure therefore stands as a convenient benchmark of poverty as defined by income.

Which rural producer groups are included under this measure? Table 1 lists incomes for individual income earners, not households. The current sizes of each group are not known, but recent district studies suggest that perhaps a third of all rural households had absolute poverty incomes.

Table 1
Mean Monthly Incomes of Rural Producers⁷
(Figures in Rupees: Rs.20 = C\$1)

<u>Occupation</u>	<u>Mean Income (Rs.) from all sources</u>	<u>Mean Income (Rs.) from main source</u>	<u>% Income from main source</u>
Paddy farmers	1,921	1,083	56.4
Vegetable, other foods	1,187	572	48.2
Coconut, tea, minor exports	1,768	886	49.0
Livestock	992	452	49.0
Rubber tappers/ Rubber estate workers	563	311	55.2
Tea pluckers/ Tea estate workers	401	297	74.1
Coconut estate workers	561	345	61.5
Other agricultural workers	630	392	62.5
Fishermen, Hunters, et al	1,343	1,054	78.5
Forestry workers	1,032	762	73.8

The average household earning under Rs.700 had 1.18 individual income earners, with the larger grossing households having more and the poorest only one.⁸ This last group includes many families in areas of high un/under-employment and most female headed households. As can be seen from the table, some entire occupational groups fall under the Rs.700 per month per household ceiling. These include estate workers from all three major types of estates as well as "other agricultural workers" which would include many casual, seasonal, landless labourers. The plight of most of Sri Lanka's fishermen is not reflected in the table. Most fishermen are so poor that they

⁷ Central Bank of Sri Lanka, Economic Survey: 1981/82, Table 5.37, p. 216.

⁸ Ibid. Extrapolated from Table 5.5, p.180

do not own the boats and tackle they use every day. It is likely that boat owners and others who exploit fishermen are included in the income figures.

• Gender:

In Sri Lanka, rural women are the most un/under-employed segment of the population, with only 12.7% of them classed as employed in 1981-82, compared to 45.7% of men.⁹ Women on plantation estates are a notable exception here, with 51.4% employed (marginally more than men in that sector) but the vast majority work for very low wages.¹⁰

Table 2
Daily Wages in Unorganized Agriculture: Gender Specific¹¹
(Figures in Rupees: Rs.20 = C\$1)

	<u>1985 Average</u>	<u>February 1986</u>
DOMESTIC		
Paddy		
Ploughing (Male)	48.54	37.50
Transplanting (Male)	37.08	35.00
Transplanting (Female)	28.09	31.67
Harvesting (Male)	39.17	42.30
Harvesting (Female)	29.68	31.06
PLANTATION		
Tea		
Preparation of Land (Male)	28.24	32.16
Plucking (Female)	24.55	25.00
Rubber		
Planting (Male)	36.32	36.67
Tapping (Male)	29.81	32.62
Tapping (Female)	27.87	30.73
Coconut		
Digging Pits (Male)	39.41	39.50
Plucking (Male)	52.68	48.87

In the dry zone, women form two distinct groups. In the areas of new irrigation schemes, where population density is low and labour scarce, women often do farm work usually done by men elsewhere on the island. For this group, un- and under-employment is relatively low.¹² Women

⁹ Ibid., p.112.

¹⁰ Ibid. p.150.

¹¹ Central Bank of Sri Lanka, Bulletin, July 1986, Table 56.

¹² The Central Bank Survey divides the country into five Zones, two of them in the dry zone. It does not differentiate between irrigated and non-irrigated areas.

In unirrigated parts of the dry zone suffer from severe un/under-employment and, due to social restrictions, cannot move far from their home villages in search of work.

It must be noted that, with the exception of tea plucking, all of these jobs are seasonal, so average daily income spread over the year can be much lower due to frequent periods of unemployment. As can be clearly seen, female workers in the rural sector receive lower wages than males, even for the same occupation (notably for rice transplantation, customarily a women's job). The marginal increase in most wages, reflected in the 1986 figures, is general even though prices for tea, rubber, and coconut have weakened.

• Size of Farm Holding:

It is difficult to determine just how small a holding must be in order to declare it "sub-economic" and the farming household poor, though GOSL and the Sri Lankan banks blithely do so all the time.¹³ For many households size of holding is not an accurate reflection of poverty because farming is only one of two or more sources of income. This is particularly true in the wet zone and especially near major towns and cities, where individual holdings might be very small but more opportunities for off-farm employment exist. The following comments apply to those households whose income is mostly or entirely from agriculture.

Small farmers in the dry zone (Moneragala District in this case) defined the subsistence holding as a maximum of 0.8 hectare (2.0 acres) of paddy and 1.0 hectare (2.5 acres) of rainfed slash-and-burn plots, called "*chena*."

Villagers considered a yield of about 50 bushels of paddy per year (about 1050 kg.) adequate to feed a five to six member household. This, with the understanding that the household's diet is complemented and diversified with produce from home gardens and uplands ("*chena*") up to such a level as to guarantee food self-sufficiency at any time of year.¹⁴

¹³ Central Bank of Sri Lanka, Department of Rural Credit, New Comprehensive Rural Credit Scheme Operating Instructions (Colombo: Central Bank, 1985), 4.

¹⁴ Koenraad Verhagen, Cooperation for Survival (Amsterdam: Royal Tropical Institute, 1984), p. 73.

This production estimate fits the 1981-82 average rural household size (all income groups) of 5.21 persons.¹⁵ However, another estimate puts the requirement for such a household much lower, at 545 kg.¹⁶ This totals under 300 grams per day per person, while the former estimate yields over 550 grams. Though a person may be able to survive on 300 grams per day, the larger estimate may well include other necessities of life, measured in saleable output.¹⁷

The size estimates assume that the paddy land receives adequate water, either from rain or irrigation. Average yields of paddy have risen significantly in the dry zone as improved varieties are grown in irrigated land. The average yield was 3088 kg. per hectare in 1983-84 rising to 3420 kg. per hectare in 1984-85.¹⁸ This means that our small farmer, with 0.8 ha. should, on average, have harvested 2736 kg. of paddy, or more than double the higher subsistence figure given above. It must be remembered that yields vary considerably; they are highest in the irrigated dry zone, decline in the wet zone, and can be very low in the unirrigated dry zone.

Speaking of the narrow transitional belt between wet and dry zones, Wanasinghe states that,

Poverty in the rice sub-sector, usually exists among the farmers on holdings of less than 2.0 acres [0.8 ha.] in size... It is generally recognized that farmers with over 2 acres of rice tend to remain above the level of destitution even when traditional techniques of cultivation are adopted.¹⁹

It is difficult to define the focus group in terms of size of land holding, due the wide variation in land quality and the presence or absence of controlled water supply. Crudely put, farm households

¹⁵ Central Bank of Sri Lanka, Economic Survey: 1981/82, p. 22.

¹⁶ Ibid, p.246. Here the average rural consumption per person, per month (all income groups) is 8.7 kg. Multiplied by 12 months and 5.21 persons per household, this yields 545 kg. per household per year as a rural mean consumption.

¹⁷ In a case the writer is closely familiar with, his live-in domestic help at his rented house in Matara, each of the two men was expected to survive on .5 kilogram of rice per day (priced at Rs.7.50 per kilo) plus Rs.5 per day for all other food requirements. This yields a total monthly cost of Rs.262.50 per man. Thus an adult male performing light labour consumes more than a third of the food stamp allowable income in food alone. In a family of more than five, the eating would be marginal indeed.

¹⁸ GOSL, Department of Census and Statistics, Ministry of Plan Implementation, Statistical Pocket Book of the Democratic Socialist Republic of Sri Lanka, 1986 (Colombo: GOSL, 1986). Figures averaged over both *Maha* and *Yala* seasons.

¹⁹ Ananda Wanasinghe, Small Rice Farms and Agricultural Credit in the Wet Zone of Sri Lanka (Armidale, Aust.: Dept. of Geography, Univ. of New England, 1982), p. 4.

with less than one acre of irrigated land and less than two acres in total will more than likely be in the focus group (if agriculture is the only source of income). Table 3 shows that 39.5% of crop farmers could fall into this category.

Table 3
Land Ownership by Economic Sub-Sector²⁰
(% of sector total)

<u>Area Owned</u>	<u>Cultivators and Farmers</u>	<u>Livestock Farmers</u>	<u>Agricultural Laborers</u>	<u>Fishermen</u>
None	6.6	12.9	52.8	33.5
< 1 acre	16.7	32.3	28.2	59.7
> 1 and < 2 acres	16.2	12.9	9.1	3.9
> 2 and < 3 acres	18.7	12.9	5.3	---
> 3 and < 4 acres	13.7	10.7	1.8	0.6
> 4 and < 5 acres	9.8	4.3	1.0	0.6
≥ 5 acres	18.3	14.0	1.8	1.7
Total	100.0	100.0	100.0	100.0

• The Landless:

As Table 3 also illustrates, a major sub-group in the rural sector are the landless, most of whom work as agricultural labourers or fishermen, if they can find work at all. Sixty percent of rural working people classed themselves as "employees".²¹ Improvement of their standard of living can be most immediately effected by ensuring steady employment and increasing real wages. Irrigated cultivation of High Yielding Varieties (HYVs) is 31.3% more labour-intensive than traditional varieties or rain-fed cultivation.²² In the newly irrigated areas of the dry zone this has meant that there is a labour shortage (relative to the rest of Sri Lanka), which results in better wages for agricultural labourers there.

The poorest group differentiated in government statistics is concentrated in the estate sector, especially tea, as Tables 1 and 2 indicate. These people are mostly landless employees of

²⁰ W.A.A.S. Peiris and Dixon Nilaweera, Rural Poverty Alleviation in Sri Lanka (Rome: FAO, 1985), p. 14.

²¹ Central Bank of Sri Lanka, Economic Survey: 1981/82, p.147.

²² N. Amarasinghe, "The Impact of High Yielding Varieties of Rice on a Settlement Scheme in Ceylon," Modern Ceylon Studies 3(1), 1972.

plantations who have fewer economic options than landowning farmers. They often have reasonably steady work, but the wages are the lowest in the country. They usually live right on the estate, away from towns and villages, and are thus isolated from economic and educational opportunities.

It must be noted here that some of the landless are not poor. These include salaried government employees, such as school teachers, who earn middle class incomes, and many traders and petty capitalists who can amass considerable personal wealth without owning any land at all. In this thesis, references to the landless do not include those earning over the food stamp eligibility ceiling.

• The Focus Group Defined:

The poorest people in rural Sri Lanka may be classed in four overlapping groups: 1) very small farmers, especially dry zone farmers depending on rainfed cultivation; 2) women, particularly older women and those heading households; 3) plantation workers; and 4) landless labourers.

Aggregate data is too crude to determine the size of each of these groups accurately. Collectively, they form at least a third of the rural population. When the provision of financial services is specifically addressed, all these groups can be assisted, though their needs often differ substantially.

Income level and the security of that income are the best indicators for focus group identification.²³ The four groups named above are mostly composed of those whose incomes are low and/or insecure. GOSL's district-level Integrated Rural Development Projects (IRDPs) define their focus group of poor households as all those eligible for food stamps (Rs. 700 per month maximum household income), which says something about income level, if not security. Targeting those households receiving food stamps is a convenient way of differentiating a segment of the

²³ Sunimal Fernando, National Assessment of Rural Landlessness - Sri Lanka (Rome: FAO, 1985).

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MicroD

rural poor because the government has already, if somewhat haphazardly, done so.²⁴ Further focussing is done by some IRDPs to identify a subgroup of the very poor, those households earning Rs.300 per month or less, but this group is difficult to identify without house by house surveys. One suggested qualitative benchmark of rural poverty is the presence of earthen floors in houses; generally, the better-off rural people will pour a concrete floor as one of the first improvements to their homes.²⁵ The focus group in this thesis shall be taken to be all households which should receive food stamps. Special attention will be paid to farmers with landholdings under one irrigated acre or two acres in total and no off-farm income, women in general, the unemployed (often landless labourers) in general, those in remote locations, and those with poor connections to external (usually government) resources

5.2. Credit Needs of the Rural Poor in Sri Lanka

There have been no recent attempts to measure demand for credit in rural Sri Lanka. The fact that the rural people, usually more articulate and better-off farmers, have repeatedly asked for credit schemes is one indicator that demand exists. The demand of the poor may not be vocally expressed, but the number of loans of Rs.2000 or less which are intensively used for coir production, petty trading, home gardens, *et al* would indicate that they have a strong demand, too.²⁶ This section gives broad indicators of historical demand, using figures from the 1980s.

²⁴ The usefulness of this measure is decreased by the revelation that many poor households have been deemed ineligible while some better-off households receive food stamps. See International Fund for Agricultural Development, Small Farmers and Landless Credit Project... Appraisal Mission Report, Working Paper 3 (unpublished project document: IFAD, 1987). As a comparative measure for the field study, the Food Stamp Scheme was less than ideal because GOSL did not respond to requests for information on the methodology of screening. Nor did GOSL supply requested figures of food stamp recipients (nationally and in the field study district).

²⁵ Mick P. Moore and Gemini Wickramasinghe, Agriculture and Society in the Low Country - Sri Lanka (Colombo: Agrarian Research and Training Institute, 1982), p. 59.

²⁶ Loan portfolios of the TCCSs, Indian Overseas Bank, and National Savings Bank, all examined during field work in Matara District bear this out.

Statistics on rural Sri Lanka are often divided between the "estate sector" and the "rural sector" (relabelled "village sector" herein for clarity). This reflects the dichotomy of the rural economy, where estate workers are employees of a large agricultural enterprise (tea, rubber, coconut), located in specific parts of the wet zone. The rural or village sector is composed mostly of smallholders and non-estate rural landless, spread over the entire country. Estate workers are regularly paid a low wage from a single job, whereas village sector people earn more, but sporadically, often from several sources.

Table 4
Categories of Loan Use in Rural Sri Lanka²⁷
 (Figures in % and Rupees: Rs.20.= C\$1)

<u>Purpose</u>	<u>% Village Sector</u>	<u>Average Amount</u>	<u>% Estate Sector</u>	<u>Average Amount</u>
Agriculture	17.4	1029	2.8	1067
Capital	(6.3)		(0.2)	
Paddy Cultivation	(8.4)		(0.9)	
Other Crops and Livestock	(2.7)		(1.7)	
Consumption	33.0	257	89.2	292
Ceremonies and Funerals	(24.0)		(46.4)	
Other	(9.0)		(42.8)	
Industry	14.9	12203	---	---
Commerce	10.9	1728	2.8	1650
Housing	11.7	1803	---	---
Settlement of Debt	2.7	746	0.7	212
Other	9.4	589	4.5	376
Total % / Sectoral Average Rs.	100.0	558	100.0	308

Several clear trends are visible. First, the village sector makes more use of credit for agriculture than the estate sector. Village producers of such crops as paddy require seasonal injections of working capital. Plantations, especially the large state-owned ones, are largely self-financing and, in any event, grow long-term crops such as tea and rubber which require fewer seasonal inputs. Second, "consumption" use for credit in the estate sector is far larger than in the village sector, partly since productive opportunities are limited for estate workers and partly because they receive low wages and may need to borrow for any consumption beyond barest necessities.

²⁷ From Central Bank, Economic Survey, 1981/82, p. 295,296

Third, "rural industry" is mainly an endeavor of the better-off, as indicated by loan size, and does not concern the rural poor apart from the wage employment they may gain. Fourth, housing loans do not concern the estate sector, since most estate workers live in estate-owned housing, though the quality is often very poor.

5.2.1. Farm Credit Requirements in Sri Lanka

There is some dispute about which group of farmers can make the best use of a credit scheme. Some researchers suggest that small farms are inhibited from adopting new techniques because of capital shortage and will make the most efficient use of small sums.²⁸ The opposing camp insists that small farms cannot absorb productive credit due to risk aversion, diversion to consumption purposes, and inadequate knowledge of new techniques.²⁹

Table 5
Average Seasonal Credit Needs of Paddy Farmers in Kurunegala District³⁰
(Yala 1980, Maha 1980/81 averaged)

<u>Land Size Class (acres)³¹</u>	<u>Percentage of Farmers</u>	<u>Percentage of Farmers in Class Needing Credit</u>	<u>Average Credit Requirements (Rs.)</u>
0 - 0.5	7.4	11.1	400
0.5 - 1.0	16.9	26.8	1090
1.0 - 2.0	28.4	47.8	926
2.0 - 5.0	37.0	43.3	1782
5.0 +	10.3	76.0	3336
All classes	100.0	42.8	1695

²⁸ FAO and ICA, Financing Agricultural Development Through Cooperatives and Other Institutions, quoted in Konrad Engelman, Building Cooperative Movements in Developing Countries: The Sociological and Psychological Aspects (New York and Washington: Praeger, 1968), p. 130. See also R. Dwartinath et al, "Potentialities of Marginal Farmers for Agricultural Development..," U.A.S. Technical Review (Bangalore, India), 7, 1974.

²⁹ G.S. Lavanis, M.M. Bhalerao and Kalicharan; "Co-operative Credit and Agricultural Production - A Regression Analysis," Indian Co-operative Review, 6(2), 1969, p. 305-308. Also T. Bahadur, "Impact of Farm Finance and Resource Productivity," Indian Journal of Economics 55(219), 1975, p. 409-420

³⁰ Ibid., Table 3, p.10.

³¹ Gunewardena does not create mutually exclusive size categories. His study is an evaluation of a World Bank assisted credit component for a GOSL IRDP; World Bank did not regard those with holdings under 2 acres as viable units because of their history of frequent default under old GOSL credit schemes and not because of production potential. Also there was no differentiation of irrigated and unirrigated land, though it is almost certain that these figures are for irrigated land only since government credit schemes rarely fund unirrigated plots.

Two studies in Sri Lanka (wet and transitional zones) suggest that irrigated rather than unirrigated and larger rather than smaller holdings will make best use of credit.³² Gunewardena's study, considering paddy cultivation only, determined that 43% of farmers had an established need for credit; notably those with larger holdings. The study further stated that three quarters of farmers financed 1/4 to 1/2 of their costs exclusively from loans. In balance, it must be noted that both of these studies examine credit demand from formal (government) sources, which are biased in favor of larger, irrigated farms. Under the circumstances it is not surprising that small, unirrigated farms do not attempt to borrow from these sources. Although those farmers who have irrigation would possess more potential for productive improvements from credit, small and unirrigated farms can and do benefit from modest credit. Access to that modest credit is a continuing problem.

What do farmers use credit for? Demand for credit is a complex subject which cannot be analyzed thoroughly here. Simple observation in Sri Lanka indicates that poor farmers have need of credit, mostly short-term production credit. Demand of the poor for medium and long-term credit is very difficult to gauge, since they have never had access to it from either formal or informal sources. There is little doubt that they could use it for permanent improvements such as land purchase, tube wells, and irrigation repair if returns were attractive and interest affordable.

• Short-Term Credit (up to 1 Year):

Main uses: seasonal production inputs, consumption, family crises.

Paddy is grown island-wide and is the single largest crop of the smallholder sector, though it is not very profitable, especially in the wet zone where average yields are lower. In the quest for national food self-sufficiency, the government has intermittently given incentives to food

³² A. Wanesinghe, Small Rice Farms, and P.J. Gunewardena, Agricultural Credit Schemes Under the Kurunegala Rural Development Project: An Evaluation (Colombo: Agrarian Research and Training Institute, 1981).

producers, focussing especially upon paddy. Paddy farming is by far the main recipient of government credit and considerable analysis of paddy cultivation has taken place over the years. Therefore, the discussion of short-term credit also focusses on paddy, though other crops are just as deserving of attention.

Even though the technology for attaining paddy yields over 100 bushels per acre has existed since the early 1950s and the adoption of high yielding varieties (HYVs) is widespread in the dry zone of Sri Lanka, "it appears that the poor yields are due to the non-adoption of the package of practices necessary for high yields."³³ Lack of finance is only one of several reasons for this.³⁴ Adoption of HYVs requires more purchased inputs than traditional varieties, including the seed itself, fertilizers, biocides, and labour. The choice of traditional or HYV farming systems is succinctly described by Wanasinghe (1982):

Traditionally, rice cultivation in the small farms of Sri Lanka required very little investment from outside the farm. The traditional varieties cultivated and the methods of cultivation had become adapted to each other over a very long period. Thus these varieties did not require transplanting which consumed much labour. Being tall plant types they were able to compete with weeds, and the little weed control required was carried out by the use of family labour. Further, over long periods of time these traditional varieties had also developed tolerance to pests and diseases. The fertilizer requirements were adequately met with the organic manures produced on the farm. The yields produced by these varieties under such management were sufficient to satisfy the peasants' needs. Therefore, the requirements of capital for the purchase of inputs for traditional rice cultivation was minimal. ... (However) these varieties were incapable of producing the surplus required by the growing population.

With the advent of the new high yielding varieties of rice this situation has changed drastically. These are short plant types that do not lodge, but are easily covered over by weeds and are susceptible to pest and plant disease attack. Responsiveness to large doses of inorganic chemical fertilizers for delivering higher yields are bred into them. Under these circumstances investments on fertilizers and agro-chemicals are important. Without these purchased inputs the yields from high yielding varieties can even be lower than those from the traditional varieties as discussed.³⁵

³³ Ananda Wanasinghe, Small Rice Farms, p.1.

³⁴ Others include lack of good HYV varieties for wet zone conditions, inadequate water management, poor input delivery systems, and inferior extension. All of these, along with the depressed price for paddy, discourage the risk averse farmer from adopting HYVs.

³⁵ Ananda Wanasinghe, Small Rice Farms, p. 30-31.

The single largest seasonal purchase for HYV production is fertilizer. Chemical fertilizers have been pushed by the government for decades, undermining the use of manures and other organics. Despite problems of distribution (e.g. fertilizer not available when required) and problems of application (many farmers tend to ignore recommended types, quantities and application times), fertilizer use has been directly credited for the increase in productivity of rice and other foods.³⁶ Government subsidies and distribution through local co-op stores made their use attractive until the more than 100% price increase of 1981. Many farmers can no longer afford to buy them, irrespective of the subsidy, which itself is in peril. Cheap credit may not be enough to entice farmers to use fertilizers to the recommended degree.

The use of agro-chemicals roughly parallels that of fertilizers. However, though heavily pushed by both trans-national manufacturers and the government, farmers were not as willing to use chemicals as they were to use fertilizers and when they did it was often too little, too late. The government subsidizes chemicals as well, but, like fertilizers, prices have risen steeply in recent years. Agricultural chemicals definitely have some negative effects and should not be recommended without reservation. Herbicides displace labour, especially women, and both herbicides and pesticides have long-term potential for serious toxic contamination.³⁷

Small farmers without access to an assured water supply are not likely to adopt the full package of improvements associated with HYVs.³⁸ Neither, therefore, are they likely to demand as much production credit. The risks of crop failure are so high in the rainfed areas of the dry zone that, for the risk averse farmer, borrowing to cultivate a crop merely increases the magnitude of

³⁶ Mahinda Silva, Development of Agriculture for Regional Cooperation: Sri Lanka Country Study (Colombo: Marga Institute, 1963), p. 131.

³⁷ The commonly used herbicide 2,4,5-T and several insecticides have long-lasting toxic effects in the soil and water, according to S. Weeraratne and C.H. Fernando, "Some Aspects of the Ecology of Ricefields," in C.H. Fernando (ed.), Ecology and Biogeography in Sri Lanka, The Hague, Holland: Dr W. Junk Publishers, 1984. Improper handling and application (noted in Nuwara Eliya District) can lead to human ingestion of toxic materials.

³⁸ To date there are no HYVs of consistent quality and yield specifically developed for the wet zone. The "Green Revolution" in rice has been in varieties bred for irrigated but low precipitation conditions. The vast majority of paddy sown in the wet zone is of traditional varieties.

potential failure. Rationally, subsistence producers seek to minimize potential losses, so they are very reluctant to take credit, regardless of concessional interest rates.³⁹ On the supply side, no bank in Sri Lanka would lend to small farmers under such circumstances.

Wanasinghe found that credit use was not a significant influence on other factors of production and that those other factors had limited influence on credit use, concluding that "credit is an unimportant factor within the economic framework of this sample."⁴⁰ This appears to fly in the face of the established model of credit need and utilization. Wanasinghe, ascribing to the established view himself, suggests that his quantitative results could have been influenced by sampling problems.

More important is his untested contention that lack of credit use is linked to the stage of agricultural development at which the sampled farmers operated. He explains low credit use as a combination of factors including small farm size, lack of technical knowledge, risk aversion and institutional red tape, all yielding strict capital rationing.

It is still too early for agricultural credit to be a critical factor in the process of adoption of modern technology. Provision of physical facilities, infrastructural developments, and changes in farmer attitudes through formal and informal education appear to be essential pre-requisites if farmers are to begin to perceive the need for agricultural credit.⁴¹

From this it may be inferred that credit is not a significant factor in traditional cultivation methods and, perhaps, that traditional use of credit from informal sources is mainly for consumption. It further suggests that need for credit must be assessed on a local level, depending upon the provisions noted above (especially the presence or absence of assured water supply). It is going too far to suggest from Wanasinghe that credit is unnecessary, but it may safely be

³⁹ Substantiated in the field (rainfed transitional zone) by Ananda Wanasinghe, Small Rice Farms, p. 73-74.

⁴⁰ Ibid., p. 37.

⁴¹ Ibid., p. 83.

concluded that some small traditional farmers will not, given a choice, elect to take a loan for production purposes.

Since many farmers do not have accumulated investment resources, flexible and affordable credit (among other things) would assist the poorer farmers in the adoption of improved practices leading to self-reliance. All crops, but especially HYVs, demand that inputs be supplied on time. Timeliness itself creates a demand for credit, since farm revenue flow rarely coincides with payments to input suppliers. (This is also a good argument for provision of savings facilities in that earnings are more easily retained till needed for next season's productive investment.)

Although dry zone farmers concentrate on paddy more than their counterparts in the wet zone, they have good potential for increased income from other crops. The classic plantation crops of tea, rubber, and coconuts are not viable in the dry zone and are currently suffering from depressed prices. However, some dry zone vegetables, such as potatoes, onions, and peanuts are currently bringing good prices in the domestic market and have strong potential for sustained demand.⁴² Except for onions, these have traditionally been grown in *chena* plots. These plots, besides becoming more scarce and more intensively used, are not irrigated and rarely receive fertilizers or biocides, therefore *chena* farming usually provides very little marketable surplus.⁴³ In some places there is considerable scope for improving the quality of *chena* cultivation. To this end, some credit may be required, even by farmers who have no irrigation. One example here is the improved productivity of potato and chillie patches when protected with biocides.

• Medium-Term (1 - 3 Years) and Long-Term (3 - 10 Years) Credit

Main uses of medium-term loans: small permanent improvements, small machinery and equipment

Main uses of long-term credit: land purchase and improvement, major machinery.

⁴² Personal visit to Sri Mahinda TCCS in Nuwara Eliya district.

⁴³ Mahinda Silva, Agriculture for Regional Cooperation, p.18.

Medium-term credit can be vital for some small farmers, especially if used for improvements such as a tubewell, which can ensure against crop failure due to drought.

In Sri Lanka rice cultivation is often adversely affected by water surfeits and deficits associated with high rainfall variability and inadequate facilities for water storage and distribution. Drought is the worst single natural constraint affecting its cultivation. The Dept. of Census and Statistics (1974) estimates that about 35 percent of all crop failure in rice is due to drought. 44

Farmers (especially in the dry zone) also face problems due to lack of rudimentary infrastructure. For example, in one village in Moneragala District, the Multi-Purpose Cooperative's "shortage of working capital and storage capacity forces [small farmers] in need of cash to sell at least part of their crop to private traders at less advantageous conditions (underweight, lower prices)." 45 In a case such as this, medium-term credit could help farmers to build their own small storage bins, allowing them to delay sale of their output until prices rise and therefore to improve their incomes.

All land upgrading and irrigation works constitute permanent capital improvements. The "lumpy" investments required are simply not available to small farmers out of their own liquid assets. Further, borrowing for such investments must be in the form of long-term loans. Such loans are not favored by institutional lenders in Sri Lanka, except when refinanced by the Central Bank. Even then, the loans are offered only to larger producers. The best approach here would seem to be organization of the small farmers in a single irrigation area (a traditional grouping in Sri Lanka) to apply for group loans.

In the wet zone, village expansion of crop lands needs "large volumes of capital in order to be developed." 46 In the evaluation of formal lenders, the people of these villages lack the capacity to repay loans of the size necessary for land development. In the dry zone, settlers in newly irrigated areas are obstructed from credit access because they hold 99 year leases on their land and not

44 Ananda Wanasinghe, Small Rice Farms, p. 4.

45 K. Verhagen, Co-operation for Survival, p. 76.

46 W.A.A.S. Peiris and Dixon Nilaweera, Rural Poverty Alleviation in Sri Lanka, p. 32.

outright title. Because such leases cannot be offered as security on loans, the leasees are at once less likely to lose their land, but less able to borrow for its improvement. Elsewhere in the unirrigated dry zone, medium and long-term credit may be required for conversion of appropriate *chena* plots into permanently cultivated fields.

The government, banks, and foreign aid agencies have all pushed mechanization,⁴⁷ but some capital investments can harm agricultural labourers. Included here are tractors for ploughing, paddy seeders for row seeding, and Japanese weederes for weeding between rows.⁴⁸ The tractors displace men and buffaloes in preparation of the ground, while the seeders and weederes displace female workers. Credit programmes which facilitate the acquisition of these tools mainly benefit the better-off farmers. No blanket assumptions are advisable, however. For example, while it may seem sensible not to support the purchase of a tractor because of possible labour displacement, it may be that the tractor in question will be used mainly for transport of inputs and outputs (a common use for tractors in Sri Lanka, as the fleets of ubiquitous Canadian Massey-Ferguson's and Japanese Kubota's attest), which would substantially help small producers.

Unfortunately, medium and long-term credit is even more difficult than production credit for small farmers to obtain. Since only limited amounts of medium and long-term credit are refinanced by the Central Bank and since small farmers are deemed to have poor repayment capacity for longer-term loans due to the amount of interest which accrues over the period of outstanding debt, lenders with commercial policies will make very few loans of this type to the poor. Returns to medium and long-term investments must be large enough and consistent enough to repay principal and considerable interest. For example, if a loan is taken for coconut cultivation, which takes several years from planting to yield, and the price of coconut slips in the meantime, then the farmer may default. There must be a large potential profit margin to cover such eventualities.

⁴⁷ Mahinda Silva, Agriculture for Regional Cooperation, p. 46.

⁴⁸ P.J. Gunawardena, Kurunegala Rural Development Project, p. 43-44.

Agricultural production is the single largest end use for rural credit. Seasonal crop loans are the major demand of the poor, although demand for medium and long-term loans with which to effect permanent improvements would likely boom if the poor thought they could get such loans at affordable rates. Lenders have usually assumed that seasonal crop credit is the type they should supply, so medium and long-term loans for agriculture, and all non-agricultural categories, have been neglected.

5.2.2. Non-Agricultural Financing

- Credit for the Landless:

Most of the rural landless earn their income doing agricultural labour on a seasonal basis or as fishermen. The other activities of the landless, and for a large number of farming households with non-agricultural sources of income, are in three main categories:

- Building Skills and Materials: This group of activities includes carpentry, brick-making, masonry, timber cutting and sawing, *et al*. These jobs are more profitable if the brick-maker (for example) sells bricks she has already produced directly to the customer. This requires the use of working capital to produce stock in advance of sale and therefore bears some risk. If the bricks are made to order, then the need for working capital (and risk) is eliminated, but may mean that the brick-maker is employed as a day labourer, so the work would be less profitable.
- Craft-Based Manufacturing Activities: Included here are coir (cocunut fibre) production, weaving, tailoring, tourist craft making, pottery, lace making, *et al*. There are two ways in which these activities may be pursued. The producer may be in a dependent relationship with a trader who will supply the materials and purchase the output at a predetermined (low) price. It is more profitable for the producer if he or

she is independent of such middlemen and the product is produced and then sold on the market to the highest bidder. This implies that there is some working capital needed and that it bears some risk.

- Consumer Goods Trading and Service: This broad category includes petty trade between town and village (not the big middlemen), bakers, bicycle repairmen, food stall proprietors, *et al.* Most such activities require working capital and maybe even fixed capital, again implying risk.

It is much more difficult for the landless poor to obtain credit than it is for small farmers. Their capacity to repay is judged to be low, they usually have inadequate convertible security and guarantors are hard to find. It is also suspected (by bankers) that they use more of their loans for consumption than do land-owning farmers.⁴⁹

Nonetheless, very modest loans can create income earning capacity for this group. As with small farmers, they apply considerable labour to tiny capital resources, therefore loan funds are likely to be used very efficiently. Cottage industry is the main use for loans to the landless. These micro-enterprises include coir making, fish drying, pottery, brick making, tailoring, carpentry, bicycle repair, and any number of other shoe-string operations. When they succeed, they can remove dependence upon seasonal agricultural labour and create more evenly timed income flows.

While some formal lenders have minor programmes for loans in the Rs. 1500 - 2000 range, demand for small loans is far greater than supply. Much of this demand is for smaller amounts, such as the Rs. 750 loans offered through Thrift and Credit Cooperative Societies (TCCSs) by some Integrated Rural Development Plans (IRDPs) for female coir producers. There is huge scope for increasing this type of lending.

⁴⁹ Konrad Engelman, Building Cooperative Movements, p. 130.

● Credit for Women:

No studies have been done specifically on women's credit needs in Sri Lanka, but by determining their main economic activities and the welfare concerns of women in similar circumstances, it is possible to isolate women's specific needs.

Women are involved in certain prescribed agricultural activities. For example, they plant, weed, harvest, and conduct petty sales but do not buy inputs, prepare the ground, build or repair irrigation works, transport or manage major crop sales. These are generalizations, of course, and there are always exceptions, especially in labour-short areas of the dry zone. They are also heavily involved in cottage industry, from weaving to brick-making, from coir pounding to broom-making, from pottery turning to charcoal-making, from fish drying to salt-making. Quite often these activities can be started or enhanced with very small loans, rarely over Rs.3000 - 4000 and quite often from Rs.500 - 1500.

Women do not have good access to credit, despite Sri Lanka's progressive (for Asia) attitude towards women's rights and development. Commercial lenders apply their usual rules, which discriminate against women more than men. Women do not usually own land, since land is inherited through the male line,⁵⁰ therefore land cannot be offered as collateral. Guarantors are almost always male.

Specific mechanisms must be designed to ensure that women receive fair access to credit. There are a few NGO programmes specifically for women, but these hardly scratch the surface of women's credit demand.

● Credit for Estate Workers:

While estate workers are among the most disadvantaged on the island, they can make only limited use of credit facilities at this time. According to Table 6, a very large proportion of credit

⁵⁰ A new law has just made widows eligible for half their husband's estate, which should improve the welfare of this highly disadvantaged group. Should this law be enforced, it should be especially beneficial to Muslim and Hindu widows.

currently taken is used for consumption purposes. Due to their isolation and relatively low levels of education, estate workers have difficulty working out economic alternatives to estate work. It seems that more basic educative and welfare work needs to be undertaken in this sector before much credit can be used for productive purposes.

In Nuwara Eliya, Dutch assistance is being used to help the IRDP form new TCCs on the estates. Since estate workers, especially women, earn regular if small incomes, a savings facility and education on the benefits of savings would be highly beneficial. Credit use could be slowly introduced after further education and building of a savings base. TCCs with small resources frequently make very short term emergency loans to members. Table 6 suggests that this is a common credit need on the estates, so even small TCCs could help alleviate occasional dependence upon moneylenders.

5.3. Savings Facilities for the Poor in Sri Lanka

Reasons why savings facilities are needed by the rural poor are explained in detail in Chapter Two. Since savings and credit are complementary services often offered by the same institution, it is worthwhile seeing how the services are matched in Sri Lanka. An institution which offers one service while neglecting the other is not performing adequately.

• Need for Savings Facilities:

Savings capacity has been a focus of dispute for decades, with one side claiming that the rural poor do not have any capacity to save, being in fact net dissavers, while the other side insists that even the very poorest will seek to create a buffer to meet crises and major life expenditures. The latter argument is supported by the evidence in Sri Lanka.

Results of the Central Bank's Economic Survey: 1981/82 indicate that all income groups under Rs.2000 per month per household incur net dissavings.⁵¹ This ranges from minus 1.8% for those earning Rs.1501-2000 down to minus 39.9% for the very poorest, earning from nothing to Rs.400 per month. The same survey also indicates that the village sector as a whole has net savings of 11.6%, while the estate sector has net dissavings of minus 21.2%.⁵²

Table 6
Financial Investments of the Poorest⁵³

(All figures except final column in Rupees per month per household. Rs.20 = Cdn.\$1)

<u>By Sector</u>	<u>Average Income</u>	<u>In Savings Accounts</u>	<u>In Fixed Deposits</u>	<u>In Current Accounts</u>	<u>Total Deposits as % of Income</u>
Urban	2320	195.6	37.0	91.4	14.0
Village	1499	128.9	15.0	46.8	12.7
Estate	1098	31.7	0.1	5.3	3.4
Income Group (Rs./month)					
0 - 200	202 ⁵⁴	19.2	0.0	0.5	9.8
201 - 400	324	8.8	0.1	49.0	17.9
401 - 600	541	12.6	4.8	5.6	4.2
601 - 800	722	25.1	0.7	10.8	5.1
801 - 1000	856	32.4	1.5	18.1	6.1
1001 - 1500	1149	50.6	3.0	21.0	6.5
1501 - 2000	1709	102.2	7.2	40.9	8.8

Evidence for the counter-argument can also be gleaned from the Economic Survey. It can be seen in Table 8 that those households which earn under Rs.2000 per month, net dissavers, still make use of savings facilities. Their dissavings are not reflected by failure to use financial investments. Dissaving must occur through accumulation of debt, sale of assets, and other avenues. Furthermore, savings accounts and savings certificates account for 68% of village sector and 85% of estate sector financial investment (mostly in the National Savings Bank, People's Bank, and

⁵¹ Central Bank, Economic Survey: 1981/82, p.275.

⁵² Ibid, p.274.

⁵³ Extrapolated from Central Banks, Economic Survey: 1981/82, p.277,279.

⁵⁴ There is no explanation offered in the Economic Survey for this inconsistency.

Bank of Ceylon. . all state owned). Low use of formal savings mechanisms in the estate sector may stem from several (untested) reasons. 1) lower average wages, leaving less after consumption, 2) fewer convenient savings facilities at which to make deposits, and 3) the tendency of traditional Hindus (who perform most estate labour) to hold savings in jewellery. The anomalous high rate of saving in the Rs.201 - 400 income group is very perplexing, as is the fact that most of it is in current accounts. No explanations can be offered with available evidence.

The claim that the poorest will not save is also refuted by field experience. A Sri Lankan NGO, the Sarvodaya Shramadana Movement, collects tiny amounts from village children and notes that women seem to be better savers than men, even though they usually have less surplus income.⁵⁵ The Thrift and Credit Cooperative Societies have very low income earners as depositors, some of whom cannot afford the Rs.100 share which would entitle them to loans.⁵⁶

It may be concluded, then, that savings facilities are a worthwhile service for the rural poor and should be economically located where they are accessible.

⁵⁵ Canadian International Development Agency, Sarvodaya Shramadana Movement: Report of the CIDA Review Mission, Vol. I (Hull: CIDA, 1985), 48-74.

⁵⁶ Personal observation. Field trip to Aluwatta TCCS, Kegalle District, Nov. 1, 1986.

CHAPTER SIX

SUPPLY OF CREDIT AND SAVINGS IN SRI LANKA

6.1. Supply of Loans to the Rural Poor

Supply of credit in Sri Lanka comes from a wide array of formal sources, few of which lend to the poor, and informal sources, especially family and friends, who supply the majority of loans. The formal lenders shall be dealt with briefly here.¹

Table 7
Means of Financing Paddy Production (Kurunegala District)²
(as % of total sample)

<u>Means of Financing</u>	<u>Yala 1980</u>	<u>Maha 1980-81</u>
Income from crop sales	79.4	68.7
Government service and self employment	31.3	21.7
Hired labor	24.3	13.4
Private loans ³	21.8	41.0
Institutional loans	6.6	7.4
Other (landlord supplied inputs, sale of cattle, pawned goods...)	4.5	4.6

Needs are met from a variety of sources. Taking paddy production as an example, the first source of production funding should be from sales of the previous crop. If not, other sources of household income may be available. Failing that, relatives and friends are approached for informal loans at no or low interest. If the farmer is still short of cash, then formal lending institutions or informal lenders charging high interest are the last resorts.

¹ For a thorough review of GOSL and commercial bank policies and effects, please see Rural Credit and Savings in Sri Lanka: An Inventory with Programming Suggestions for CIDA, produced by this writer for CIDA, March 1987.

² P.J. Gunawardena, Kurunegala Rural Development Project, p 7.

³ Private loans are not differentiated as to type and interest rate in Table 7, from Gunawardena's study. A better breakdown occurs below in Table 8.

Column totals do not add up to 100% because many farmers had at least two sources of funding for their crop. If government service and self employment may be taken as reasonably steady throughout the year, then its reduced percentage for the *Maha* season (the major cropping season) reflects the substantially increased need for crop finance at that time. All of the first three categories drop about 10% for *Maha*. Private loans are the major way of meeting increased demand. Note the low percentage of farmers who use institutional credit in either season.

6.1.1. Government Credit Schemes and Agencies

The Government of Sri Lanka (GOSL) has offered subsidized credit for paddy and selected other crops continuously since 1957, though there were lesser programmes long before that.⁴ Yet these schemes have not seemed to reach the poorer strata to a significant degree. The mechanisms for disbursing, supervising, and recovering credit have suffered from weak design and faulty implementation.⁵

The current programme is called the New Comprehensive Rural Credit Scheme (NCRCS). In it, the Central Bank refinances seasonal loans run through the commercial banks and, since the *Maha* season of 1986-87, through the Thrift and Credit Cooperative Societies (TCCSs). First the intermediary bank makes the loan to the end user, charging 9% per annum (about half the market rate). The loans are then refinanced for 240 days by the Central Bank at 1.5% per annum. This is by far the largest rural credit scheme in the country.

- 4 NCRCS has credit ceilings per acre for each crop, but these invariably fall short of the required amount, despite the fact that they are adjusted by a special board every year.

⁴ There is no space here for a history of the many schemes and institutions devised in Sri Lanka. For a review of these, see H.N.S. Karunatilake, Economic Development in Ceylon (New York: Praeger Publishers, 1971); R.G.G.O. Gunasekera, Cooperative Information Note No.8: Democratic Socialist Republic of Sri Lanka (Rome: FAO COPAC Secretariat, 1981); and Gabriele Ström, Rural Development Strategy.

⁵ This was noted as far back as 1959 in A.D.V. de S. Indraratne, "An Analysis of Agricultural Credit in Underdeveloped Countries with Special Reference to Ceylon," Ceylon Journal of Historical and Social Studies 2(2), 1959: 182-202. The view was shared by S. Amunugama, "Rural Credit in Ceylon: Some Sociological Observations," Ceylon Journal of Historical and Social Studies 7(2), 1964: 135-143.

Commercial lending policies of the major banks effectively "ration-out" the poorer producers. They are said to have "non-viable" (too small) operations, are accused of diverting credit to consumption purposes, are not able to offer strong securities, are expensive to administer on a per-Rupees-lent basis, and are judged to be high overall credit risks.

The heavy subsidy attracts middle-class and wealthy producers and it is they who receive the lion's share of credit. Until recently the default rate on government production loans was enormous, over 70% for some seasons. Politicians got in the habit of forgiving agricultural debt as an election goody, loan recovery by the banks was not vigorous, and a psychology of default engendered a view of credit-as-welfare. This situation has been improving under stricter lending guidelines and stronger recovery enforcement, but these measures have forced most of the poor out of the market.⁶

The Central Bank also operates a Medium and Long-Term Credit Fund (MLTCF), which refinances loans for capital improvements and equipment purchases. Again, the programme is run through commercial banks whose rates to borrowers are variable. The Central Bank charges 8.5% for loans it refinances. These loans are even less accessible to the poor than production loans because amounts are higher, terms are longer, and the banks are more cautious still. Labour displacing two-wheeled tractors have been a favorite item financed under the MLTCF.

The two major commercial banks, both owned by the state, are the People's Bank (PB) and the Bank of Ceylon (BC). People's Bank has operated in rural areas since the mid-1960s and now has hundreds of branches in small towns, but its main functions (apart from channelling government credit) are collection of savings, which are then sent to higher yielding urban markets, and pawnbroking. The latter function gives credit to the poor; they can pawn any liquid valuables, especially jewellery, in exchange for cash at an interest rate of 30% per annum, the most expensive formal loans available in Sri Lanka. PB does not offer much of its own collected deposits to rural borrowers, though it has run a number of minor programmes through the years.

⁶ S.M.P. Senanayake, Farm Credit Situation, p. 502-503.

Bank of Ceylon's only activity in the rural financial scene until 1973 was credit for very large farmers and plantations. Since 1973, BC has participated in the Central Bank's refinancing schemes, but like PB has offered very little of its own funds as credit to the rural sector.

Since 1985, the Central Bank has been slowly building its Regional Rural Development Banks (RRDBs) in a few districts, ostensibly to serve the rural poor. Forwarded not as a competitor to the commercial banks but as an adjunct to them, there is good evidence that the RRDBs' loan clientele are smaller producers than those borrowing from the commercial banks.⁷ Although the RRDBs rarely service the very smallest producers, they are a substantial improvement on the old credit channels. It will be a very long time before the penetration of RRDB branches reaches a simple majority of the rural poor.

The government owned National Savings Bank (NSB), primarily a savings mobilization institution without good penetration into the countryside, is operating a pilot programme in lending to small borrowers in Matara district, mostly for non-agricultural purposes. NSB plans slow expansion of the programme. A foreign bank, the Indian Overseas Bank (IOB) also runs a pilot programme for small borrowers in Matara. It is intended as a demonstration programme and no expansion is planned. Finally, the privately owned Hatton National Bank runs NCRCs and MLTCF credit through only three branches.

Although the RRDBs, NSB, and IOB are all targeting the small rural borrower, there are as yet very few branch offices doing so. As of the most recent lending season (*Maha* 1986-87), the RRDBs had 23 branches, the NSB 2 branches, and IOB only one.

While there is no room here for a comprehensive review of formal lenders in Sri Lanka, government and independent observers have long noted the inability of the system to provide financial services for the rural populace. To its credit, the Central Bank has made repeated improvements, but the efforts have not reached far down. Most improvements have increased

⁷ Central Bank, Loan Statistics, Maha 1986 and Loan Statistics, Maha 1986-87.

access to credit for middle and wealthy farmers. Commercial lending policies are still far too prevalent to open access for the poor. Some lenders refuse to go along with CB recommendations (Peoples' Bank declined to participate in CB's recent default rehabilitation programme, for example) and some conduct experiments and pilot programmes of lending to the poor. Even physical distribution of branches of formal lenders is contracting. After very rapid growth in the number of branches in the 1960s and 1970s, the commercial banks are "rationalizing" operations in major towns, closing locations in smaller centres. The net result of all this is that the rural poor will not likely be served by the commercial lenders and will increasingly rely upon GOSL's new Regional Rural Development Banks and the Thrift and Credit Cooperative Societies.

6.1.2. Informal Credit

In view of the shortcomings of the formal credit system, the major source of rural credit remains informal lenders, be they relatives and friends or professional moneylenders and middle-men. In Table 8, these are the "Without Interest" and "Money Lenders" categories respectively. Notice that the lowest income groups are especially reliant upon these sources, and that the very poorest have difficulty gaining loans even from moneylenders. Estate sector workers get almost no formal credit at all (assuming that the undefined "Other" category includes no formal lenders).

Interest-free loans in Sri Lanka are almost exclusively from relatives and close friends with whom strong reciprocal arrangements may be made in trust. Informal lenders who lend for a profit charge highly variable rates, but 15% per month (180% per annum) seemed common.⁸ Shopkeepers who give credit for customer purchases charge much less, though this is unsubstantiated in the field. In any case, loan access is quick and repayment arrangements flexible when informal lenders are used.

⁸ Personal interviews with moneylenders in Matara, October 1986

Table 8
Source and Amount of Loans: By Sector and Income Group⁹
 (All figures in % of Rs. borrowed per month per household)

By Sector	Agricultural¹⁰ Credit Schemes	Rural Banks	Other Banks	Co-op- eratives	Money Lenders	Without Interest	Other¹¹	Total
Urban	---	0.6	38.9	1.5	26.8	23.7	8.5	100
Village	0.4	5.1	33.1	1.7	20.3	29.2	10.2	100
Estate	---	1.1	5.6	---	24.1	32.8	36.4	100
By Income Group (Rs./Month)								
0 - 200	---	---	---	---	29.1	50.4	20.5	100
201 - 400 ¹²	---	2.2	16.5	0.2	18.2	55.1	7.8	100
401 - 600	---	6.0	3.1	1.3	35.5	37.7	16.4	100
601 - 800	---	5.9	9.7	2.1	24.7	47.0	10.6	100
801 - 1000	0.4	1.3	8.9	0.8	26.7	45.5	16.4	100
1001 - 1500	---	1.5	20.6	1.2	30.5	31.3	14.9	100
1501 - 2000	---	2.8	9.5	2.2	50.3	26.3	8.9	100

New settlements (mostly in newly irrigated areas of the dry zone), drawing their inhabitants from different villages and social groups elsewhere in the island, do not have the social bonds necessary for this type of lending to take place. Middle-men have moved into the vacuum. They will lend for production inputs at the beginning of the season and return for a disproportionately large share of the harvest. Thus credit is so expensive for settlers that it may inhibit their production. Countering this reliance on middle-men is the fact that most settlers are not from the poorest strata of their regions of emigration. Furthermore, the focus of government agricultural credit is on settlement areas. Since possession of a plot in a newly irrigated area is almost a guarantee of agricultural success, allocation of those plots is a very political process. Those with good political connections, almost always the better-off, tend to be the beneficiaries.¹³ Once a farmer is

⁹ Extrapolated from Central Bank, *Economic Survey, 1981/82*, p.297, 299.

¹⁰ This is special, direct Central Bank schemes only and masks the major government refinancing schemes, which account for a major portion of the loans under "Other Banks" (i.e. commercial banks) and some of the loans from "Rural Banks".

¹¹ The category "Other", which is highly significant to the Estate sector and the lowest income group, is unfortunately not explained in the source material.

¹² There is no ready explanation for the high proportion of credit acquired from banks and low reliance on money lenders by the Rs.200 - 400 per month group. If the statistics are accurate, this point bears further investigation because it is not supported by any of the other evidence, which points to a clear progression of increased access to formal lending as income increases.

¹³ M.P. Moore and G. Wickramasinghe, *Low Country*, p.157.

operating in a new settlement, he¹⁴ is much more likely to receive government agricultural credit than farmers elsewhere since the government has heavy political and financial capital invested in major irrigation and settlement projects.¹⁵

Table 9
Distribution of Loans by Rates of Interest and Sectors¹⁶
(in %)

<u>Rate of Interest Per Annum</u>	<u>% Village Loans Granted</u>	<u>% Total Rs. Village Loans</u>	<u>% Estate Loans Granted</u>	<u>% Total Rs. Estate Loans</u>
0	52.9	29.2	35.7	32.8
01 - 10	3.0	6.3	1.3	0.8
11 - 20	11.1	16.6	27.0	37.2
21 - 30	6.5	18.5	3.7	6.2
31 - 40	1.1	15.5	2.1	1.2
41 - 50	0.8	0.7	0.3	0.3
51 - 60	1.8	1.3	2.9	2.7
61 - 70	---	---	---	---
71 - 80	0.3	0.6	0.3	0.1
81 - 90	0.1	---	1.0	0.9
91 - 100	1.2	1.0	0.8	0.5
Over 100	21.2	10.3	24.9	17.3
Total	100.0	100.0	100.0	100.0

The large proportion of estate loans with interest from 0 - 20% per annum is fully 70% of the total amount. The next table adds that average amounts borrowed are similar to the village sector. The explanation is difficult to determine, but it is likely that many estate sector loans are within the tight social grouping of labourers on a single estate, encouraging low or no interest. Further, although estate labourers are poorly paid, they are regularly paid, perhaps improving the confidence of informal lenders.

¹⁴ Due to social and financial restrictions, woman-headed households do not move away from their home villages. *Ibid.*, p. 157.

¹⁵ NCRCS lending has been heaviest per loan and per acre in Anuradhapura and Polonnaruwa, the two districts with major settlement schemes in land newly irrigated by the Accelerated Mahaweli Project, the damming and diversion of Sri Lanka's largest river. Figures from Central Bank, Loan Statistics, both volumes.

¹⁶ From Central Bank, Economic Survey: 1981/82, p. 302.

Table 10
Average Monthly Borrowings and Repayments by Income Groups¹⁷
 (figures in Rs. per month per household)

<u>Income Group</u> <u>(Rs. / Month)</u>	<u>Village</u> <u>Loan</u>	<u>Village Loan</u> <u>Repayment*</u>	<u>Village</u> <u>Net Debt</u>	<u>Estate</u> <u>Loan</u>	<u>Estate Loan</u> <u>Repayment*</u>	<u>Estate</u> <u>Net Debt</u>
0 - 200	138	---	138	---	---	---
201 - 400	141	8	133	167	30	137
401 - 600	197	34	163	237	35	202
601 - 800	220	43	171	209	63	146
801 - 1000	232	64	168	242	79	163
1001 - 1500	397	103	296	386	92	294
1501 - 2000	487	205	282	527	283	244

* Accumulated principal and interest paid.

The stunning fact that emerges from this table is the huge proportion of monthly income which must be borrowed by the poorest groups. Their repayment levels are also low. These figures indicate considerable financial distress in this group. It is quite likely that borrowed funds are used for consumption or handling a crisis, when this group, of all groups, needs income generating activity and the investment such activity may require.

It can confidently be said that although the poor have demand for credit, they do not satisfy much of that demand from formal sources. For the majority, informal sources are the main supply. There is nothing wrong with low or no interest informal loans; they are the first recourse of the borrowers and are to be preferred to all other forms. However, informal loans depend upon stable social relationships and surplus income in the community. Where either of these conditions is disrupted, there can be crises of production and consumption for the poor.

¹⁷ Extrapolated from Ibid, p. 293,307.

6.2. Supply of Savings Facilities

Aggregate statistics from Central Bank reports are somewhat coarse, in that poor rural savers cannot be differentiated from the better-off rural people in the statistics. In fact, rural and urban savers are not differentiated either (except that deposits at Rural Banks and TCCSs are mostly rural savings). Generally, what is clear is that savings, which were 92.9% from the household sector in 1972,¹⁸ have been growing rapidly. The rise in domestic savings was 35% per annum from 1970-75 and 66% per annum from 1975-82, though share of GDP declined from about 16% of GDP in 1970 to about 12% in 1982.¹⁹ It is also clear that the commercial banks (notably People's Bank and Bank of Ceylon) and the National Savings Bank are by far the most important institutions mobilizing savings.

Table 11
Volume of Deposits By Type of Institution²⁰
(Figures in Millions of Rupees: Rs.20 = Cdn.\$1, current rate)

Year	Commercial Banks	National Savings Bank	Rural Banks	Finance Companies	Thrift and Credit Cooperatives	Total
1970	2394	708	17	75	16	3210
1975	3610	1657	74	129	11	5481
1980	17291	4905	334	147	74	22751
1981	21136	5397	434	709	71	27747

Table 11A
Share of Deposits By Type of Institution
(Figures in %)

1970	74.6	22.0	0.5	2.4	0.5	100.0
1975	65.9	30.2	1.4	2.3	0.2	100.0
1982	74.4	21.0	1.5	2.8	0.3	100.0

Only the TCCSs and the new Regional Rural Development Banks make a solid effort to relend locally what they raise locally, though it can be seen that this amount is miniscule compared to the total.

¹⁸ S. Kahagalle, "An Estimate of Savings and its Determinants in the Sri Lanka Economy 1960-1972," in Central Bank of Ceylon, *Staff Studies*, 5(2), September 1975.

¹⁹ G.M.P. de Silva, "Rural Savings Mobilization in Sri Lanka," in APRACA, *Mobilization of Rural Savings in Selected Countries in Asia and the Pacific*, p.376.

²⁰ From *Ibid*, p.385.

All three of these institutions are rapidly increasing the scale of this practice, but it will be a very long time, if ever, before the rural sector gets back a simple majority of what it saves.

What explains the dramatic rise in savings? Part of the explanation no doubt lies in the increase in bank branches and an active campaign of promotion. Part may also lie in real interest rates paid on savings.

Table 12
Real Interest Rates Paid by Commercial Banks on Savings²¹
(Figures in %)

<u>Year</u>	<u>Inflation Rate²²</u>	<u>Real Rates of Interest</u>			
		<u>Savings</u>		<u>Time Deposits (12 mo.)</u>	
		<u>Max</u>	<u>Min</u>	<u>Max</u>	<u>Min</u>
1970	5.9	1.4	1.4	1.2	1.4
1975	6.7	-1.2	-1.2	0.8	0.3
1976	1.2	4.3	4.3	6.3	5.8
1977	1.2	6.0	6.0	13.8	12.8
1978	12.1	-4.9	-4.9	2.9	1.9
1979	10.8	-1.8	-3.6	4.2	3.2
1980	26.1	-12.1	-16.1	-6.1	-6.1
1981	18.0	-4.0	-8.0	4.0	2.0
1982	10.8	3.7	-0.8	11.2	9.2
1983	14.0	0.5	-4.0	8.0	1.0
1984	16.7	-1.7	-6.7	8.3	-2.7
1985	1.5	8.5	13.5	20.5	10.5

What is apparent here is that those savers able to sacrifice liquidity in time deposits were able to realize real gains during almost the entire period, whereas savings account holders often lost.

Table 6 reveals that the rural poor prefer savings accounts and do not invest much in fixed deposits. Yet, of Rs.47,261 million in savings and fixed deposits (December 1985), Rs. 14,884 million were in savings deposits and Rs.32,330 million were in fixed deposits.²³ Clearly, fixed

²¹ Extrapolated from Central Bank of Sri Lanka, Annual Report 1985, (Colombo: CB, April 1986), Tables 15 and 50. Inflation rate based on Colombo Consumers' Price Index; may not be totally representative of rural inflation due to differences in consumption patterns.

²² These inflation rates are official government rates, but may be underestimated, at least for recent years. V.G. Kulkarni, reporting in The Far Eastern Economic Review, June 12, 1986 stated, "Although the government claimed that inflation was down to 1.5% last year [1985], independent observers doubt the accuracy of the official consumer price index. ...Moreover, official sources privately conceded that inflation currently could be about 6% and do not rule out double-digit inflation this year [1986]." More recent IFAD's Small Farmers and Landless Credit Project...Appraisal Mission Report suggests an inflation rate in 1985 of 12%.

²³ Central Bank, Annual Report 1985, Table 49.

deposits are a phenomenon of better-off Sri Lankans. Further, with the majority of the increase in gross savings held in fixed deposits, the figures give cause to wonder how much of an increase in savings, if any, the rural poor have experienced. Such figures are unavailable.

Clearly, the rural poor need savings facilities, but there are no quantifiable indicators of how well or poorly this group is presently served. It is safe to assume that village level institutions would better serve small depositors since proximity is vital to villagers who wish to make frequent deposits. A positive real interest rate on simple savings would complete the package.

6.3. Persistent Problems of Rural Credit and Savings in Sri Lanka

The credit needs of small farmers in Sri Lanka are not being met. Informal sources are either inadequate or exploitative. Institutional credit is merely inadequate, since nearly 80% of rural credit is from informal sources.

Most government credit is short-term production credit only and is directed primarily to paddy and chillies.²⁴ Credit ceilings are determined on a national basis and are not tailored to specific local needs. Application procedures remain complex and time consuming, especially when compared to the ease of arranging an informal loan.²⁵ The government-set rates of interest coupled with the administrative costs of handling numerous small loans do not encourage institutional lenders to channel funds into agricultural credit.²⁶ Low interest rates also encourage

²⁴ In 1978, a big year for disbursements, 75% of all rural credit was for crop production purposes; 10% was for animal husbandry, crop diversification, and small industries; 10% was for purchase of plant and machinery; and 5% was for house construction and electrification. S.M.P. Senanayake, Farm Credit Situation, p. 506.

²⁵ In his Moneragala research village, Koenraad Verhagen notes the following typical experience of one farmer with government credit through an Agrarian Service Centre: "For eight months he had to pay monthly visits to the Centre, to get his loan worth Rs.750 (US\$42), part of which was given in kind in the form of seed. The seed was of poor quality and had lost its germinating power. As a result he was now unable to repay the loan and had no intention of doing so." Cooperation for Survival, p. 78.

²⁶ For example, the interest charged under the government short-term production credit schemes (currently NCRCS) has been 9% per annum (12% for arrears), while the rate of inflation was from 12-15% and commercial interest rates were 21-30%. S.M.P. Senanayake, Farm Credit Situation, p. 508.

borrowers to pay high-interest non-formal loans first.²⁷ Penetration of institutional lenders into the countryside is limited to GOSL's Agrarian Service Centres (Bank of Ceylon), Multi-Purpose Cooperative Societies' local headquarters (Rural Banks), and People's Bank branches, all of them in less than 1500 towns and larger villages, leaving most of the approximately 23,000 villages in Sri Lanka with no truly local agent.

When it comes to creating a self-sustaining savings and loan system, the most damaging problem remains default. The cycle is succinctly described by Dudley Seers.

Ceylon has severaltimes repeated an unfortunate rural credit sequence. Funds are loaned on a generous scale to cover production costs, without supervision. They often do not yield the output to cover repayment because they finance inappropriate techniques or even consumer needs, weddings, or payments to village moneylenders. Some borrowers are promised re-scheduling as a political gesture, and so they delay repayments. Local co-operative credit societies then default on their own debts ...and become defunct, so that not only defaulting farmers but also their innocent neighbours are unable to borrow. Credit dries up, fertilizer and pesticide uptake falters, and the innocents decide that they too might as well default next time. The Government winds up the scheme, then starts a new one, and the cycle begins again.²⁸

Sanderatne lists six inter-related causes for defaults, most of them alluded to by Seers: 1) defects in agrarian structure, 2) variability in income due to seasonal or unforeseen factors, 3) defects and inadequacies in the organization disbursing the credit, 4) attitudinal conditions not conducive to repayment, 5) misallocation of borrowed funds, and 6) other miscellaneous reasons.²⁹ Apart from the World Bank system designed for the Kurunegala programme, there has been little effort to prosecute defaulters, though Sri Lankan bankers are fully aware of the need for discipline,

²⁷ These last two reasons are held as major reasons for credit system failure by Dale W. Adams, "Why Agricultural Credit Programmes in Low-Income Countries Perform Poorly," in Asian Productivity Organization, Farm Credit Situation. Adams' criticisms of subsidized credit are fleshed out more thoroughly in D.W. Adams, D.H. Graham and J.D. Von Pischke (eds.), Why Cheap Credit Undermines Rural Development (Washington: Economic Development Institute of the World Bank, 1979).

²⁸ Dudley Seers, quoted in R.G.G.O. Gunasekera, Co-operative Information Note, p. 31.

²⁹ Nimal Sanderatne, "An Analytical Approach to Small Farmer Loan Defaults in Savings and Development," Marga Institute Quarterly Review 2(4), 1978.

which is, in turn, reflected in more stringent loan approval criteria similar to the World Bank system in Kurunegala.³⁰

The effects of default could be largely blunted by an effective crop insurance scheme, but the existing scheme is not attractive to farmers because of gross inefficiency and low indemnities. Crop insurance is a prerequisite for NCRCS loans, but that is the only reason most farmers buy insurance. The Agricultural Insurance Board is itself very weak financially and often has problems covering its commitments.³¹

Finally, poor credit/recovery has effects in the greater economy. Less money is available for non-agricultural credit schemes or other government expenditures. Sri Lanka, with a weakening currency and balance of payments problems, is under pressure from the IMF to tighten-up government spending. One likely measure from the IMF point of view would be to extend the tough prescription of the World Bank credit scheme nation-wide, thereby reducing the cost of the system but drastically reducing the availability of credit for small farmers. GOSL seems to be adopting this tight regime, thus forcing down defaults by rationing-out smaller producers and denying previous defaulters credit eligibility.

Clearly, both formal and informal credit systems fail to serve the rural poor adequately. Most of the focus group cannot overcome capital shortages which block the creation of new enterprises or the improvement of existing ones. While lack of credit is not the only obstruction, it is an important one to that portion of the focus group which has the opportunity and incentive to proceed.

Although savings programmes are becoming more effective at mobilizing funds in rural areas, they are not benefitting the communities of the savers because of the flow of funds out of the rural and agricultural sectors. While savings deposits have not been at much risk when held with the

³⁰ S.M.P. Senanayake, Farm Credit Situation, p. 513. In counterpoint, P.J. Gunawardena, Kurunegala Development Project, notes farmers lack of understanding for banking rules.

³¹ S.M.P. Senanayake, Farm Credit Situation, p. 510.

major banks, the proliferation of other forms of savings institutions, including MPCs Rural Banks and TCCs, has prompted the Central Bank finally to begin the deposit insurance scheme it was originally mandated to form in Sections 32A and 32B of the Monetary Law Act.³² At an annual premium of no more than 15 cents per Rs. 100 of total deposits, this would be an excellent idea for increasing depositor confidence, especially in the savings schemes of newer cooperatives.

What Sri Lanka seems to need in its RFM is an institution which can mobilize large volumes of local funds and lend those funds locally. The rural poor of the locality should have full access to credit, which requires specially designed mechanisms for them. Within these guidelines, the lending/saving institution must maintain at least minimum standards of financial viability. This implies (among other things) good bookkeeping, strong loan appraisal abilities, loan portfolio diversity, and adequate supervision of the loans. All this must be achieved at low cost, which boils down to good local management skills. Until and unless such a system is widely established, the rural poor cannot expect to have access to affordable credit which could help them to create their own income flows.

³² Government of Sri Lanka, Monetary Law Act (Chapter 422). Incorporating Amendments up to 7 March 1979 (Colombo: Dept. of Government Printing, 1979).

CHAPTER SEVEN

SETTING OF THE FIELD RESEARCH: MATARA DISTRICT

In order to determine the actual effectiveness of TCCSs as a mechanism for delivery of credit and savings services, it was necessary to collect primary data from the Federation of Thrift and Credit Cooperative Societies (FTCCS), from a District Union (DU) of the TCCSs, and from some of the primary societies themselves (TCCSs). By subjecting the data to the criteria already elucidated, it should be possible to evaluate procedures, financial viability, and institutional capacity. Information from the primary societies pertaining to access for the poor is also highly relevant. Thus institutional viability, tempered with clear access to services for the poor, forms the yardstick of analysis.

This chapter clarifies broad economic and social trends in the field study district. The economic structure of the research district is more constrained than in the country at large. Conversely, social and occupational mobility is less constrained. The definition of the focus group is drawn in finer lines than in the national picture drawn in Chapter Five.

7.1. Matara District

Matara,¹ in the far south of the island, is a good choice for several reasons. The district has seen more programmes and experiments in rural credit than any other district in Sri Lanka. Although the reasons for this have never been clear, it means that there are many institutional models.

¹ Districts are named after the major town which serves as the district seat. References to "Matara" in the text refer to the district, not the town.

serving the same population to compare with the Thrift and Credit Cooperative Societies (TCCSs). The District Union and TCCSs in Matara are what could be loosely categorized as half-way along the TCCS developmental continuum. While not as numerous, nor as mature as the TCCS systems Kegalle or Kandy Districts, the Matara TCCSs are not as embryonic as those of Amparai or Batticaloa. Unlike the TCCS movements in Ratnapura and Nuwara Eliya, for example, the Matara TCCSs are experiencing an explosion in the number of registered societies which is creating some severe problems.

Matara is not typical of the island as a whole in terms of resources and systems of production. The district is considered resource poor, having little else besides agriculture for its economic foundation. Matara is mostly in the low country wet zone, though part of eastern Matara is "transitional" (drier).² This means that agricultural production, while not subject to drought, is quite limited in crop selection, restricted mainly to plantation crops and paddy, none of which has good possibilities for improvement. Most plantation crops are suffering from poor prices and paddy is more efficiently produced in the irrigated "dry zone", where High Yielding Varieties may be grown. Though paddy is widely grown in Matara, yields are low and it is not a very profitable crop.³ Coconuts, rubber, and tea, the three main plantation crops of Sri Lanka, are all grown extensively in Matara. However, the only large plantations are those of the two state-owned estate boards in the northern part of the district. Most of the production of crops other than tea is by

² The transitional areas have higher paddy yields and are, overall, much better agricultural land since there is less cloud cover and fewer drainage problems. The south-eastern corner of Matara is much more productive than other parts of the district, partly due to climate and partly due to higher rates of adoption of improved agricultural practices.

³ M.P. Moore and G. Wickramasinghe, Low Country, p. 24ff. In 1984/85, average *Maha* yield was 3149 kg./ha., versus a national average of 3498 kg./ha., while *Yala* yields were 2,459 kg./ha. compared to the national average of 3343 kg./ha. Sources: Dept. of Census and Statistics, Dept. of Agriculture. Mick Moore has been attached to the Institute of Development Studies at the University of Sussex and has written extensively on many aspects of rural society, politics and economics in Sri Lanka. Gemini Wickramasinghe is a senior researcher at the Government of Sri Lanka's Agrarian Research and Training Institute in Colombo who continues to write on agricultural themes.

smallholders (though since "smallholders" include farms of 20 acres and more, many "smallholders" are rich by Sri Lankan standards).⁴

Non-agricultural income is important in Matara, but these, too, are limited in range and viability. The strongest hope for increased income in the district lies in remittances from skilled people exported to Colombo, semi-skilled people to the Middle East, and labourers to the dry zone. Migration is seen as the main hope for improved incomes. Unemployment and underemployment remain chronically high.

Matara, like other districts in the coastal lowlands of the wet zone, has a relatively well-educated population. When this is added to a high rate of absentee landlordism and moderately active (for Sri Lanka) labour organization, there is a strong undercurrent of left-wing political mobilization. Although the left vote collapsed in the 1977 United National Party sweep of the district, almost half of the 1972 vote went to the Communist Party and two other parties of the left. This followed upon the 1971 national insurrection of the JVP (Sinhalese acronym for the People's Liberation Front), a far left underground party led by educated, unemployed rural youth. The JVP heartland was in Matara District. Although the JVP is now illegal and its members vigorously repressed, and although left parties hold no seats in Matara, the left remains very active and the "threat" of the left still has a significant bearing on government policy and the dynamics of the TCCSs in the district (see 9.3.).

Matara's socio-economic matrix is very similar to Galle District, immediately to the west, and shares problems of unemployment and limited economic prospects with other wet zone districts. The similarities fade the closer one gets to the greater Colombo metro area, where trade, transport, and manufacturing create the country's only enclave of "modern" economy. The central

⁴ "An agricultural holding of less than 20 acres and under the same operational status was considered as a small holding. In some cases however a holding might consist of several parcels and the total area of these add together to 20 acres and above, this holding is still considered a small holding." GOSL, Ministry of Plan Implementation, Sri Lanka Census of Agriculture 1982 - Matara District Report (Small Holding Sector). (Colombo: Dept. of Census and Statistics, Ministry of Plan Implementation, 1985), p.4.

highlands of Sri Lanka share Matara's problems of unemployment, underemployment, and lack of economic opportunities. The plantation economy is much more oriented to tea and the estate sector is very large in the central highlands. Social constraints, such as poor mobility of women and strong patronal powers of landlords, are more pronounced in the highlands, since the traditional "Kandyan" social structures have proven more resilient there.

The dry zone, comprising the northern and eastern two-thirds of the island, is very different from Matara, featuring non-plantation mixed agriculture with encouraging prospects for improvement, though there is a strict dichotomy between irrigated and unirrigated areas. Ethnically, zones of strong Tamil majorities and sizeable Muslim minorities possess less social and economic mobility than Matara's lowland Sinhalese population. The point to be taken from these comparisons is that, although climatic, ethnic, and socio-economic conditions vary in Sri Lanka (and Matara cannot be taken as typical of the whole in those aspects), a poor stratum of the rural population, in need of financial services, exists islandwide.

7.2. The Focus Group in Matara District

The 1981 population of Matara District was just under 644,000 of which 89% were classed as rural.⁵ With a density of 516 persons per square kilometer, Matara is one of the densest districts in the country. Furthermore, much of the population is massed in a narrow belt along the coast, creating densities of over 3000 per square kilometer. This belt includes the two major towns and both the main highway and southern railway line from Colombo. The district contains 712 villages,⁶ though the definition of a village is quite loose since most wet zone villages are not

⁵ GOSL, Ministry of Plan Implementation, Sri Lanka Census of Population and Housing 1981, Matara District Report, Vol. 1, Part VIII, (Colombo: Dept. of Census and Statistics, Ministry of Plan Implementation, 1984), Table 1.

⁶ Matara TCCS DU, 1987 Education and Project Plan (unpublished: Matara DU, 1986).

densely clustered habitations surrounded by fields, but individual homesteads situated on separate plots, often strung along whatever road or track exists.

Table 13 shows that 45.8% of operational holdings (including owned and rented land under cultivation) are under one acre, thereby falling into our national focus group on the basis of productive landholding, though the heterogenous nature of most household incomes in Matara means that land holding is an imprecise indicator. The average size of operation is 1.61 acres, which is below the national average of 1.94 acres. When it is considered that paddy yields are among the lowest in the country, then the small size of farming plots is indeed critical. Further, all statistics herein concerning farmed land include both paddy and *chena* (upland) areas, the latter being far less productive. In Matara, only 26.9% of farmed land is in paddy, while 73.1% is in home gardens and *chena* (including tea, rubber, and coconut plantations).⁷

Table 13
Size of Operational Holdings in Matara⁸

<u>Size of Holding</u>	<u>Percentage of Holdings</u>	<u>Percentage of Area</u>
< 1/8 acre	4.3	0.2
1/8 to < 1/4	9.8	0.9
1/4 to < 1/2	13.1	2.3
1/2 to < 1	18.6	7.1
1 to < 2	26.4	20.9
2 to < 3	13.8	19.6
3 to < 4	5.8	11.9
4 to < 5	2.9	7.7
5 to < 7	2.5	8.9
7 to < 10	1.3	6.3
10 to < 20	1.2	9.3
20 and above	0.3	4.9
Total	100.0	100.0

Potential improvements in smallholder agriculture are limited, partly due to the lack of crop variety in the wet zone and partly due to the superior comparative advantage of dry zone producers of most crops. One measure for improving output and incomes is improving the efficiency of

⁷ Ibid., Table 2.14.

⁸ GOSL, Ministry of Plan Implementation, Census of Agriculture 1982 - Matara, Table 2.6

existing plots of plantation crops which have been classified as having poor quality of land use.⁹

"There is no simple strategy for promoting the development of wet zone smallholdings in such a way as to increase employment and alleviate poverty."¹⁰ Therefore, although Matara is overwhelmingly rural, agriculture can only provide limited opportunities for increased employment since productivity per acre cannot be easily increased; alternative forms of income generation must be found.

Land ownership, which is usually a good measure of wealth and security for most rural peoples, clearly shows that a large proportion of the rural populace does not own adequate land to earn a living from farming alone. Table 14 shows that over half of all agricultural producers, assuming income is exclusively from agriculture, would have to cultivate land they do not own in order to produce enough food (i.e. rice) for their families and, possibly, some surplus for sale.

Table 14
Land Ownership in Rural Matara¹¹

<u>Type of Holding</u>	<u>Percentage of Operators</u>	<u>Percentage of Area</u>
No land ownership	10.8	0
Owning home garden only*	41.4	15.0
Owning home garden and other lands	25.5	45.4
Owning other lands only	22.0	39.6
Total	100.0	100.0

* Home gardens are small plots attached to the dwelling which produce vegetables and fruit for household consumption only.

If landowners only are considered, the size of landholdings also reveals that the majority of landowners do not possess enough land to produce a surplus over consumption, unless additional rented land is worked or non-agricultural income is made.

⁹ Matara Integrated Rural Development Project, Land Use Classification Study, 1985 (unpublished project document). Poor land use consists of such conditions as old stands of coconut without adequately cycled replanting, poor varieties of tea, sparse planting of a crop where dense planting is possible, *et al*

¹⁰ M.P. Moore and G. Wickramasinghe, Low Country, p. 11.

¹¹ GOSL, Ministry of Plan Implementation, Census of Agriculture 1982 - Matara, Table 2.9

Table 15
Size of Owned Plots in Matara¹²

<u>Size Class</u>	<u>Percentage of Holdings</u>	<u>Percentage of Area</u>	<u>Average Acreage</u>
Less than 1 acre	44.9	11.3	0.4
1 to < 2	26.2	20.5	1.1
2 to < 4	20.3	30.2	2.1
4 to < 7	5.8	16.6	4.0
7 to < 10	1.3	6.6	6.8
10 acres and above	1.5	14.8	14.2
All classes	100.0	100.0	1.4

Based on land ownership and size of operational plots, the majority of rural smallholders in Matara would seem to be well within the focus group. However, there is strong evidence to suggest that economic heterogeneity spares most rural households in the district from severe poverty

Observers familiar with 'peasant' societies, i.e. societies in which the dominant form of economic organization is the family farm, might tend to expect that the distribution of income is mainly a reflection of the distribution of property, especially land. The rural Low Country (including Matara) is not in this sense a peasant society... The distribution of income is very much affected by the distribution of land, but the correspondence is far from complete... Households whose only source of income is the family farm are typically numbered in the poorer half of the population."¹³

Most rural households in Matara must earn income from several sources.¹⁴ Yet in an area of dense population and lack of employment opportunities, returns from most enterprises are quite low. The search for employment generating activities is therefore very frustrating.¹⁵ Fortunately, residents of the southern half of Matara have the advantage of good transport connections and access to urban centres. It is possible for villagers to commute to work in Matara town or one of the other towns along the coastal belt. This mobility increases the variety of possible jobs.

¹² Ibid., Table 2.10.

¹³ M.P. Moore and G. Wickramasinghe, Low Country, p. 62-63.

¹⁴ Ibid., p. 9.

¹⁵ S. Amarasekera, Project Director, Matara IRDP. Personal communication. This is corroborated by M.P. Moore and G. Wickramasinghe, Low Country, p. 9 ff.

In 1981, 22.7% of the rural population of the district were classed as employed.¹⁶ A strong indicator of the heterogeneity of employment is that only 53.6% of employed persons in the rural sector were classed as agricultural, animal husbandry and forestry workers or fishermen.¹⁷ On the other hand 31.1% of all employed rural people work at government or "semi-government" jobs (though such jobs tend to go "predominantly to those households who are already relatively well-off in comparison with their neighbours"¹⁸) By contrast, only 26.8% of employed persons consider themselves self-employed.¹⁹ Of the latter group, fully 72% are in agriculture, animal husbandry, forestry, or fishing. However, if these occupations are considered as a whole, then 60.6% of workers in agriculture, animal husbandry, forestry, and fishing are "employees".²⁰ Nonetheless, "in the absence of any positive policy measures, smallholder agriculture in ...Matara is unlikely to generate extra jobs at the same rate as the labour force is increasing."²¹

Where will those new jobs come from? Unemployment is a serious problem in rural Matara. Official statistics state that 50,432 persons were "unemployed" in 1981, yielding an official unemployment rate of 28%.²² The real figure is almost certainly higher, but how much higher is unknown. Of these, 7.4% were heads of households and 1.2% were female heads of households, mostly middle-aged, some of whom are among the poorest households in the district. The continued export of trained persons to Colombo, the dry zone, and foreign jobs is one answer, though it applies to the better educated and wealthier strata of rural households. Similarly, jobs in government estates are also taken by middle-income people.²³ "Many of the non-agricultural

¹⁶ GOSL, Ministry of Plan Implementation, 1981 Census of Population - Matara, Table 18.

¹⁷ Ibid.

¹⁸ M.P. Moore and G. Wickramasinghe, Low Country, p. 34.

¹⁹ Both figures from GOSL, Ministry of Plan Implementation, 1981 Census of Population - Matara, Table 22.

²⁰ Both figures from *ibid.*, Table 23.

²¹ M.P. Moore and G. Wickramasinghe, Low Country, p. 33.

²² Extrapolated from GOSL, Ministry of Plan Implementation, 1981 Census of Population - Matara, Tables 18 and 29.

²³ M.P. Moore and G. Wickramasinghe, Low Country, p. 64. A major problem with all government and "semi-government" jobs is that they are allocated politically. Even those seeking jobs as estate labourers and bus conductors must curry the favor of the MP or other local party men in order to gain employment.

opportunities - shop-keeping, trading, etc will require capital and experience, and will tend to go mainly to the less poor section of the population."²⁴ The field study seeks to identify an accessible channel for the poor to alleviate the capital problem, testing the Thrift and Credit Cooperative Societies as the most suitable existing route.

The Matara IRDP has identified several distinct development areas 1) the coastal belt, 2) "backward areas" just north of the coastal belt, and 3) the estates of the north.²⁵ The coastal belt is not good agricultural land. There are problems of poor drainage (including saline water logging) and heavy clay soils. Better farmland is found further north, where population densities are lower. Some villages just north of the coastal belt are "backward" due to severe fragmentation of agricultural plots and the low caste of some entire villages. Their personal connections and communications skills are poor, so their ability to demand government services is not good; they are relatively deprived of benefits. The estate sector is not typical of the national profile for estate employment. Most estate labourers, except in the extreme north, are Sinhalese villagers who do not live on the estates. The large tea estates of the far north do contain populations of live-in Tamil labourers whose living conditions are very poor.

Who are the poor (low, insecure income) people in Matara? Moore and Wickramasinghe identify three especially disadvantaged groups:

- Women:

Women in Matara are important contributors to household income. There are four factors which determine women's participation in the labour force. First, there is quite rigid division of labour, wherein women simply do not do certain types of work. Second, if the ratio of available jobs to labour is low, male heads of households have priority. Third, the social status of a household goes up as the amount of physical labour performed by its women goes down. Fourth, there are

²⁴ Ibid., p. 34.

²⁵ Matara Integrated Rural Development Project, Development Plan (Phase II) (mimeograph: MIRDP, 1986).

particular social, cultural, or religious restrictions, especially among Muslims, on women working outside the home

Women perform considerable agricultural work, particularly in the numerous cases where the male family head has migrated to look for more remunerative work outside the district (very common in Matara). Because of relatively high levels of educational attainment and the necessity for households to be economically heterogeneous, women in Matara "are permitted considerable personal freedom."²⁶ However, the social structure is very male-oriented and village life tends to be dominated by an "old-boys" network. Apart from the 614 woman-headed households where the woman was unemployed, it is unknown how many of the 33,661 employed women in the rural sector were heads of households.²⁷ These households cannot easily make claims, even at the village level. Furthermore, "female wage rates are normally much lower than male rates, they are inadequate to support a family."²⁸ It is fair to say that the number of female-headed households in economic distress is quite high in Matara.²⁹

● Those with Poor Access to Extra-Village Resources:

Since so much employment and so many resources are channelled from the public sector, those without influence in the right places or with the right people are at a severe disadvantage. There is "ample evidence of a strong connection between socio-economic status and degree of access to state resources. For a host of related reasons, a substantial portion of the resources distributed by the state are of direct benefit only to the wealthier sections of the village population."³⁰ Even the humblest of jobs, such as agricultural labourer on a state plantation, is doled out on a patronage system dominated by political appointees. With the migration of landlords to Matara town, Colombo

²⁶ M.P. Moore and G. Wickramasinghe, Low Country, p. 29.

²⁷ GOSL, Ministry of Plan Implementation, 1981 Census of Population - Matara, Table 18.

²⁸ M.P. Moore and G. Wickramasinghe, Low Country, p. 63.

²⁹ Ibid., p. 63. Moore and Wickramasinghe state: "Insofar as a choice exists, extra unskilled work (and higher wages) for middle-aged women would be the best way of alleviating the worst poverty through employment creation."

³⁰ Ibid., p. 152-153.

and elsewhere, the traditional patronage systems of many villages has broken down. Many households, without traditional or government patronage connections, are hard pressed to find employment.

● The Spatially Marginalized:

Often the poorer households in a village are physically distant from the centre of social and economic activity in the village (since Sinhalese villages are not clustered). This means a lack of information, psychological ostracism, and a tendency for males to migrate in search of better opportunities, leaving fatherless households behind (facing even greater marginalization).

Also, entire villages may be disadvantaged by remote location, especially in the low mountains in the north of the district. Even those villages located on a road in the north may still be four hours by bus from Matara town. Villages off the road must add time to that. What this means is increased cost of transport for inputs and outputs and greater distances for all government services, some which never reach the village (agricultural extension and veterinary services are good examples). People with patronage power rarely live in remote villages, so the villagers are often unconnected. Most forms of employment require that the worker move from the village, which generates little employment itself.

What are the solutions to the un- and under-employment crises in Matara? Moore and Wickramasinghe are clear on this point and field observations support their contentions:

The implication is that the poorest stand the best chance of obtaining jobs created in the informal and small-scale sectors - self-employment, or hired work for small scale businessmen or cultivators. ...Since they travel less and have relatively few sources of information, the poorest will stand the best chance of obtaining jobs which are created in their home villages.³¹

³¹ Ibid., p. 64.

They add that the jobs required should not require "formal educational qualifications or mobilisation of social and political contacts,"³² since such jobs go to better-off members of rural society

Returning to theory and experience then, it is important for financial intermediaries to address village-level needs for credit and savings services so as to remove at least the capital-shortage obstacle to employment creation in the villages. At the same time, it seems that the income enhancing value of credit for agricultural purposes is quite limited in Matara. The emphasis of government credit programmes on agriculture, and paddy in particular, does not seem to be well directed at alleviating poverty in the district

It is the contention of this thesis that a financial intermediary located and controlled in the village, circulating capital within the village, will create new improved enterprises in the village and create new employment right there, thus benefitting the poor

³² Ibid., p. 154

CHAPTER EIGHT

THE FEDERATION OF THRIFT AND CREDIT COOPERATIVE SOCIETIES (FTCCS)

The country has no institution which comprehensively serves the financial needs of the poor, but the Thrift and Credit Cooperative Societies (TCCSs) are by far the leading contender. This movement is organized into three tiers: the village primary societies (TCCSs), the District Unions (DUs), and the national Federation of the TCCSs (FTCCS). In policy, structure, bylaws, and operational guidelines, the TCCS movement is well suited to serving the rural poor, though some problems of access remain. The major question is just how well the TCCSs actually perform these functions.

8.1. A Brief History of the TCCS Movement

Around the turn of the century, the British colonial administration in Madras, India experimented with encouraging cooperatives for delivery of services and building of political patronage in rural areas. One of their methods was to encourage members of the rural elite to form savings and loan societies in the villages. While cast in the role of benefactor, a society patron could replace his weakening power of control over land with control over local financial intermediation. Although the patron and middle-class borrowers could benefit, the poor majority were affected not at all. Since they could not benefit from borrowing, they did not join the societies. Although never truly intended as such, the village society was a failure as a development mechanism.

Undeterred (or perhaps encouraged by the political results) the British repeated the exercise in Sri Lanka (then Ceylon), beginning in 1911. Again, small producers did not benefit. Nonetheless,

by 1942, there were 1786 societies, not all of them active. But in 1942, the wartime Government of Ceylon introduced consumer cooperatives to distribute rationed food supplies. While the number of these new cooperatives increased rapidly, even after the war, the TCCSs suffered. "The quality of service rendered declined and there were many instances of malpractices and mismanagement."¹ After Independence, in 1948, the consumer cooperatives were heavily sponsored by government and eventually evolved into the Multi-Purpose Cooperative Societies (MPCSs) in 1957, amalgamating most of the other cooperatives in the country. The TCCSs were ignored due to their low level of activity and were among the few types of cooperative not swallowed by the MPCSs. By the mid-1960s there were over 4000 registered TCCSs, but almost half of them were defunct. Membership and capital accumulation were low. By 1978 there were only 1281 active societies. Although the movement was weak, there were some societies which were strong and serving their members well, though few if any were growing in membership or lending resources.

In 1978, P.A. Kiriwandeniya, current President of the national-level Federation of Thrift and Credit Cooperative Societies (FTCCS), began to revitalize the TCCSs in his home district of Kegalle. The first District Union (DU) was formed there in 1979. Largely through tireless educational efforts and training of volunteer officers, the momentum reversed from decline to ascent. In 1980, the national apex organization was formed and more district unions registered (there are now District Unions in all the districts of Sri Lanka except Trincomalee). In 1981 new model bylaws for primary societies were formulated and People's Bank offered refinancing facilities. GOSL's Cooperative Department (CD) authorized upgrading of services offered by solid TCCSs to create informal "Cooperative Banks", though such "banks" are still cooperatives and not true banks as defined by the Monetary Law Act.

¹ P.A. Kiriwandeniya, Development Programme for the Thrift and Credit Cooperative Societies in Sri Lanka: 1986-1989 (Colombo: FTCCS, 1985).

The revival of the TCCSs has been accomplished with no government assistance. The basic strength of the TCCSs was that they had to raise all the required funds for lending, training, and operational expenses from their own members (though funds for the latter two budget categories have come from foreign agencies in recent years). This led to disciplined financial operations, lean and efficient administration, and independence from outside influence.

The TCCSs are organized on three tiers: primary societies in the villages (Chapters 10 and 11), the District Unions (DUs) for 24 of the 25 districts in Sri Lanka (Chapter 9) and the Federation of the TCCSs (FTCCS) at the national level. In the most general terms, the FTCCS forms new DUs and nurtures them if need be and provides the services listed below. The DUs do the same for primary societies. On occasion (rarely now since most DUs are capable and the number of primaries so large) the FTCCS serves primary societies directly. Thus, the TCCS movement is moving into a mature stage.

The movement is mobilized by educated, middle-class, rural people. While most of the active and central people in FTCCS are young, the old cooperators are still encouraged to participate and a number are still active. There is plenty of room for participation in the movement, mostly at the primary society and District Union levels. Societies entirely of women, or tea-estate workers, or hospital employees exist. There is active mobilizing in Tamil districts, even during the time of civil strife, since the District Union leaders are all resident Tamils in those districts. The poor, as defined in preceding chapters, do not participate in leadership roles. This is partly because of relative lack of education, compared to middle-class people, and partly because most leadership positions are voluntary and consume time and effort the poor need for their daily survival. The focus group could certainly be nurtured more by the middle-class members.

8.2. Functions and Problems of the FTCCS

The main long-term objective of the TCCS movement is to become an instrument of total village development. Starting with the premise that small scale private enterprise can create wealth for members and their communities, the TCCS seeks to provide the financial capacity to undertake both improved production and purchase of consumer goods, including housing. Once the TCCS and its members have a solid financial footing, other development activities, both financial and non-financial can be undertaken

The main functions of the FTCCS tend to be somewhat fluid, depending upon the expressed needs of the membership, the long range plans of the FTCCS leadership, and the pressures exerted by GOSL. Currently, the main categories include national organizational activity, banking and financial affairs, training and education, and village development and member services.

8.2.1. National Organizational Activity

- Government and Foreign Liaison.

This is carried out almost exclusively by the FTCCS President, Mr. Kiriwandeniya. Given the delicate relationship which must be maintained with GOSL, Mr. Kiriwandeniya's skills have proven a great boon to the movement. Deft political maneuvering is necessary to keep the government from co-opting the TCCSs as they co-opted the MPCSS in the late 1950s. Given the weakness of virtually all other rural secular institutions in Sri Lanka, GOSL is very interested in using the TCCSs as a vehicle for government programmes (about which more below).

Mr. Kiriwandeniya's efforts with foreign agencies have also brought great benefits. Assistance for the FTCCS has come from Australia's Community Aid Abroad (an affiliate of Oxfam) and from the Cooperative Union of Canada. Recently, as the success of the TCCSs has become acknowledged, the World Council of Credit Unions (financed in this case by USAID), CARE International and others have come into the FTCCS office in Colombo with offers of assistance. The FTCCS has been cautious

in dealing with these groups and has rebuffed proffered assistance from USAID more than once while rejecting CARE outright.

Mr. Kiriwandeniya is most definitely a charismatic leader. While this is not at all unusual in Sri Lanka, it leaves one wondering who or what will take the helm when Mr. Kiriwandeniya steps down. While the small FTCCS staff is dedicated and competent, there is little sign that upper level cadre are being developed. Hopefully, leadership is being developed in the districts, rising through elected or paid positions on the basis of merit.

- Organization of New TCCSs.

FTCCS is still involved in formation of new societies, despite the involvement of the Cooperative Department and the DUs. The objective is to have at least one society in each *Grama Sevaka* division.² The process is designed in six steps: 1) preliminary discussions, 2) education and motivation rallies, 3) formation of the society, 4) meetings of the committee members and general membership, 5) correct maintenance of records, and 6) registration of the society. The process can be lengthy, especially registration with the Cooperative Department, which can take a year or more. Often a village leader, local government official, or existing voluntary organization will be approached to help make the initial contact with the villagers-at-large. These catalysts will often receive a training session themselves. If the approach to TCCS formation is through one of the first two agents, there is a potential problem of "elite" direction or even domination of the eventual society.

FTCCS is involved mainly in areas of the country where the DUs are weak and the distribution of primary societies thin on the ground. For example, special attention has recently been given to the Tamil estate workers by the hiring of the former District Secretary from Jaffna (a woman) and a second Tamil field officer to mobilize the estate Tamils in the central part of the country, where they hope to form 15 new TCCSs per month. Their attention is also directed to the east coast,

² This is another unit of civil administration, the smallest used by GOSL. It comprises one large village or several small ones and environs and has a government official in charge.

where the DUs are young and formation of new TCCSs among the Tamils is anticipated to be rapid, as well as to the better established TCCSs of the north. Since this special focus on the Tamils was developed recently, the budget requirements had not, at the time of the interview (February 23, 1987) been met. This shows again where the otherwise laudable enthusiasm and flexibility with which FTCCS approaches its tasks sometimes shows a lack of adequate planning.

- Organization of District Unions

The formation of DUs should be complete by the time this is written, Trincomalee being the only district without one at the end of the field work period. Some "quasi-districts" (the creation of new districts by GOSL is still a fluid process, with subdivision of existing districts occurring at irregular intervals) will also get their own DU. Even when the formation process is complete, most new DUs need considerable organizational, administrative, and financial support.

- Cooperative Change Agents Training Programme:

Where it is necessary to do considerable groundwork or where there are no other appropriate local catalysts, FTCCS has a "change agents" programme, similar to other change agents programmes run by other organizations in Sri Lanka. Essentially, a local youth is selected for training and trained extensively by the DU, and sent back to his or her home area as a volunteer to mobilize villagers into new societies. The change agent can broaden the scope of his or her work to include other development activities, but the focus remains the TCCS.

8.2.2. Banking and Financial Affairs

- Administration of Funds:

By the end of 1986, GOGL was pumping loan funds into the TCCSs through the Million Houses Scheme, the New Comprehensive Rural Credit Scheme (NCRCS), and from Integrated Rural Development Projects (IRDPs) in some districts. These schemes, especially the housing programme, have increased the administrative burden on the FTCCS.

FTCCS is also setting up an interlending programme to channel funds from one district to another (duplicated at the district level by the DUs, who channel funds to and from TCCSs in their districts). In addition, FTCCS is trying to form a national level "cooperative bank" (see below). All these efforts require considerable input from the few FTCCS staffers.

The 1987 FTCCS budget calls for expenditures of Rs 5,352,300 (C\$267,615), certainly a modest amount to cover the intended activities of the organization. The membership will supply Rs. 2,880,000 (C\$144,000) and the Cooperative Union of Canada has been approached for Rs. 1,250,000 (C\$62,500), a 4% increase over the CUC contribution for 1986. FTCCS will seek the difference elsewhere: the Australian NGO Community Aid Abroad, which was the main financial supporter from 1978 to 1984 (but not in 1986), will be approached again, and discussions have been broached with the Dutch NGO HIVOS for some funding in Anuradhapura district. It is likely, however, that an offer of assistance from the World Council of Credit Unions, funded by USAID, will be accepted, at least in part. FTCCS sees problems in this, elaborated below in the discussion on housing loans.

• National Cooperative Bank

FTCCS envisions a three-tiered banking system, paralleling the primary, district, and national levels of the TCCS movement. There are already some TCCSs which are called "banks", these being mature TCCSs with a permanent office and manager. Eight "District Banks" have also been established in DU offices, acting as conduits for lending of external funds and interlending funds to member TCCSs. Some TCCSs, notably the village banks hold reserves with the district banks, qualifying them for interlending services. The TCCS "National Cooperative Bank" does not yet exist, but is scheduled to begin informal operations within the next year or two, depending upon government constraints.

Herein lies the major problem with the concept of a national cooperative bank. The TCCSs are cooperatives operating under the Cooperative Law, No. 5 of 1972 and the Amendment Act, No. 32 of 1983, which strictly defines what financial operations may be performed by cooperatives.

Banks are regulated under the Monetary Law Act, which even stipulates that no institution but a chartered bank may call itself a "bank." The TCCSs are already challenging this rule. The FTCCS objective is to have the Cooperative Law amended to expand TCCS powers, or, preferably, to have a new Act of Parliament expressly for the TCCSs.³

Under the status quo there are considerable problems with the FTCCS plan. The Monetary Law would force the sort of controls on the TCCSs that it is already trying to escape. The TCCS tenets of democratic decision making would be severely constrained by Central Bank regulations. There are numerous rules which the national bank could contravene as a hybrid of cooperative and bank. For example, as the Multi-Purpose Cooperatives' Rural Banks discovered in the mid-1960s, cooperatives are not permitted to offer current accounts. Worse, the national cooperative bank would, as a bank, have to keep up to 25% of its deposits on reserve in the Central Bank at no interest. The FTCCS national bank will face a confusing array of difficulties in this regard and may well be prevented from undertaking the full range of banking functions. FTCCS does not presently have high-level professional banking advice to deal with the technical aspects of setting up a bank. Indeed, the initiative seems to be driven more by perceived need than by comprehensive planning.

Although a primary TCCS bank is only supposed to exist "as the only financial organization in its area of operation,"⁴ and therefore not compete with the commercial banks, the so-called "banks" already in existence in Matara district are not at all far removed from commercial bank branches. It may be expected that all competing financial institutions would oppose the proposed cooperative banking system. Coupled with the technical and legal difficulties, it seems likely that FTCCS will expend considerable energy in an effort that may not, in the end, yield the sort of banking system they envision. The most constructive path would seem to be to put the national bank initiative on hold while consolidating the abilities of an ever larger number of primary societies and DUs. Once an impressive number of the lower two tiers are performing at the maximum allowable level

³ FTCCS. Policy Declaration of the Thrift and Credit Cooperative Bank Activities in 2000 A.D. (unpublished mimeograph of resolutions from the Dambulla National Workshop, 1986).

⁴ Ibid.

under the Cooperative Law, there may be enough financial momentum to overcome political inertia.

- Interlending Scheme and Loan Protection Scheme

The interlending scheme entails taking deposits from TCCSs which cannot relend all their savings to their own members and lending those funds to other societies whose deposit to loan demand situation is the reverse. While it would seem that very few societies would possess a surplus of deposits, Mr. Kiriwandeniya insists that they exist in sufficient numbers to warrant the interlending scheme. Interlending would operate at two levels: first, within a district, with deposits and loans running through the District Bank; second, at an interdistrict level, with funds flowing through national level cooperative bank. As yet, the scheme in the districts is too new to draw any conclusions about it and the interdistrict plan is not yet in place.

In concert with interlending, FTCCS is in the process of implementing a compulsory loan protection scheme (target start up date: March 1, 1987), whereby each borrower contributes Rs.0.65 per 1000 rupees borrowed in order to cover defaults. The scheme is national, so that even heavy loan losses by a single TCCS would not result in loss of that society's members' savings. This prudent mechanism should reassure depositors that their savings are safe (even though there have been no admitted losses since the beginning of reorganization of the TCCSs in 1978) and thereby increase the amount of savings held with TCCSs as savers transfer funds from other holdings

- Revolving Fund:

FTCCS intends to create a revolving fund for use by the poor. As yet, there are few guidelines in place for operation of the fund. It is intended that the fund will be administered by the national "cooperative bank" which FTCCS intends to form.

8.2.3. Training and Education

• The Four Main Training and Education Programmes

The pillar upon which the TCCS movement rests is the motivation and commitment of its members, which is catalyzed by education of ordinary members and training of officers and staff. FTCCS has been heavily involved in this since its formation and a large proportion of expenses, partly met by Community Aid Abroad and the Cooperative Union of Canada, has gone directly into education and training.

Education of the general membership consists of four major topics: 1) principles and practices of cooperation, 2) development of the rural economy, 3) rules and bylaws of the TCCS, and 4) types of deposits and uses of credit. It is intended that primary societies themselves should be responsible for this training, but in fact the FTCCS and, more and more, the DUs are taking on the work, though they try to concentrate their efforts on the most motivated members in the hope that these individuals will pass on what they have learned to the other members of their societies.

Committee members of the primary societies are also to receive training. Topics include: 1) duties and responsibilities of committee members ("collective identity"), 2) internal management, 3) bylaws, standing orders, and regulations, 4) diversification of deposits, 5) mobilization and use of deposits, 6) management decision making, and 7) reorganization of weak societies. It is intended that committee members of successful societies be used as trainers, thus maximizing the scarce resources of the FTCCS and DUs.

Office-bearers in the primary societies are regarded as the critical individuals in the running of day to day affairs. Their training includes: 1) planning, 2) accounting, 3) management, 4) decision-making, 5) use of resources, 6) rural economic development and the credit cooperative society, and 7) community development.

Managers are the last group targeted for training. Only well-developed societies really need a "manager" if their executives are competent. Once a society becomes a "cooperative bank", handles

a large volume of transactions, or takes on additional functions, a half or full-time manager may be needed. Training includes: 1) cooperative principles and practice, 2) accounting, 3) management process, 4) banking, 5) rural development and credit cooperative societies, and 6) public relations."

Training and education is planned to take place at three levels: the village, the Assistant Government Agent's division, and the district.⁵ The village is the most frequent venue and rightly so. There has been no independent evaluation of the effectiveness of any of the training and education programmes. Given the importance attached to this major component of FTCCS and DU activity, there should be some evaluation. Mr. Kiriwandeniya agreed with this idea when it was suggested to him.

With the development of the DUs, education and training has been passed on to them as they become mature and competent themselves. Some districts with new or weak DUs still rely on FTCCS for these services.

The range of training and education programmes includes:

- District Secretaries Training Programme:

This is for the continuous training of the Secretaries of District Unions. Monthly sessions are held at FTCCS head office in Colombo, providing regular personal contact between the DUs and between the DUs and FTCCS. New programmes and strategies are discussed and problems aired

- District Presidents and Secretaries Workshops:

It is planned to hold at least three of these per year to permit district level officials to exchange ideas and collaborate on problem solving. This sort of interaction at the national level promotes cohesion in the movement.

⁵ The Assistant Government Agent's Division is a standard administrative unit of GOSL. The FTCCS uses it as a convenience, since there are no formal links with GOSL at this level.

● Programme for the Motivation and Activation of Women and Children:

The FTCCS description of programmes for the 1986-89 period claims that women, while the key decision-makers on expenditure in families, are not active members of TCCSs (a conclusion challenged in the field study conclusions). A programme to train women in both traditional and income earning roles is proposed for the DUs. FTCCS also suggests "special womens sections or organizations under the auspicious [sic] of the TCCS movement." While this idea might be good for very limited applications, such as certain producer groups, it should not be used to justify creation of "womens' auxiliaries" to the TCCSs themselves. Nor should it result in women being relegated to responsibility for womens' affairs alone. This is the best assurance that women's needs will be met is having women participate fully and equally in the TCCS itself. There are no social proscriptions against women in Sinhalese TCCSs, though women tend not to be as vocal as men in mixed meetings. In Muslim TCCSs, it may prove much more difficult for women to participate fully. A report from Jaffna, in the main Tamil region of the island, suggests that women have reserved places on the committees of many TCCSs there.⁶

Children are also chosen for special attention in order to engender a savings habit early in life and create future members for the TCCSs. This is a role already vigorously pursued by the Sarvodaya Shramadana Movement, an indigenous NGO with a more extensive presence in the villages than the TCCSs. Some sort of linkage between the Sarvodaya children's programme and the TCCSs would seem to be natural, but the two organizations have differences which hinder collaboration (see the discussion of the "Human Development Programme", below, for more on this relationship).

● Youth Skills Development Programme:

One DU plans to run a programme of skills development for unemployed youth in Kuliyaipitiya (near Colombo) in order to give them marketable skills. If successful, the programme could serve as a model for other districts.

⁶ Personal communication with Mr. Gnanapragasam, Cooperative Department (Jaffna), held in Kegalle, November 1, 1986.

- **Leadership Training Camps:**

FTCCS wants to sponsor two residential training camps for Change Agents, in which leadership skills can be taught.

- **Communications:**

This is a general programme of guest lectures, field trips, newsletter production, mass meetings, festivals and other means of disseminating information and generating enthusiasm. The main motor for these activities will be the DUs.

8.2.4. Village Development and Member Services

- **Programme for Project Identification, Preparation and Evaluation:**

FTCCS runs occasional training sessions for selected members of primary societies to instruct them on how to inventory the human and physical resources in their home villages and how to formulate investment projects, funded by the TCCS, based on those resources. The intent is to both utilize members' savings in the very village where they were raised to create employment and aid overall development. This is a very tall order in most villages. An evaluation of the effectiveness of this programme is in order, since it is potentially so constructive yet so difficult.

- **Programme for Integrated Development:**

FTCCS sees the primary societies as an ideal village agent for coordination of government development programmes and to that end has developed workshops and seminars for members to familiarize them with the idea and proposed process. Collaboration in the areas of land development, irrigation facilities, agricultural activities and subsidies, and marketing are contemplated in addition to the links already forged for agricultural credit (New Comprehensive Rural Credit Scheme) and housing credit (National Housing Development Authority). Both of these links are discussed in 8.3.

While the idea looks very good in theory, in practice it is difficult. While the TCCSs have been chosen for handling housing loans, this is because they are financial institutions handling a

financial activity. Gaining cooperation from line ministries is a very difficult task in Sri Lanka, as the status quo is very jealously guarded by bureaucrats at every level (such behaviour was witnessed by the researcher at the Matara IRDP, itself a government office). At the village level, roles taken on by the TCCSs would be infringing upon the powers of the *Grama Sevaka*. Furthermore, too close a collaboration with government risks total co-optation by government, as happened with the MFCSs in the 1950s.

• Life Insurance Scheme

Another national programme being developed by FTCCS is "life protection", in which a small premium will protect the dependents of TCCS members. The savings and debts of any member up to age 70 are covered under the plan. Should the member die, his/her family will receive twice the amount of savings he or she had deposited at time of death. All outstanding debt will be paid. Although FTCCS has not worked out the details, including a precise estimate of cost and premia, the scheme is potentially a very good one in that it fills a traditional role in Sri Lankan villages, that of the death society. The traditional death societies collected premia for the same reasons, since a death, especially that of an income earner, could seriously threaten the economic survival of a family. The FTCCS insurance scheme will prove very attractive, even in competition with traditional death societies, because risk will be spread very broadly and payment of benefits will be more secure.

• Human Development Programme

The long range goal of the TCCS movement is to make the primary society a major non-governmental, multi-function development institution in the village. Objectives include "national unity, women and child care, adult education, health, nutrition, agriculture and small industries and modernization of traditional agricultural methods, creative skills and other community activities".⁷ To this end, FTCCS and the DUs have been working to select 300 TCCSs in as many

⁷ FTCCS, Tasks of the Thrift and Credit Cooperative Societies in Rural Development - Declaration Policy (unpublished mimeograph of policy declaration, National Workshop held at Dambulla, 1986)

villages nationwide to be models of development. Extra attention and resources shall be directed to these TCCSs so that they may serve as examples of more integrated development, far beyond offering credit and savings alone. Slow expansion of functions is a good idea for strong TCCSs that have a large proportion of the adult village population as members. However, results of the Matera field study suggest that many primary societies are too ambitious in this regard and should concentrate on consolidation of financial services first.

Interestingly, although these ultimate objectives are very similar to those of the Sarvodaya Shramadana Movement, another very large indigenous NGO, and although the TCCSs have resolved to "act in conjunction with other state and voluntary organizations"⁸ towards those objectives, there is no present or contemplated collaboration with Sarvodaya. While the TCCSs begin with a solid financial base, rooted in savings and credit, Sarvodaya, which is active in many thousands of villages, builds from *shramadana*, in which voluntary community labour is utilized to solve problems identified by the community itself. Thus Sarvodaya builds community spirit through affirmation of traditional values. Many Sarvodaya villages have a children's home garden and saving scheme. The strength of Sarvodaya financial services is dependent upon local initiative and there is only minor direction from the national organization. The problem is that Sarvodaya and the TCCSs seem to be in competition with each other, at least in the provision of financial services. The cooperation which could improve the performance and penetration of both movements is not at all evident. It is possible that this at least partly stems from differences between the Presidents of the two organizations; Mr. Kiriwandeniya of FTCCS was once a protégé of Mr. Ariyaratne of Sarvodaya. In any event, work towards total village development would benefit from cooperation.

8.2.5. Conclusions on FTCCS Programmes

FTCCS has an ambitious array of programmes, most of which will need to expand as the number of primary societies expands: that is, very rapidly. Although the Cooperative Union of Canada is

⁸ Ibid.

assisting with new training facilities, FTCCS does not have a large base of trained and experienced staff to manage these programmes. Passing on responsibility to DUs is a good idea, if the DU in question is itself well enough developed to manage the programme. The FTCCS role in this case could be reduced to supply of materials, supervision, and evaluation. Alternatively, perhaps FTCCS should reduce the array of programmes to a more manageable size through consolidation.

More effort must be expended evaluating the effectiveness of all the programmes. This is necessary both to make maximum use of limited human and financial resources and to ensure that villagers are receiving the resources they need to operate a successful TCCS. Presently, FTCCS holds an annual week-long evaluation and planning session attended by four representatives of each DU. Nonetheless, more technical evaluation is required to determine, as objectively as possible, how well programmes are running.

Planning, particularly long range planning, is weak at FTCCS. At a conference held at the FTCCS training centre in Kegalle, the President expressed the desire to expand the number of societies threefold by the year 2000. Some problems with this ambition are already coming home to roost due to the current rapid expansion of TCCSs. There are plans to increase training capacity, but not to the scale required to meet demand. There must be many hundreds of newer societies which have not received any education or training at all. Development of a competent army of banker-accountants is nowhere in sight. Nurturing of top level management is similarly invisible. The development path for the proposed national cooperative bank is particularly cloudy and treacherous. Representatives of international agencies present at the conference urged FTCCS to consolidate its considerable gains and put further expansion on temporary hold.

8.3. Relations with the Government of Sri Lanka

Sri Lanka is a small country with a weak economy and severe political divisions. The government is an institution under constant pressure, both economically and politically, and is therefore very

sensitive to the distribution of power in both of these spheres. Any other institution growing in power and profile must bear close scrutiny from GOSL. If it hopes to maintain its growth and autonomy, it must not be perceived as hostile to GOSL's ideology or activities. The TCCSs are such a growing institution and need look no farther than the Multi-Purpose Cooperatives, regulated by the same Act of Parliament, to see how the government can emasculate an institution. It is vital that the FTCCS demonstrate to the government that it is at least neutral to government or, better still, that it can engage in symbiotic relations with government. Yet the TCCSs cannot get too close to GOSL, lest the government decide that the TCCSs would better serve as government agencies. The survival of the TCCSs as independent and financially viable institutions depends upon a delicate balance.

As mentioned above, the TCCSs are "cooperatives" registered under the Cooperative Societies Law.⁹ As such, they are subject to supervision of GOSL's Department of Cooperative Development, referred to herein as the Cooperative Department (CD), which is itself bound by ossifying bureaucratic procedures. For example, it often happens that a new TCCS is organized, submits its application for registration, begins to operate informally and waits to be investigated and recognized by CD. The waiting period can sometimes be two years or more. This problem has only recently been relieved under pressure from the Prime Minister's office and the National Housing Development Authority (elaborated below)

CD audits all TCCSs yearly and has strong powers of inquiry and enforcement, listed in Chapter VIII of the Cooperative Societies Act.¹⁰ The Registrar of CD has a long list of investigative options, some of which could be regarded as intrusive by the society under scrutiny. Should irregularities be disclosed, the Registrar may go so far as to dissolve the executive committee of the errant society and appoint managers for up to two years. In extreme cases, he may dissolve the society and

⁹ GOSL, Cooperative Societies Law, No. 5 of 1972 (Colombo: Dept. of Government Printing, 1982).

¹⁰ The researcher made a written request under the signature of the Director of the Matara IRDP to the CD head of audits requesting general information on audit procedures and content as well as audit information on the Matara DU of the TCCSs. Upon leaving the country much later, no response had been received.

dispose of its assets. While close government supervision of financial institutions is hardly out of the ordinary, and while the TCCSs and DUs have only rarely been disciplined, the TCCS movement feels constricted by CD personnel and practices. For this reason, among others, a long term goal of the TCCSs is creation of a separate Act of Parliament for them alone.¹¹

While there is nothing unusual about government supervision of this type, the potential for abuse is definitely present. While the TCCSs have not yet suffered under these powers, the Multi-Purpose Cooperative Societies (MPCSs) certainly have. Members of Parliament have long had the privilege of appointing a majority of the board members to MPCSs in their constituencies, rendering those "cooperatives" into patronage tools and wrecking the financial strength of many of them. After a new government was elected in 1977, opposition MPs refused to support policy changes regarding the MPCSs, resulting in the dismissal of the boards of all the societies under their patronage and replacement with government appointed officers. This was a clear political use of the provisions of the Act by the present government, albeit upon institutions which were already highly politicized. However, as the TCCSs are inexorably drawn into government programmes, the potential for arm-twisting through the provisions of the Act increases.

• Housing Loans:

The main threat to stable TCCS growth is increased government use of the TCCSs as conduits for government programmes. The first such programme has the TCCSs channelling subsidized housing loans from the National Housing Development Authority (NHDA) to end users. Mr. Kirilwandeniya has said that FTCCS originally agreed to this on the understanding that the money would only go through financially strong and stable TCCSs. The Ministry of Housing and, at the top of the hierarchy, the Prime Minister's office, have other ideas.¹² It is the intention of the government to

¹¹ FTCCS, Policy Declaration on the Rules and Regulations of the Thrift and Credit Cooperatives in Sri Lanka (unpublished mimeograph of policy resolutions from TCCS Dambulla Conference, 1986).

¹² The Prime Minister is the number two man in the political hierarchy, after the President. A simplified division of powers has the President oversee major portfolios such as foreign affairs, defense, and finance while the P.M. directs most of the domestic portfolios. There is subtle rivalry between these two and dispensation of patronage is an important tool.

distribute the funds equally to all electorates in the country, regardless of whether or not a strong TCCS exists in each; CD has been instructed to form new TCCSs in electorates where there are none. The result has been an explosion in the number of TCCSs, many of them with little or no education for members or training for officers. This has presented FTCCS and the District Unions with an enormous challenge. They do not feel in any position to refuse funds, but they lack the resources to strengthen the new TCCSs or even to enforce bylaws. There is a much higher risk to the reputation of the TCCSs should one of the instant societies, formed to receive housing loans, default on the loans. The resulting collapse would seriously damage the hard won credibility of the TCCS movement as a whole.

Whether FTCCS felt it had any choice in accepting or rejecting the role of housing loan conduit is unknown. It is quite clear that active resistance to the wishes of the Prime Minister could have serious effects, possibly including the use of CD and the Cooperative Law as a weapon to obstruct the functioning of the TCCSs, the DUs, or even the FTCCS itself. The government takeover of private cooperatives in the late Fifties forms the clearest and most serious precedent. More recently, this government has used their powers to replace the Boards of primary societies to effect political take-over of Multi-Purpose Cooperative Societies beholden to opposition MPs. FTCCS has always tried to maintain smooth relations with GOSL and, in the case of housing loans, may be trying to play along in order to minimize the damage.

Simultaneously, FTCCS and the DUs are mobilizing to educate and train the new societies. Considerable assistance has been offered by the Cooperative Union of Canada (CUC) and the World Council of Credit Unions (WOCCU). FTCCS has long had a strong partnership with CUC and is very grateful for the assistance. However, FTCCS is suspicious of WOCCU because that latter is based in the United States and is funded, at least in this case, by USAID, which is also providing the lion's share of the housing loan funds through GOSL. WOCCU and the US Embassy have repeatedly approached FTCCS with offers of assistance, but FTCCS is trying to keep them at bay. This is because FTCCS perceives a hidden American agenda of political support for the government and,

despite channelling housing loans, does not want to be suspected of political leanings in any direction. Since housing loans at 6% per annum clearly buy support for the government, FTCCS fears being made a stooge for patronage. WOCCU attempts to place an unrequested technical advisor with the FTCCS have been rejected outright, but offers to help pay for the expansion of field staff may be accepted to top-up the contribution of the CUC towards the same ends.

- New Comprehensive Rural Credit Scheme (NCRCS) Loans

Beginning with the *Maha* 1986-87 season, TCCSs are able to act as agents for GOSL agricultural loans under the NCRCS. There are strict criteria and rules for this, set by the Central Bank (CB), but FTCCS does not like the degree of control which CB and the commercial banks would have in this operation.

The TCCSs are junior partners in the scheme, contributing a surety of 25% of the value of the loans as fixed deposits with the partner commercial bank. This deposit will restrict the amounts applied for, which, while ensuring that no TCCS gets overextended, can potentially drain the TCCS of loan funds for other purposes. Of the 7.5% spread offered under NCRCS refinancing, the bank would get 2.5% and the TCCS 5%. The bank would lend a lump sum to the TCCS and the TCCS would dispense it to members under its own bylaws and regulations. There are numerous other points of contention which FTCCS has with the Central Bank and its NCRCS regulations.

- Central Bank would choose the districts in which the TCCSs would be eligible to participate

The first district chosen was Kegalle, because of the strength and maturity of most Kegalle TCCSs and the Kegalle District Union. FTCCS feels that the Kegalle TCCSs have the absorptive capacity to handle NCRCS loan funds, but that the TCCS movement, at all levels, should have some say in who participates.

- Central Bank also chooses which commercial bank will be the conduit between it and the TCCSs. FTCCS wishes to be free to choose its own partners. Participating TCCSs must be recommended by their DU and examined by the partner bank before being offered to the

Director of CB's Rural Credit Department for final approval. This creates lines of authority which will make the process cumbersome; FTCCS would prefer short lines of approval.

- Participating societies must have at least one paid employee to maintain the books. While it is desirable to have such a person, this rule restricts participation to those successful and mature societies which can afford to hire a manager/bookkeeper. Such TCCSs are inevitably those least in need of the loan funds.
- Central Bank requires at least one loan supervisor for every 500 loans, including those the TCCS makes from its own resources. CB seems to have missed the point of local supervision, present TCCS methods of volunteer loans committees and peer pressure are producing repayment rates unequalled by any other formal lending institution in Sri Lanka
- Unlimited liability societies, which includes the vast majority of rural TCCSs must try to expand their membership to 300 - 350 members within 3 - 5 years. The average size of survey respondents in Matara district was 114 members. Forced increase in size will expand many TCCSs beyond their natural village borders; the result could well be a loss of the social cohesion necessary to smooth operations and high recovery rates. CB offers no reason for this demand, though it probably concerns supervisory efficiency for the partner banks and CB and perceived strength in numbers for the society's financial viability.

While there are some positive aspects to this programme, notably a reduction in the minimum landholding for paddy and most other crops,¹³ participation would be much easier if CB were not so intrusive.

The results of the first season amply demonstrate the lack of enthusiasm for the programme only 5 TCCSs in four districts (Badulla, Galle, Kurunegala, and Matale) participated, granting a total of 37 loans for a sum of Rs.95,105. The area financed was only 47.6 acres.¹⁴ This yields an average

¹³ All crops except potatoes, red onions, Bombay onions, chillies, and "vegetables" have half the land minimum required of those borrowing from a bank.

¹⁴ GOSL, Department of Rural Credit, NCRC Cultivation Loan Statistics, Maha 1986-87 (Colombo: GOSL, April 1987), p. 65.

of Rs.2570 per loan, very similar to the averages of the RRDBs, NSB, and IOB. The average size of acreage financed was 1.3 acres, similar to the RRDB average and significantly above the specified minimums of 0.125 for chillies (only one of the loans) or 0.25 acres for paddy (the other 36 loans). It would appear that once again the very small farmer, although eligible, is not receiving loan funds.

It is notable that, even without NCRCs refinancing, the TCCSs provided 13% of the total production credit extended by the commercial banking system in 1984.¹⁵ That is, funds raised as savings by just over 2000 TCCSs provided a significant amount of the largest single credit requirement of rural producers. This bodes very well for the future ability of the TCCSs to meet credit demand in the countryside.

8.4. Overview of the TCCS Movement

Casual evaluation of the TCCSs conjures a vision of the (almost) perfect village institution. The institutional structure of the TCCSs blends well with the enlightened self-interest of the members and strict rules in the bylaws of all levels of the movement create a solid financial base. The lending base is growing rapidly, loans are mostly for productive purposes, and recoveries are very high. The societies, at all levels, are democratically run and the poor have access to services. Overall performance and participation seem to be very strong indeed. The TCCSs would appear to be an indigenous success story.

However, while not denying that the TCCSs are indeed the best institution currently involved in Sri Lanka's RFMs, there are areas of weakness at all three levels which bear further investigation. Here, we shall restrict criticism to the top level, FTCCS, and the movement as a

¹⁵ International Fund for Agricultural Development, Sri Lanka Credit Project, Annex 2, p.25.

whole. Analysis of the District Unions, specifically the Matera DU, occurs in the next chapter, while results of the field survey of primary TCCSs is detailed in Chapters 10 and 11.

Some weaknesses in the FTCCS institutional structure have been pointed out above: pressures from government, lack of top leadership development, inadequate evaluation of programming *et al.* There are also financial concerns which contradict the rosy picture put forward by FTCCS and its many admirers. The problem with verifying FTCCS claims is lack of data. For example, FTCCS claims that overdues and defaults in its member societies are very low, but they offer no corroborating figures. For this ratio, as well as other measures listed in 3.5, FTCCS does not appear to have a good data gathering mechanism. Having refused a computer offered by USAID, FTCCS must manually tabulate every figure it receives. With membership booming all over the country, data gathering and processing simply cannot keep up. FTCCS receives monthly reports from the DUs, but solid information from primary societies to the DUs is very weak indeed, if the Matera field results are any indication. FTCCS needs a competent research and data processing unit, compulsory reporting of a simple set of figures from the primary societies through the DUs to FTCCS itself, and well-defined performance measures made at regular intervals.

Perhaps the best aggregate information is compiled by the Cooperative Department, since CD audits all registered societies every year. From the field survey, there is reason to doubt the quality of these audits, too, though an audit is supposed to be thorough. Unfortunately, the Cooperative Department did not cooperate with the researcher, so audit procedures and resulting figures for some sample societies and the DU in the field study were not available for analysis.

However, CD does provide a glimpse at the overall performance of the national movement. An example is the national lending portfolio. The TCCSs have a reputation for strong productive lending and high rates of recovery. (These claims are tested for Matera District TCCSs in Chapter 11.) Nationally, the 1984 portfolio shows productive loans comprising under 62% of the total volume, which is not all that strong. CD classed house construction and food purchases as productive (though neither activity creates any repayment capacity) yielding a productive loan rate of almost

78% Figures for Matara, based on survey results, confirms a low rate of productive lending, only

48% Figures for cumulative recoveries are not available

Table 16
TCCS National Lending Portfolio, 1984

<u>Type of Loan</u>	<u>No. Loans</u>	<u>Amount (Rs.000s)</u>	<u>%</u>	<u>Average Loan</u>
Productive Purposes				
Crop Production	21,906	22,984.60	16.14	1,049
Purchase of Cattle	630	588.37	0.41	934
Purchase of Land	2,327	7,437.08	5.22	3,196
Land Improvements / Leases	2,634	3,966.85	2.78	1,506
Trading	6,185	8,891.91	6.24	1,438
Purchase Farm Equipment	401	624.20	0.43	1,557
Veterinary Charges	1,999	1585.30	1.11	793
Others	18,739	41,626.95	29.23	2,221
Sub-total	54,821	87,705.26	61.59	1,600
Non-Productive Purposes				
House Construction	9,970	20,340.07	14.28	2,040
Purchase of Food	2,596	2,568.05	1.80	989
Payment of Old Debts	7,557	18,102.59	12.71	2,395
Ceremonies	2,511	1,704.33	1.20	679
Others	13,316	11,986.95	8.42	900
Sub-total	35,950	54,701.99	38.41	1,522
TOTAL	90,771	142,407.25	100.00	1,569

Source: Cooperative Department

While Matara District may not be typical of the TCCS movement as a whole, the field results in the following chapters certainly confirm doubts about TCCS performance. Nonetheless, financial performance and access for the poor are superior to those offered by any government programmes, commercial banks, or other village organizations. Some smaller NGOs offer similar services and even better access for the focus group, but their scale is limited to very few villages and their ability to replicate their projects is extremely limited. With a few improvements (to be suggested), the TCCSs could offer a stronger, and truly national solution of the savings and credit problems of the Sri Lankan poor.

CHAPTER NINE

THE MATARA DISTRICT UNION OF THE TCCSs

The District Union (DU) is the secondary level organization of the TCCS movement. Since the number and geographical dispersement of the primary societies is far too extensive for FTCCS to manage, powers of organization, education and training, interlending and other services have devolved to the DUs. Depending upon their individual development and maturity, each DU has a greater or lesser degree of autonomy from FTCCS. In districts where the DU, and perhaps the entire TCCS movement are relatively new, FTCCS takes a strong role, at least in education and training. In other districts, including Matara, the DU has taken on most of the local work, calling on the assistance of FTCCS when required.

This chapter addresses the strengths and weaknesses of the Matara DU, with an eye to how its effectiveness or lack of same bears on the primary societies it exists to serve and, by extension, on the rural poor. In the overall scheme of things, the DU is the linchpin to the expansion of TCCS membership and range of services. It is vital glue, without which primary societies would be relatively isolated and self-contained, meaning they would be less capable. Yet, as will become clear, there is a complex political dimension to the DU which is critical to its present and future functioning. These dynamics, coupled with the rapid expansion of DU membership, form the main challenges to the DU and, ultimately, to the primary societies and their members.

9.1. Organization of the Matara District Union

The Matara DU was formed on November 11, 1980 with a membership of 12 TCCSs. As of December 31, 1986, there were 92 members out 141 registered societies in the district. Most of those 48 non-members were very new and were expected to join the DU shortly.¹ There were 119 more organized societies waiting for registration by CD. This rate of expansion has already exceeded the expansion target for the entire 1986-89 period.² The reason, of course, is the drive by CD to form new societies and the reaction of the DU to try to lay claim to more villages.

General meetings are held once every three months on average. One of them is the Annual General Meeting at which officers are elected and an Annual Financial Statement adopted. The DU claims that about 3/4 of the societies send a representative to each meeting. Questionnaire respondents corroborate this approximation.³ Those sixteen societies which reported that they had "never" sent a representative to DU meetings had all been registered for less than eight months. The day-long general meeting the researcher attended had approximately 95 people present (though there was some coming and going) out of a then current membership of 110. It is notable that DU bylaw amendments require approval of 75% of the total membership, which means that virtually the entire assembly at a typical meeting would need to vote in favor of an amendment to assure passage.

The DU submits a monthly financial statement to FTCCS, but given the weakness of the DU's data gathering, this statement may not accurately reflect the activity of the primary societies which are members of the DU. FTCCS also sends a representative, usually the General Secretary, down to Matara between once a month and once every three months, while a DU representative, most often the Mr. Dehamsiri (DU President), goes to national meetings. FTCCS works closely with the DU on training programmes for all levels of personnel. The more mature and competent the DU becomes,

¹ By the time this researcher left Sri Lanka at the end of March 1987, 150 of the 174 registered societies were DU members.

² The DU Development Programme, written in 1985, called for 48 new societies in 1986, 40 in 1987, and 36 each in 1988 and 1989.

³ Q: Does a representative from your society attend the District Union general meetings? A: n=115(119), 1) always=31 (27%), 2) most=41 (36%), 3) some=26 (23%), 4) few=1 (1%), 5) never=16 (14%).

the more independent it is of FTCCS. Compared with other DUs, Matara is considered fairly well developed in its membership, programmes, and overall stability.

• The DU Board of Directors:

The DU is run by a Board of Directors elected by the DU general membership at the Annual General Meeting. Currently, the Board of 9 men (no women) is dominated by men from TCCSs in the "heartland" of the Matara TCCSs; 7 of the 9 are from the coastal belt running 12 miles from Matara town east to Dickwella. One of the remaining two is from a TCCS less than half way up the district on the east side. The final member, from Akuresse in the middle west, is, like the one from Matara Hospital, an almost honorary Board member with little input into DU affairs and a spotty attendance record at meetings. The Akuresse TCCS did not even respond to the questionnaire. Therefore, the DU is essentially run by 6 Board members, all from within an 8 by 4 mile belt.

Another extremely important aspect of the Board's composition is that the President and probably some of the other active members are members of the Communist Party. This has led to profound political effects, which are elaborated in 9.3.

As is the case nationally, school teachers form a core of TCCS leadership; both the President and Vice-President (and an unknown number of the others) are teachers.⁴

Board members have received training from FTCCS and CD, for most of them have attended classes and seminars, run by FTCCS and CD, for about three weeks. Ongoing workshops, sponsored by FTCCS, offer a continuous cycle of training.

• DU Employees:

There are 4 employees at the district office: 1) an education extension officer (acting manager), 2) a District Bank manager, 3) an accounts clerk, and 4) an office peon. All of them are enthusiastic and energetic young men with "O" level (junior high equivalent) or "A" level (high

⁴ Approximately 55% of members in leadership roles nationwide are teachers. Personal interview with R. Hettiarachchi, General Secretary, FTCCS.

school) educations, supplemented with FTCCS training. In the case of the acting manager, FTCCS originally trained him for a week and supplements this with two additional days every month under the District Secretaries Training Programme. Subjects included principles of cooperation, bookkeeping methods, loan application assessment, investment counselling, education techniques, mutual insurance, and communications. Under his regular job title of education extension officer, a well-rounded knowledge with emphasis on education techniques and communications is essential.

The DU has problems raising the money to pay adequate salaries to these employees, part of a broader problem of overhead shortfall. The senior position of the four, the acting manager, earns only Rs 1000 per month, which is less than his skills are worth in a bank or the public service (approximately Rs. 1400 plus perquisites and virtually lifelong job security). The DU President worries about losing some of these staff members, all of whom have been promised salary increases by the end of 1987.

The position of general manager has been approved and the DU was looking for a suitable candidate. Australia's Community Aid Abroad will pay the salary for at least a year. A second accounts clerk was also planned for the near future. The DU says it needs additional employees, notably field officers to carry out the ambitious education and training programmes (see 8.2.3.), and is counting on FTCCS supplying 12 field officers by the end of 1987, one for each GOSL Assistant Government Agent's division in the district.⁵ FTCCS, with the assistance of the Cooperative Union of Canada and, probably, from USAID, hopes to have trained field officers placed in every A.G.A. division in Sri Lanka sometime late in 1987. FTCCS and its foreign sponsors will pay the training costs and five years of salaries for these field officers, after which the DUs are supposed to take

⁵ A.G.A. divisions: the appointed Assistant Government Agent is GOSL's main local political and administrative authority. He is the real power on a local level, as he has resources to dispense and the authority of the national government to back him up. However, as a political appointee, he is likely to show strong biases in allocation of resources. In the government hierarchy, the A.G.A. lies below the Government Agent (G.A.) for the district, who resides in the district capital, and the village or multi-village level *Grama Sevaka*, who are the bottom level of political authority. Traditional village councils and various quasi-governmental committees at the village level have very little power, or money and little or no legal authority.

over responsibility. The swift and comprehensive implementation of this plan is critical to the entire TCCS movement.

- Overheads.

It was obvious to the researcher that provision of adequate overhead is a problem. DU offices, open five and a half days per week, are barely adequate and necessary equipment is simply not present. The limitations this places on the ability of the DU to serve its burgeoning clientele are and will remain severe until adequate overhead is committed, if not from the DU, then from FTCCS or elsewhere.

The DU maintains a three room office and a meeting room in an old building down a dirt alley from a major commercial road in the heart of Matara town. Although located in the commercial district, the facilities are extremely humble, so much so that the acting manager's desk had to be moved when it rained because of a hole in the roof. Besides the acting manager and accounts clerk in one room, the District Bank occupied another, and the peon and volunteers a third. The meeting room, a sweltering upstairs room over an adjacent shop, cannot hold forty people comfortably. Larger meetings are held at the National Cooperative Council building, about three kilometers away, but even this facility is inadequate for meetings of the general membership, since the L-shaped room separated the attending representatives into two groups who could not see and sometimes not hear each other, though the President (who chaired the meetings) could be seen and heard by all.

The DU does not possess a Roneo machine (mimeograph), unlike the much smaller DUs in Ratnapura and Nuwara Eliya districts who were provided with Roneos by Dutch-sponsored IRDPs. In a pinch, the DU prevailed upon the Matara IRDP for photocopying or mimeograph services, but this privilege did not extend far enough. The District Bank has no safe and must deposit cash daily in the People's Bank. The DU had no telephone until February 1987. The telephone is not all that useful except for quick communications with FTCCS in Colombo. In most cases, calling a member society would entail having someone from the society arrange to be at a sizeable Post Office or other public telephone, usually an impossible arrangement.

More seriously, the DU had no motorized transport. Only one of the four DU employees is a field officer, and he has no mode of transport other than the public bus. It is very unlikely that he can reach more than one society per day in the northern part of the district, which takes between two and four hours one-way from Matará town, depending upon the destination. Therefore, the ability of the DU to physically reach all societies, for whatever purpose, has been severely limited in the past. Sixteen percent of survey respondents, mostly new societies, said that a DU representative had never yet visited them.⁶ This is entirely a function of lack of personnel and motorized transport. Small motorbikes are the most efficient solution, but no money has been available for them.

The DU made a profit for Rs 30,000 in 1986 on the operations of the District Bank.⁷ A profit of Rs 80,750 is anticipated for 1987, but this does not approach the projected DU overhead of Rs 221,900. If external funds are not raised, then the Roneo machine (Rs 35,000), the safe (Rs 35,000), and/or additional staff (total salary bill, including current employees = Rs 115,200) will likely be cut. There is still no budget for motorbikes.

The DU should be charging its members more to help defray expenses. Right now, members pay only Rs 5 to join, Rs 100 for a share, and Rs 20 annually towards operating costs. This might serve to encourage fledgling societies to join the DU, but for large established societies it is miniscule. If nobody else is going to underwrite legitimate costs, then the users must pay. Unfortunately, as explained in the next section, CD blocked a proposed bylaw amendment to do exactly that. An alternative solution would be for the DU to charge member societies according to a sliding scale, depending upon deposits and loans held with the District Bank. This would be more

⁶ Q. How often do officials from the District Union come and visit your society? A. n=115[119], 1) once a month or more often=9 (8%), 2) between once a month and once every three months=25 (22%), 3) between once every three months and once every six months=20 (17%), 4) between once every six months and once a year=32 (28%), 5) less frequently than once a year=10 (9%), 6) so far, no official has visited=19 (16%)

⁷ Any society, large or small, which earns more than Rs 27,500 gross profit in a given year is subject to a 10% tax. Larger operations, such as the District Banks, which pool resources from their members, are thus penalized.

progressive than flat per capita fees. The DU is also a prime candidate for foreign assistance. A very modest amount would purchase several vital items, some of which could be tied to procurement in the donor country (especially if that country is Japan). Without such essentials, the DU cannot operate efficiently and effectively.

9.2. Functions of the District Union

The DU's main tasks are to carry out many of the FTCCS's programmes (see 8.2) and operate the District Bank, whose financial services are described below.

• Monitoring of Primary Societies

The DU is partly responsible for monitoring the primary societies, trying to ensure that they adhere to the spirit and the letter of their bylaws. Auditing of each society is performed annually by CD, though FTCCS has a plan for internal monitoring by the movement itself (though there are no resources for this at the moment). There is some contention between CD and the DU about responsibility for supervision of primary societies. CD has some strong supervisory rights under the Cooperative Law, but these are intended to limit abuses, not to assist in planning and direction. The line between CD and DU spheres of influence is drawn in different places depending upon who formed the society and the sympathies of each TCCS executive committee.

Although the DU sells standard record books to all societies (savings passbooks, cash book, general ledger, deposit ledger, charge ledger, and loan register), the mechanism for the DU to monitor the finances of the primary societies seems weak. The range of recordkeeping abilities is very wide, as revealed by the quality (or lack of it) in the responses to financial questions in the survey (Chapter 11). Also, fully half of survey respondents have not submitted a financial statement to

the DU, while 16% submit monthly statements⁸ This very inconsistency suggests that something is seriously amiss. The DU should maintain some form of financial monitoring, but until the resources are available to do more, it should closely examine the annual CD audit of each society. Bylaw infractions require a clear reporting mechanism which guarantees the anonymity of the complainant, since repercussions in the village and TCCS could be almost as destructive as the original infraction.

At this point in the rapid growth in the number of TCCSs in Matara, there is no way for the DU to monitor finances and bylaw adherence, even if the system for data collection was more systematic than it is. There are not enough DU staff to do so. However, the DU, in consultation with the member societies, should begin to set up minimal reporting mechanisms and insist upon regular compliance.

● Education and Training:

With the rapid increase in the number of TCCSs in the district, education of individual shareholders and training of society officers have become priorities as never before.

Plans for 1987 education and training sessions call for either 45 or 50 sessions in each of the 12 A.G.A. divisions, which should substantially improve the TCCS presence in underrepresented parts of the district, notably the north and west. It should also help address the problem of uneducated new societies formed by CD field officers. However, the DU's monthly work plan has sessions fairly evenly distributed throughout the year, though it is clearly beyond capacity to perform 91 sessions in January, for example, without a sizeable volunteer commitment. Without the field officers promised by FTCCS, there is no way that the DU can perform the stated grand total of 1131 education and training sessions.

⁸ Q: Does your society send in financial statements to the District Union? A: n=111(119), 1) no=55 (50%), 2) once a month=18 (16%), 3) once every three months=5 (5%), 4) once every six months= 6 (5%), 5) yearly=27 (24%).

The increases in the number of programmes indicated in Table 17 may be compared to the increase in the number of registered societies from December 31 1985 (44 TCCSs) to December 31, 1986 (140 TCCCs), a 218% increase in one year. The overall increase in education and training is not that much more and is focussed especially upon membership (critical for new societies) and committee education (most notably including membership and loans committees). These effort should go far to improving the viability of the TCCSs, provided that the quality of the sessions is good, an assumption that has not been tested, even by FTCCS

Table 17
Comparison of Matara Education and Training Programme Projections
FTCCS 1985 vs. Matara DU 1986⁹

Activity	FTCCS Projection	Matara DU Projection	% Increase of Programmes
Member Education	120	560	367
Committee Education	60	392	553
Executive Officer Training	12	36	200
Managers' Training	12	24	100
Womens' and Childrens' Motivation	14	24	71
Human Development Programme	3	4	33
Organization of New TCCSs	40	50	25
Project Preparation	6	12	100
Integrated Development	12	12	0
Others	15	15	0
TOTAL	294	1131	285

• Organization of New TCCSs:

As the table above notes, the DU is involved in forming new societies, even though CD is also doing so at the behest of the National Housing Authority. To its credit, the DU intends to form new TCCSs in areas of the district which are now underrepresented (CD is ostensibly doing it that way as

⁹ FTCCS projections, from P.A. Kiriwandeniya, Development Programme for the Thrift and Credit Cooperative Societies in Sri Lanka (Colombo: FTCCS, 1985), were before the involvement of CD in forming new TCCSs in the district. Matara DU projections, from the DU's unpublished 1987 Education and Project Plan, were formulated in late 1986, when the rate of membership expansion was clear.

well). For example, the DU intends to form 10 societies in the Weligama A.G.A. division in 1987, doubling the number from that area, while not forming any at all in the Dickwella A.G.A. division, which forms part of the present TCCS "heartland" in the district. A total of fifty new societies is targeted, bringing the number organized to over 300 (the newly declared target for the year) even before considering the continued effort of CD, which at present shows no intention of slowing its activities. Of course, given the vigorous competition between the DU and CD, it is hardly surprising that the DU might wish to organize a given village before CD can get to it.

• District Bank

This bank, although not legally a "bank" according to Sri Lankan law (see 8.2.2 on the anticipated National Cooperative Bank), does perform several important financial functions. The most important of them is acting as conduit for external loan funds. The District Bank has an elected loans committee, parallel to that of the individual TCCS. A society, not the individuals in it, applies for loan funds and the application is usually dealt with in less than a week (substantially faster than a commercial bank). Amounts are limited by the surety of 10% of value held in shares and sliding scale in deposits, from nothing (for loans up to Rs 5000) to 20% (for loans of Rs 25,000-35,000). The maximum allowable loan is no more than Rs 300,000, though no loans even approaching that size will be possible for some time. There have been no declared over dues and no defaults, although the bank is quite young and few of its loans have reached maturity.

The largest source of funds emanates from the Million Houses programme of GOSL's National Housing Development Authority (NHDA), part of the Ministry of Housing. The total is anticipated to be Rs. 7 million (C\$350,000) in 1987. This is 2/3 of all moneys the District Bank will see during the year. If the DU has its way, any society wishing to take advantage of external funds, including housing loans, must be a member of the District Bank and hold deposits with the bank as a performance guarantee. This is sound financial policy, but politics may override this intention as the National Housing Development Authority and CD push loan funds towards newer, weaker

TCCSs. There has already been at least one incident of CD field officers seeking to countermand DU actions on housing loans (the incident is described below in 9.3.).

Table 18
Matara TCCS District Bank 1987 Capital Budget¹⁰
(C\$=Rs.20)

<u>Liabilities</u>	<u>Amount in Rupees</u>
National Housing Development Authority	7,000,000
MIRDP Office	1,500,000
Share Capital	215,000
Member Deposits	500,000
Non-member Deposits	200,000
Fixed Deposits	400,000
Commercial Deposits	850,000
TOTAL	10,665,000
<u>Assets</u>	
Housing Loans	7,000,000
Short Term Loans	2,000,000
MIRDP Self-Employment Loans	1,500,000
Instant Loans	165,000
TOTAL	10,665,000

These figures must be taken with several grains or even a whole teaspoon of salt. While a large amount from the National Housing Development Authority may indeed appear (rising from Rs.624,500 in 1986), due to the strong political impetus and support from USAID behind it, it is quite likely that the projected MIRDP commitment may fail to be fully disbursed. For the 1986-87 fiscal year, MIRDP had committed Rs.500,000 to the TCCSs (and a few bit players), but ended up paying out only Rs.299,300 because the GOSL Treasury arbitrarily cut the entire MIRDP budget by 10% in December 1986, well after most other funds had been fully committed.¹¹ There are political reasons, explained below, for MIRDP to keep its commitment low. Share capital may

¹⁰ Matara District Union, 1987 Education and Project Plan (unpublished: Matara DU, 1986).

¹¹ MIRDP Self-Employment Programme funds are grants, not loans. MIRDP prefers to grant funds to selected individual TCCSs, bypassing the DU. The original plan called for the TCCS to retain the money as a rotating fund, completely internal to the TCCS. This contravenes the bylaws of the DU, which states that all external funds flowing to members must pass through the DU. The problem remained unresolved at the conclusion of the field study.

also be overestimated, since the 1986 total was only Rs. 10,050. Presumably, there is still a substantial amount receivable in this category from TCCSs which have already joined the District Bank

The interlending fund is comprised of deposits which the individual TCCSs who raised them could not relend to their own members at prevailing rates or have deposited with the District Bank in order to be eligible to borrow. The money is instead deposited with the District Bank, instead of at a commercial bank as has been the case, and is relent by the District Bank to TCCSs which do not have enough lending resources to meet demand. While the money is thus kept in the district and in the movement, this sort of lending creates yet another pot of gold for weak societies to pursue. However, FTCCS plans to protect these funds against default with its loan protection scheme (see 8.2).

It remains to be seen how much can be mobilized in this way. Represented by the member, non-member, fixed, and commercial deposits, totals for 1986 were Rs. 458,642 in member savings, Rs. 2,260 in non-member savings, Rs. 147,000 in fixed deposits, and nothing at all for commercial deposits. When compared to the 1987 projections in the table above, one is left to wonder why regular member savings are projected to rise by only 9%, while fixed deposits rise by 172% and non-member savings rise by more than 8700%! Since the District Bank will pay 1% more in interest rates than other deposit taking institutions, the DU must be assuming that societies and individuals will voluntarily transfer funds from commercial banks and, further, that the presence of a TCCS right in the villages will unearth "new" savings. The 1987 projection for commercial deposits, an entirely new source of savings, seems completely arbitrary.

Given 1986 figures, the 1987 projections would seem to be grossly optimistic and call into question the managerial expertise of the DU. However, the DU has been given plenty of reason to believe that the explosion of TCCSs and the flood of external funds will bring about the massive increases in the projections. Even the expectation of large infusions from the National Housing Development Authority and MIRDPA would be enough to substantially increase share capital,

member deposits, and fixed deposits substantially, should access to external funds be firmly tied to District Bank membership and loan ceilings attached to amount of deposits at the District Bank. The DU may have difficulty with this, given the predilection of both NHDA and MIRDPA to channel funds directly to individual TCCSs or, if funds must go through the DU, without DU strings attached. Non-member and commercial deposits remain unexplained.

● Other DU Functions:

The DU is also mandated to carry out some of the programmes sponsored by FTCCS and described in the previous chapter. Education and training and organization of new societies have already been mentioned. Others are the Change Agents Programme, the Human Development Programme, the Activation and Motivation of Women and Children, the Integrated Development Approach, and the Programme for Project Identification, Preparation, and Evaluation

9.3. Liaison and Political Matters

The TCCSs of Matara were and are undergoing a tremendous expansion. This expansion is both in the number of societies and in the resources now or soon to be channelled through them. In April 1986 the district had 68 TCCSs. By December 31 there were 140 registered with CD (though only 92 were DU members at the time, almost all were expected to join shortly) and up to 120 more awaiting registration. Far from being an indicator of the strength of the TCCS movement in Matara, it is very alarming that the number of societies should grow so rapidly with so few resources for educating the membership and training the officers.

The reason for the explosion is partly due to the ambitions of FTCCS and the Matara DU, but mostly because of the efforts of CD on behalf of GOSS's Million Houses Scheme. Since April 1986, CD field officers have been paid Rs.60 (C\$3) for each of four visits to a village to form a new TCCS. This mandate, coming from the National Housing Development Authority, and ultimately from the Prime

Minister's office, has resulted in more "instant societies" than established ones. Four visits may be enough to inform potential members about the benefits of TCCSs and nudge them towards actually forming one. It is not enough to educate them and train volunteer officers in the operational aspects of running a TCCS.

A conflict of unknown depth is currently bubbling between the DU and CD. This stems from the CD's new mandate to form societies for housing loans coupled with their supervisory role in unlimited liability TCCSs. The problem is mostly manifest in the CD attempt to retain some control over the TCCSs it forms. While no solid evidence exists, a DU general meeting provided some revealing insights. Some CD field officers had been elected by TCCSs in their own villages to be member representatives at the meeting. Attendance at the meeting was approximately 95, 6 of whom were CD officers, one in an official supervisory role and the others as society representatives.¹² The main issue was a proposed bylaw amendment which would allow the DU to levy a Rs 1 fee for each individual member belonging to member societies in order to contribute to DU overhead. CD officers and their clique lined up against the motion. More than a quarter of all those present had a say, including the General Secretary of FTCCS, who had driven from Colombo to speak in favor of the motion. All DU Board members present spoke in favor. Although a speaker's list was kept, two CD officers kept popping up out of turn to rebut some statement or other. The eventual vote was 77 in favor and 15 opposed, but the motion failed because DU bylaws require that 75% of the total membership (not just those societies represented at the the meeting) must approve a bylaw amendment. Since membership at the time was 110 societies, CD had succeeded in scuttling the motion by six votes. It is unknown how the societies inducted into the DU since that meeting would vote, since many of them would have been formed by CD, but the DU executive seemed confident that the motion would carry when reintroduced at the next general meeting, planned for two and half months later.

¹² Fewer than one in four, and none of the CD officers, were women. Women did, however, speak in proportion to their numbers.

Out in the villages, the DU is wrestling with CD for effective control of new societies. A 1986 incident illustrates this well: In one society, the loan committee members took all the loan funds available for themselves and did not repay upon request of the DU.¹³ Subsequently, the DU blocked housing loan funds which the society was expecting. The society appealed to their local CD officer, who moved in and approved the housing funds. Deadlocked, the dispute went to arbitration with the Registrar of Cooperatives at CD. The Registrar's judgement was pending when this researcher left Sri Lanka. The point here is that the CD field officer deliberately prevented the DU from rectifying an unacceptable situation which affects the credibility of all TCCSs. CD can use the numerical superiority of its field staff and the supervisory powers given by the Cooperative Law against the one or two paid employees and occasional volunteers of the DU. Fortunately for the DU, CD field officers are not noted for their diligence and persistence and the battle may not be as one sided as it could be. Once the FTCCS field officers are in place, the DU should gain a firm upper hand.

The underlying reason for most of the contention is political. All seven of Matara's M.P.s are members of the governing United National Party, a conservative free-market party. Since housing loans are a major form of patronage, they would no doubt like to exercise some influence in just who receives these loans.¹⁴

Enter Mr. Dahamsiri, President of the Matara DU and Communist Party member from Babaranda. Dahamsiri may or may not be performing his volunteer position for reasons of cooperative altruism (he is also Southern Province representative to the FTCCS), but there can be no doubt about the potential of the TCCSs as a mobilizing vehicle for political ends. Although there is no overt evidence of any such impropriety, it is very difficult to know the depth of political intrigue in this case. For example, it is not known how many other DU Board members are Communist Party members, though Dahamsiri has at least one comrade there. The relative unity of the Board—

¹³ This society did not answer the survey question about loans to committee members.

¹⁴ Interference from M.P.s is not at all unusual in Sri Lanka. It has long been the case that anything from a bus conductor's job on the state-owned bus line to location of irrigation works and award of government tenders has involved lobbying the local MP, since the MP has considerable formal and informal leverage at all levels of government.

and results of the vote on the special levy suggest that Dahamsiri is not under any threat of losing his office. According to the MIRDP Project Director, he is not the most conciliatory person to hold the President's post. Indeed, he is resented by some for his combative style, though this was not in evidence at the meetings attended by the researcher. It should be stressed that there have been no open accusations against Dahamsiri and certainly no suggestion that the DU is a Communist front organization. Dahamsiri is a tireless worker and, Communist or not, does not draw criticism from FTCCS.

Political considerations do have a bearing on DU performance and operations. The urgency to defend the DU against CD encroachment might be blamed on it, especially when compared to the DUs in neighboring Ratnapura and Nuwara Eliya districts, which have relatively constructive relations with CD. Efforts expended by the Matara DU in its battle with CD could otherwise be used more constructively.

The Matara IRDP, which has been running Self-Employment Programme funds through the DU has problems also. Not wishing to annoy the MPs, the MIRDP Project Director (a supporter of the opposition Sri Lanka Freedom Party) wants to tread lightly. This may well be necessary in light of an attempt by MPs in Ratnapura District to gain power of approval over all programmes of the Ratnapura IRDP (for reasons unknown). The Matara IRDP refuses to cover any DU overhead, unlike the IRDPs in both Ratnapura and Nuwara Eliya, though it has received a formal application for assistance from the DU. It also has attempted to keep its Self-Employment funds moving directly to recipient TCCSs, thus sidestepping the DU in contravention of DU bylaws.

It seems that the DU is not under a serious threat at the moment, but the potential for the low-level conflict with CD to widen cannot be discounted. Should local MPs become directly involved the DU may have to replace Mr. Dahamsiri and his sympathizers on the Board with persons acceptable to the MPs. This would parallel the political interference which precipitated the decline of the Multi-Purpose Cooperative Societies three decades ago.

9.4. Conclusions

The Matara DU is the vital level of the TCCS movement in the district, especially now that so many new primary societies require training and education and so many programmes of external assistance, in place or in the offing, need to be managed. The DU's capacity to perform these tasks must be improved.

At present, the rate of growth of membership is out of control. Four employees without a Roneo machine or motorbikes cannot serve the booming demand for services. Overheads need more funding. The DU estimates a need of Rs.221,900 (C\$11,095) for 1987, but does not have the money itself. This lack of field capacity is reflected in the response of survey respondents on questions concerning education, training, and other contacts with the DU. The anticipated arrival of up to 12 field officers cannot come soon enough.

Housing loans from the National Housing Development Authority, Self-Employment Programme funds from the Matara IRDP, and possible future funds from other sources will all tax the managerial ability of the DU. It is important that the performance of the DU be monitored, probably by FTCCS, to be sure that the funds are distributed judiciously and fairly. Increasing quantities of external funds could lead to the failure of some of the primary societies should the DU fail to distribute the funds to capable societies. Yet, the compulsion to choose strong societies to receive these funds could lead to the truly needy societies not receiving a fair share.

One real test of the DU is in member satisfaction with DU performance. The survey asked the TCCSs for a subjective evaluation of DU performance and only two of them thought the DU was doing poorly.¹⁵ However, it is not realistic to expect many disaffected societies to admit as much when the survey was co-sponsored by the DU and those dissenters have no guarantee of anonymity. One society which had made its dissatisfaction known to the MIRDP Project Director did not say so

¹⁵ Q: How well do you think the DU is operating at this time? A: n=113(119). 1) very well=35 (31%), 2) adequately=76 (67%), 3) poorly=2 (2%).

In its response to the question: One of the two which did claim poor DU performance was the Matará town TCCS, by far the largest society in the district. The nature of its complaints remain unknown. Regardless, it is difficult to blame the DU for its problems, given the lack of money and personnel and the obstruction of CD. It is to be expected that DU services will improve once the growth of its membership stabilizes and more resources are committed to carrying out planned programmes.

The future of the Matará DU will be decided partly by the member societies, who will provide the policy direction and demand for services, partly by the FTCCS, who will supply field personnel and continued training for officers and managers, partly by GOSL, who can interfere or assist through CD, and, possibly, partly by a foreign donor, who could help with overhead and programming. The best guess from the researcher's perspective is that the DU will slowly gain control over the exploding number of societies in the district via the FTCCS-supplied field officers and begin to offer improved services, especially through the District Bank. As long as political tensions do not boil over, the DU should be able to fulfil adequately most of its declared functions within two years.

At this point in the evolution of the Matará TCCSs, the DU is the critical level of the three tiers of the movement. The linkage between the DU and the member societies, especially the new and weak TCCSs, is the most stressed and yet most vital to the future success of the movement in Matará District. DU services, especially education, training, monitoring, and dispensation of external funds, must be delivered according to rigorous standards, even though the resources to do so are not presently adequate. If assistance is to be granted from external sources, personnel and overhead are the best contributions, not additional loan funds. FTCCS should key its efforts on the DUs of districts like Matará which are experiencing explosive growth in membership. Failure of weak new TCCSs and increasing interference from government at the village level are the greatest threats facing the TCCSs. A strong, efficient DU is the best defence.

CHAPTER TEN

THE PRIMARY THRIFT AND CREDIT COOPERATIVE SOCIETIES (TCCSs) OF MATARA DISTRICT

The real crux of this thesis is upon the village-level TCCSs in Matara district. These are the institutions which the focus group, it is hoped, will approach for credit and savings facilities. No matter how well other organizations outside the village function, be they DU, FTCCS, banks, CD, other GOSL departments, or foreign agencies, if the village-level institution does not function well, the poor will not be served.

The TCCSs have a gilded reputation, burnished at every opportunity by FTCCS, for maintaining excellent performance standards in their credit and savings operations. The reasons for these high standards seem to flow from the structural and operational characteristics of the primary societies. One of the many TCCS cheerleaders offers a succinct list. To quote:

- [1] Membership consists of a closely knit group of individuals who are above the age of 18, permanently resident in the area and of good character;
- [2] loans are only given to members who satisfy minimum membership requirements;
- [3] societies operate on a self-sustaining basis using profits from the interest margin plus interest accrued on deposits with the commercial banks;
- [4] the size of loans advanced to members are determined on the basis of shareholding and/or deposits;
- [5] societies advance loans for productive and consumptive purposes so matching the members requirements;
- [6] loans to individuals are approved by a General Body comprising members of the society;
- [7] security is generally joint and several guarantee of two other members of the society;
- [8] lending criteria match the nature of the undertaking;
- [9] loans are normally restricted to activities for which there is adequate local demand;

[10] loans are supervised and monitored by society officials, based close to the borrower.¹

The aforementioned survey² and a series of visits to individual TCCSs were made in order to determine whether these characteristics were an idealized picture or applied generally to virtually all TCCSs. Efforts were made to probe their savings and credit procedures, their membership and leadership composition, education and training, their range of activities and potential activities, and their financial health. The overall picture which emerges gives a broad brushstroke of the primary societies, revealing several glaring weaknesses. The raw data also permits placement of individual societies within the general profile, so that some societies emerge again and again, based on different criteria, as strong and progressive. In contrast, a large number of newer TCCSs are revealed as barely functioning and weak; these deserve prompt attention from the DU and FTCCS. This degree of detail, more useful on an operational level, shall not be included in the text.

10.1. Bylaws and Organization of Primary Societies

The real strength of the TCCSs lies in the local control of each society. FTCCS offers a set of model bylaws which leaves several decisions, such as credit limits, up to the individual society. It seems that the blend of guidelines from FTCCS with flexibility for the TCCS and external auditing by CD provides a very workable institutional framework.

Operations are simple and open. Applications for loans are discussed in committee and reviewed before the entire membership at monthly meetings. The books may be examined by members.

¹ IFAD, Small Farmer Credit, Annex 2, p. 19.

² Interpretations of data from the survey responses shall be footnoted with the question ("Q:") and responses or answers ("A:"). The latter may appear in a number of relevant forms, depending upon the level of data and the most meaningful derivatives from it. Since the number of respondents is so important yet non-random, the number of respondents ("n=") is always given, followed in square brackets ("[]") by the number of potential responses. This number varies, usually between 52 (long questionnaire only), to 67 (short questionnaire only), to 119 (both).

Election of officers is done by democratic procedures. However, as will become clear below, where bylaws may be strong, operations are often weak and in need of improvement

• Limited vs. Unlimited Liability

There are two types of primary TCCSs, each with a separate set of model bylaws. By far the most common type is the "unlimited liability" society, in which all the members are personally responsible for all the liabilities of the TCCS, much like an unincorporated proprietorship in the Canadian legal system. According to Mr. Kiriwandeniya, President of FTCCS, this is the preferred type because the wealthy will not be attracted to a society since all their assets, not just their shares and deposits, would be at risk. Since the wealthy usually dominate institutions in which they become involved and then tend to direct benefits to themselves, this disincentive should be quite useful, but since default levels are very low and failure of an entire society unheard of in at least a decade, the wealthy may safely become involved in their local TCCS. Unlimited liability also forces the TCCS to be very responsible in its assumption of liabilities, since a major series of defaults could seriously damage many poorer members. The new loan insurance scheme offered by FTCCS should eliminate risk of personal losses due to the default of a fellow member.

Any profits generated by an unlimited liability society are retained in the society's own capital pool, thus strengthening the TCCS as a whole. This is a consequence of the Cooperative Law, which states: "In the case of a society with unlimited liability, no distribution of profits shall be made without the general or special order of the Registrar [of Cooperatives, CD]."³ Even if such an order were desired it would be difficult to obtain in Sri Lanka's bureaucratic morass. This regulation conveniently provides yet another disincentive for the wealthy, who would prefer to invest in enterprises which pay dividends.

The "limited liability" society, on the other hand, is much like a Canadian corporation and probably more to the liking of wealthier people. Only the shares and deposits of members are at

³ GOSL, Cooperative Law, Section 43(3).

risk and there are numerous channels for disposal of profits.⁴ External agencies have urged unlimited liability TCCSs to convert to limited liability, as they feel that involvement of wealthier villagers and mobilization of their savings in the TCCS is important for building the pool of lending funds.⁵

In Matara district, 119 of 141 societies are unlimited liability, including all the new ones. The 22 limited liability societies were all registered between 1918 and 1985 and include some of the strongest TCCSs in the district, including the home societies of the DU President and Vice President. They also include all of the institutional TCCSs such as the Base Hospital, the Teacher's College, and the Methodist Church, all in Matara town. There are 18 such societies, called "institute servant's societies"

It seems worthwhile for new societies to begin with unlimited liability so that the ordinary villagers can consolidate democratic control of the society without being led from the start by self-interested wealthy villagers. Should a mature society wish to undertake large cooperative ventures with a greater element of risk, then conversion to limited liability would be recommended.

• Admission Fees.

One of the criticisms made of the TCCSs is that the very poor may not be able to afford the Rs. 100 share which entitles them to apply for loans.⁶ If a household income is truly marginal, as is the case for a significant proportion of the rural poor, then Rs. 100 is a considerable sum. Add to that any savings deposit requirements and a serious obstacle to access is created (as above).

In an effort to make membership easier for the poor, many societies set an admission fee in lieu of outright purchase of a Rs. 100 share. A new person may buy a share incrementally, usually

⁴ Ibid., Section 43(2).

⁵ IFAD, Small Farmer Credit, Annex 2, p. 49.

⁶ Of all survey respondents, only two societies did not have Rs. 100 shares. One of them had shares priced at Rs. 80 and the other at Rs. 120.

starting with Rs. 5.⁷ To become eligible for loans, the prospective member must pay increments on schedule, up to the total Rs. 100. There was some confusion about what privileges this entitles the prospective member to. While the Cooperative Law specifies that no loan may be made to a non-member and that no person who has not paid his/her fees may vote, some TCCSs gave the impression that they allow loans to be made to someone who has not yet paid the full Rs. 100.⁸ However, FTCCS and most primary societies, in strict compliance with the law, demand full payment for the share beforehand. It seems that the main benefit of the admission fee is simply to help the prospective member commit the regular increments and acquire the share while establishing a sort of credit rating by proving that regular payments can be made.

• Types of Loans and Credit Ceilings.

There is some latitude in the model bylaws for individual societies to determine credit ceilings for different types of loans, allowing them to set their own priorities. Coastal villages may have a higher ceiling for fishing loans than land improvement loans and may not offer paddy loans at all (almost nothing edible or commercial except coconuts will grow on the shore and saline lands behind it). Newer societies, with smaller capital accumulation for lending, can set low ceilings and later increase them by amendment. This allows limited resources to be spread more widely than would otherwise be the case. It also discourages wealthy villagers from attempting to corner all available loan funds for themselves.

Many societies adjust an individual's credit limit from year to year based on a grading system of marks. A certain number of marks are given for regular savings deposits, for prompt repayment of loans according to schedule, and for minor demonstrations of good membership such as attendance at meetings and performance of voluntary duties. The annual accumulation of marks determines the individual's loan limit for the following year, within the overall credit ceilings

⁷ Q: Does the society have an "admission fee" for persons unable to afford Rs. 100 all at once? Yes ____ No ____ If so, how much is the fee? Rs. ____? A: n=41[42], yes=22, no=19, amount mode=Rs. 5, min.=Rs. 1, max.=Rs. 25, mean=Rs. 7.7. Note: the Sinhala term for "admission fee" was specifically requested of the DU to avoid confusion.

⁸ GOSL, Cooperative Law, Sections 39(1) and 11(1).

established in the bylaws. The borrower must still convince the loans committee that the intended use of a loan is worthy, though observation reveals that many consumption loans are made.

• Borrowing Restrictions

Another pair of bylaw variables are the proportion of a loan which must be held by the borrower in shares and savings deposits. There seem to be two trends in the share requirement; either one share (Rs.100) or 10% of the loan amount.⁹ If one share is 10% of a loan, then the maximum would be Rs.1000, not unreasonable for the limited funds of many societies. Since money invested in shares does not bear interest, the percentage restriction would require the borrower to lock-up more and more as the loans get larger, a way of discouraging large loan requests, and thus keeping available funds widely distributed.

A parallel requirement for a proportion of the loan amount to be held in savings is more open variation. While the mode is again 10%, many societies require more.¹⁰

The higher the combined total of these two proportions, the more restricted will be the access of the poor to adequate amounts of credit. There is already some difficulty for the very poor to come up with Rs.100 to purchase a share. Additional requirements only obstruct them. Taking the most common situation as an example, if 10% must be held in shares and another 10% in savings, the poor borrower must have Rs.200 (C\$10) in order to borrow Rs.1000, a very humble loan. Of course, there are sound financial reasons for these restrictions, such as the encouragement of share purchase and savings deposits, or matching loan amounts to ability to repay as measured in liquid assets. Nonetheless, the focus group would benefit more and ultimately increase its savings deposits, if they were simply assigned borrowing limits without the share/savings restrictions.

⁹ Q: What proportion of a loan must a borrower have in shares? ____%. A: n=62[119], mean=15.4%, min.=5%, max.=75%, mode=10%. Many responses were given as "1", probably meaning one share required, or "100", perhaps meaning Rs.100 (one share). These were all deleted.

¹⁰ Q: What proportion of a loan must [a borrower] have in savings deposits? ____%. A: n=96[119], mean=21.6%, min.=0%, max.=60%, mode=10%. Again, one hundred percent is a likely response error and has been deleted. However the response "0" is very interesting, suggesting no savings required, a bears further investigation by the DU.

A more financially sound alternative, which would retain the discipline of the share and savings restrictions on loan amounts, would be to allow the poor to purchase group shares and hold group savings deposits, permitting the group to take a loan and be severally liable for it. The group of poor could function according to the Grameen Bank model, wherein satisfactory performance by the first individual borrower in the group would entitle the second to a loan, and so forth.¹¹ This would create access to loans for the poor while protecting the TCCS

- Types of Savings Accounts and Interest Paid: (see 11.1)

All TCCSs offer a standard interest bearing savings account and most of them allow non-members to have accounts. However, the rate of interest paid on such deposits, and on other types of savings deposits which may be offered (fixed term, children's), varies according to the bylaws of the individual society. The interest rate(s) must be set so as to be attractive compared with interest paid by other nearby institutions and it must allow an adequate "spread" between what is paid out on savings and taken in on loans.

- Other Bylaw Options:

The individual TCCS has a few other options it can exercise within the bylaw structure, such as the number of members of its executive committee, but these have less bearing on the operations of the society.¹²

10.2. TCCSs in the Village: Descriptive Overview

How are the 141 TCCSs registered in Matara on December 31, 1986 distributed in the district? What is the economic base of the villages in which they operate? How much participation within the village do the societies have?

¹¹ Muhammad Yunus, Grameen Bank.

¹² Q: How many people sit on the executive committee? _____. A: n=110(119), mode (75%)=7 members, min.=3, max.=17. FTCCS insists that the number should be seven.

• Growth of the Number of TCCSs in Matara:

Table 19 shows the slow pace of development of the TCCSs up until 1986, at which point the number of registered societies more than doubled. This growth is partly because of FTCCS/DU development efforts and partly because of CD organizing TCCSs for housing loans. Back in early 1985, FTCCS estimated that Matara would see 30 new societies in 1985 and another 30 in 1986.¹³ The TCCSs own mobilization effort may have organized that many but failed to register even a third of the 1985 target due to CD delays. Of societies registered before April 1986, over half reported that they were operational before being registered.¹⁴ Despite the initiative shown by CD since April 1986, there were still a reported 120 organized but unregistered societies in Matara as of December 31, 1986.¹⁵

Table 19
Year of Registration of Matara TCCSs¹⁶

<u>Year</u>	<u>Number of Societies</u>	<u>Year</u>	<u>Number of Societies</u>
1918	1	1963	1
1931	1	1970	1
1934	2	1971	1
1938	2	1973	1
1939	1	1982	4
1950	1	1983	10
1955	1	1984	5
1956	1	1985	9
1956	1	1986	73
1957	1	TOTAL	117

• Household Participation in the TCCSs:

When a TCCS becomes established in a village, how many of the villagers become members or use the services of the society? Since physical accessibility is one of the strongest merits of the TCCS,

¹³ P.A. Kiriwandeniya, Development Programme, p.50.

¹⁴ Q1: What year did your Society begin operations? Q2: In what year was the Society registered? A (difference): n=37[52]. One year before registration = 15, two years = 4, three years = 1.

¹⁵ Personal communication with DU President Dahamsiri, January 8, 1987.

¹⁶ From Q2, in footnote 14. n=118. Mode=1986 with 64.5% of DU members registered in that year.

and since there is apparently a high demand for financial services in the villages, one would expect the ratio of shareholders to households and savings accounts to households to be high. There are no benchmarks, such as commercial bank depositors and borrowers, to gauge participation comparatively.

It must also be remembered that there are important influences which bear on participation or lack of it. For example, if a village is politically divided and the TCCS is seen to associate with a particular faction or party alignment, then the society may be boycotted by the other party or factions; although the village may have 400 households, perhaps 175 of them will not join the TCCS for political reasons alone. Economics certainly plays a strong role, too. If the village has a large proportion of very poor households, they may not be able to afford to buy a share in the TCCS. Finally, there may be internal pressures in the TCCS preventing people from joining. For example, if a new TCCS is formed primarily to get concessional housing loans, the individuals who have formed the society may wish to confine the loans to themselves and deliberately exclude others who may compete with them. The reader is reminded that these possibilities are speculative and that no specific examples of any of these behaviours can be cited.

The number of shareholders relative to number of households yields a rough approximation of village participation in the TCCS. There is no way to tell from the data whether a single household has more than one TCCS member. While the almost even split in membership between men and women might suggest that men and women from the same household hold individual shares, there is an advantage to keeping an amalgamated household budget (one member per household). By not purchasing the second share, the member household keeps Rs. 100 in a liquid, interest-bearing savings account and not in a share which cannot be redeemed for cash for at least a year and does not bear interest.¹⁷ Most poor households will realize this benefit and take advantage of it.

¹⁷ The Cooperative Law states that a member cannot transfer shares or interest on capital for at least a year and the transfer must be "made to the society, or to a member of the society, or to a person whose application for membership has been accepted by the committee." Section 17(2).

However, if spouses have totally different and independent loan requirements, or are simply estranged, they may hold separate shares.

Overall, the average village had 421 households and 79 paid-up shareholders in the TCCS.¹⁸ Thus a hypothetical "average village" would have one share per 5.3 households for a participation rate of 18.8%. When the TCCSs are divided into those more than eight months old ("established" or "older" societies) and those less than eight months old ("newer" societies), sharp differences become clear. Older societies were in villages averaging 361 households with 99 shareholders, or one shareholder per 3.6 households for a participation rate of 27.4%.¹⁹ Villages with newer societies averaged 492 households and 56 shareholders, or one shareholder per 8.8 households for a participation rate of 11.4%.²⁰ As expected, the number of shareholders increases over time, though the rate of increase cannot be determined from the data.

The number of savings accounts relative to the number of households might also indicate participation. Since savings are the foundation of the TCCS, and since savings are required in order to borrow, one could fairly expect every TCCS member to have an account, but non-members may also hold savings accounts. Again, the question arises about whether a single household might have more than one savings account. This is more likely than two or more shares since the function of a savings account is quite different. For example, some of the poor live in divided households where a female income earner is trying to protect her meagre savings or even her household expense money from a spendthrift husband. In such cases, separate savings accounts would be beneficial.

¹⁸ Responses to both the following questions are limited to those societies which answered both. Q: How many households are there in the village or villages (served by the TCCS)? ____ A: n=101[119], mean=421, min.=48, max.=1500. Some responses were quite precise, while others were obviously crude approximations. Also, deciding where village boundaries are and what constitutes a separate household is not at all easy to differentiate. Q: How many fully paid-up (share-owning) members does [the society] now have? ____ A: n=101[119], mean=79, min.=5, max.=265.

¹⁹ Only societies which answered both questions in the above footnote are included. A: Households... n=55[63], mean=361, min.=72, max.=1200. Shareholders... n=55[63], mean=99, min.=39, max.=265.

²⁰ Only societies which answered both questions in footnote 18 are included. A: Households... n=46[56], mean=492, min.=48, max.=1500. Shareholders... n=46[56], mean=56, min.=4, max.=175.

Our hypothetical "average village" had 448 households and 76 standard savings accounts, or one account for every 5.9 households yielding a participation rate of 17%.²¹ Again, it is illustrative to differentiate between older and newer societies. Villages with older ones averaged 394 households and 101 standard savings accounts, or one account per 3.9 households for a 25.6% participation rate.²² Newer societies with 48 accounts were located in villages averaging 507 households, or one account per 10.6 households for a 9.5% participation rate.²³

Overall, savings accounts trail slightly behind shareholders, especially if non-members are opening savings accounts, indicating that purchase of a share is the first priority. Another unexplained phenomenon which appears is the larger size of villages with newer societies.

Finally, we can compare shareholders to savings accounts to close this three-cornered measure of participation. By dividing the number of savings accounts into the number of shareholders, we can get the number of shareholders per savings account, an indicator of relative maturity of the society, inasmuch as a mature society would probably have more accounts than shareholders (due to non-member accounts), yielding a ratio of unity or lower. New societies, particularly those composed of poorer members, may well have many more shareholders than savings accounts for reasons elaborated above. The average over all societies was 1.5 shareholders per savings account, with older societies offering a 1.1 mean ratio and newer ones a 2.0 mean, approximately conforming to expectations.²⁴ Oddly, the lowest ratio, 0.2, was from a new society, as was the highest (as expected), at 12.2.

²¹ Figures are limited to those respondents which answered both questions. See footnote 18 for the question on household numbers. Q: What is the total number of standard savings accounts in the society?
A: n=88[119], mean=76, min.=4, max.=280.

²² Only societies which answered both questions are included. A: Households... n=46[63], mean=394, min.=90, max.=280. Standard savings accounts... n=46[63], mean=101, min.=25, max.=280.

²³ Only societies which answered both questions are included. A: Households... n=42[56], mean=507, min.=48, max.=1500. Standard savings accounts... n=42[56], mean=48, min.=4, max.=188.

²⁴ Overall ratio of shareholders / savings accounts... n=95[119], mean=1.5, min.=0.2, max.=12.2. Older societies... n=45[63], mean=1.1, min.=0.5, max.=3.4. Newer societies... n=40[56], mean=2.0, min.=0.2, max.=12.2. When the relationship between shareholders and savings accounts is checked by running a simple regression, the overall correlation is .847 ($r^2 = .718$), the older societies correlate at .692 ($r^2 = .479$) and the newer societies offer a Pearson's r of .831 ($r^2 = .691$).

Membership seems to grow slowly but steadily, with the average society more than doubling in size between registration and the present, regardless of age. In a mature society, membership reaches a plateau, beyond which membership growth is slow. Only 2% of societies anticipated a steady number of members, while 72% thought their TCCSs would grow slowly, and 26% expected rapid increase in numbers.²⁵

● Physical Distribution of Primary Societies

Analysis of the distribution of TCCSs on a map of the district shows a heavy concentration of older, stronger societies within a few kilometres of the coast east of Matara town, especially between Dondra and Dickwella. From this "heartland" the older societies thin out rapidly to the west and north. To the north this is not surprising, as population density and economic activity are more dispersed. But it is notable that the coastal belt west of Matara town, which is very densely populated, has only been developed recently. Although societies have been registered over wide areas of the district since April 1, 1986, vastly improving the penetration of the movement into the hinterland, several significant areas remain relatively untouched by TCCSs.

There are several "urban" TCCSs, notably in Matara, Dondra, and Akuressa. Some of these are the limited liability "institute servants' societies" mentioned earlier, including Base Hospital (employees), the Methodist Church, and the Teacher's College, all in Matara.²⁶ Akuressa City Bank is not a "bank" proper, but a civic employees' TCCS.

Another feature revealed in the area distribution is the lack of TCCSs in towns identified as Muslim ("Moor") and in tea estates of the far north, which are mostly Hindu (Tamil). The Matara TCCSs tend to be ethnically Sinhalese and, where religion has a bearing, Buddhist. The Christian

²⁵ Q: How do you feel about your Society's ability to expand its membership over the next five years? A: n=118(119). Very rapidly = 31, slowly but steadily = 85, remain around present size = 2, decrease in membership = 0.

²⁶ Although the Teacher's College TCCS did not respond to the questionnaire, its existence is significant in that FTCCS estimates that 55% of TCCSs nationwide have teachers in leadership roles. In the Matara DU, several board members, including the President and Vice-President, are teachers.

population of the district is very small and it is notable that the Methodist Church, a tiny fragment of the Christian community (which is overwhelmingly Roman Catholic) has its own TCCS.

One of the reasons for promoting village institutions is the inaccessibility of banks. While this may be true in less densely populated parts of the district and the island, it does not hold for the southern part of Matara. The mean distance to a bank is 2.1 km., less in the south and more in the north.²⁷ Furthermore, almost half the survey respondents said many people from their village used the bank.²⁸ It would be worthwhile to know who used the bank for what, compared with who used the TCCS, but there was no opportunity to pursue this question.

• Economic Activities in TCCS Villages:

The "long" survey questionnaire sought to paint a portrait of important economic activities in TCCS villages. This might give a broad idea about priority for loan types in a village. Respondents were asked to rank 8 activities, with a ninth ("other") category left open.²⁹ The results are summarized below in order of the mean (interactivity) rank of each activity, which is its average ranking in all villages where it occurs. The modal (intra-activity) rank indicates the most common position of the activity in villages where it occurs. The number of occurrences, "n", indicates the overall importance of the activity in the entire group of 52 TCCSs which completed the long questionnaire. Fishing, for example, was selected in only 15 cases, limited as it is to coastal villages, but in those villages its modal rank is 1, meaning that in villages where fishing takes place at all, its most common priority is first (7 cases). If all 15 villages' rankings are averaged the mean is 3.4; the difference between mean and mode indicates that in the other 8 cases, fishing is not very important at all, relative to other activities. One would expect, therefore, that

²⁷ Q: How many kilometers away is the nearest bank? ____ km. A: n=48(52), mean=2.1 km., min.=0.12 km., max.=20.0 km. Responses are from established TCCSs, most of which are in the south, biasing the overall mean downwards from the true figure for all TCCSs in the district.

²⁸ Q: How many people from your area use this bank? A: n=51(52). Few = 14(27.5%), some = 14(27.5%), many = 23(45%).

²⁹ Q: Please RANK the following economic activities in the order of their importance in your area (most important is number 1): paddy____, tea____, coconut____, rubber____, home gardens____, fishing____, cottage industry____, trading____, other____. A: see Table 20 in text.

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fishing loans would be very important in the former 7 cases, but not prioritized in the latter 8

This is confirmed from the raw data on lending, which reveals that 5 of the 7 made fishing loans

Table 20
Importance of Different Economic Activities in TCCS Villages

<u>Activity</u>	<u>n</u>	<u>Mean Rank</u>	<u>Modal Rank</u>
Paddy	43	1.8	1
Coconut	46	2.6	2
Tea	15	2.7	1
Fishing	15	3.4	1
Home Gardens	33	3.8	3
Cottage Industry	42	4.0	3
Trading	46	4.2	4
Rubber	22	4.5	6
Other	15	4.9	5

What emerges, overall, more than the dominance of paddy cultivation, is the heterogenous nature of economic activity in Matara. Non-agricultural activities (cottage industry and trading) are not high priorities but are present in a large majority of villages. Further, the number of villages involved in various activities reflects the geographical distribution of TCCSs in the district. There are 46 out of 52 respondents reporting coconut, which is not a highland crop as tea is, with only 15 villages reporting. As mentioned, there are many more TCCSs in the dense coastal belt than in the hills. Perhaps a bit surprising is the low priority assigned to rubber, a common smallholder crop in Matara and virtually the only plantation crop whose price is rising in international markets. Especially when compared to the precipitous fall in tea prices over the last couple of years, one would expect rubber to be more important.

10.3 Operational Aspects of Primary Societies

One of the most important features of the TCCSs and reasons for their success is their physical presence in the village, staffing by resident villagers, and overall village control of the affairs of

the society. More mature societies have become "institutionalized" in their villages with their own storefront operations, while newer societies must often operate informally.

• Physical Facilities and Operations:

TCCSs usually start off operating out of a private home.³⁰ This is convenient in that someone, often an adult woman of the household, is present at the house most of the day. It is easy for fellow villagers to drop by and conduct business without posting formal hours for opening and closing.³¹ Public places, especially temples, are often used as a place of business. The temple is usually the largest facility in a village and may have a spare room which can be used for a TCCS facility. In many villages, the local priest is actively involved in the TCCS, often in a leadership role.

The days and hours of operation vary considerably. While 18% report being open only 1 day, 25% say they are open 7 days per week.³² Thirteen out of 19 TCCSs open 7 days a week were run out of private homes (with 4 in public buildings, and 2 in permanent offices). Overall, society "offices" were open an average of 22.6 hours per week, which should be enough.³³ All but five responding TCCSs said that some of the hours were at times when people's daily work was done.³⁴

The most obvious sign of institutionalization is a "village bank" with its own permanent facilities and a paid manager. The DU claims that 12 mature societies have upgraded their facilities to become village banks, though they are not legally "banks." What this means is that during regular hours of operation, often in a society-owned facility with a signboard and wicket, a bank manager

³⁰ Q. Where does the society conduct its business? A: n=118[119], 1) private home= 56(47%), 2) private business= 1(1%), 3) public place= 48 (41%), 4) society's own office= 13(11%).

³¹ Although Sri Lankan Muslims are not as orthodox as Muslims elsewhere, informal arrangements such as this cannot involve a woman receiving male customers, especially if the males of her household are not present. Buddhists and Hindus do not share this restriction. Muslim communities, all of which, in Matara, are located in the coastal belt, have not formed many TCCSs.

³² Q. How many days a week is the office open? A. n=76[119], 1) 1 day= 14(18%), 2) 2 days= 8(11%), 3) 3 days= 17(22%), 4) 4 days= 2(2%), 5) 5 days= 8(11%), 6) 6 days= 8(11%), 7) 7 days= 19(25%).

³³ Calculated as "days per week" X "hours per day". n=71[119], mean=22.6 hours, min.=0 hours, max.=112 hours. Zero hours per week is a strange figure, perhaps indicating no formal opening hours. The high of 112, or 16 per day, every day, probably indicates an "always open" private home.

³⁴ Q. Do these hours [of office opening] include times when most people will be finished their daily work? Yes___ No___ A: n=71[119], yes=66(93%), no=5(7%).

sits to conduct business. These banks are all members of the District Bank and have the lending resources of the District Bank available for members. Eight additional societies have expressed their intention of forming a bank in the near future.

Since attendance at meetings of the TCCS tend to be well attended,³⁵ general meetings cannot often be accommodated in the tiny business office. Again, public places, mostly temples, are the favorite of 58% of respondents. Private homes suffice for small societies or those which must hold meetings in the open air.³⁶ Only five highly evolved TCCSs have their own meeting hall, but 42% of the societies which did not have one had plans to acquire or construct such facilities with their own resources, though the time line for this activity is unknown.³⁷

Since any financial institution must handle cash, the question of security of that cash is legitimate. A new stipulation in the model bylaws offered by FTCCS has a maximum of Rs.500 cash-on-hand kept by the TCCS in the village. The average cash-on-hand of survey respondents was Rs 912, though the most common amount was Rs.500.³⁸

Established societies were asked about the physical security of cash and records. Although the DU offers to sell iron safes by installment to member societies, only 57% of established societies said they had a secure place (not necessarily a safe) to store cash.³⁹ Preservation of records is even more important. In Sri Lanka, damp and insects (especially white ants) can destroy paper records, so a sealed steel cabinet is often used to protect them in government institutions. Only

³⁵ Q: On average, what proportion of the members attend general meetings? A: n=119[119], 1) almost all =16(14%), 2) about three quarters =68(57%), 3) about half =35(29%), 4) about one quarter =0(0%), 5) very few =0(0%)

³⁶ Q: Where does the society hold general meetings? A: n=118[119], 1) public place or temple facilities= 68(58%), 2) society's own office= 12(10%), 3) private home= 33(28%), 4) private business= 5(4%)

³⁷ Q: If there is no society-owned meeting place and office, is one planned? Yes____ No____ A: n=88[114], yes=37(42%), no=51(58%).

³⁸ Q: Is there a specific limited amount of cash on hand in the society's village office at any one time? Yes____, up to Rs____; No____ A: n=46[52], yes=41, no=5, mean=Rs 912, min.=Rs 100, max.=Rs 5000, mode=Rs 500 (55% of responses)

³⁹ Q: Is there a secure place to store cash in the village? Yes____ No____ A: n=51[52], yes=29(57%), no=22(43%).

29% of established societies possessed such security.⁴⁰ Even fewer new societies may be expected to have either a safe place to store cash or a cabinet for records.

• Non-Financial Functions of the TCCS.

Although almost all TCCSs started out performing savings and credit functions, many have branched out into other activities as they have matured, summarized in the table below.

Table 21
Non-Financial Functions of Matara TCCSs⁴¹
(N=52, established societies only)

<u>Activity</u>	<u>Yes</u>	<u>% Yes</u>	<u>No</u>	<u>% No</u>
Death	25	89	3	11
<i>Shramadana</i> ⁴²	23	82	5	18
Supply production inputs	12	57	9	43
Health	7	54	6	46
Consumer retail	7	47	8	53
School	5	38	8	62
Marketing	5	38	8	62
Transport	0	0	10	100

Although the numbers are not large, they indicate the sort of activities the villagers feel are needed which TCCSs can fill. Such activities as "death aid" and *shramadana* have long been basic village level social welfare functions and at least one TCCS was formed by members of a death aid society. A TCCS which branches out into non-financial activity is beginning the process of "total village development" which is the ultimate goal of the TCCS movement.

Given a more limited list of strictly economic functions, the TCCSs were asked if they thought the society could take on any over the next five years. Government programmes are relatively easy for the TCCSs to adopt. Sometimes services such as extension are vigorously pursued, but more often the TCCSs are looking at housing loans and IRDP Self-Employment Programme grants which are

⁴⁰ Q. Is there a locked metal cabinet to store account books and records in the village? Yes____ No____ A. n=49(52), yes=14(29%), no=35(71%)

⁴¹ Q. Does the society have any other function than credit and savings (you may choose more than one)? [Selections and responses as per Table 21.]

⁴² *Shramadana* is an honoured Sri Lankan custom of voluntary village labour to undertake works which the village itself has deemed necessary. It is akin to the North American barn raising in its labour intensity and social contact, but the goods produced are almost always public.

being offered freely by the government and which promise cash rather than services. FTCCS and the DU have a planned programme of "integrated village development" in which the TCCS acts as village agent for government development programmes (see 8.2), but there is no formal collaboration as yet in Matara

Table 22
Possible Future Functions of Matara TCCSs⁴³
(N=119, both established and new societies)

<u>Activity</u>	<u>Yes</u>	<u>% Yes</u>	<u>No</u>	<u>% No</u>
None	4	7	52	93
Government programmes	83	87	12	13
Supply of production inputs	44	54	37	46
Marketing	27	39	43	61

Given the financial functions of the TCCSs, it seems natural that other economic activities could be managed by them. However, supply of production inputs and marketing of output demand more management skill and effort from a TCCS. Many of them will need considerable assistance to build capacity before undertaking such risky activities. Those successfully doing it already can serve as teaching models.

This researcher visited one mature TCCS which was making bulk purchases of fertilizer as well as running a consumer goods retail store. The same TCCS had sponsored the electrification of the village and organized *shramadana* for road construction and maintenance. This society featured exceptional leadership (the President was an energetic school teacher who also served as Vice President of the DU) and had received foreign assistance from Australia's Community Aid Abroad. While the infusion of foreign assistance (Rs. 46,000 in 1986) might seem to invalidate replication, it is not unreasonable for mature societies of average membership size to find a similar quantity of capital to set up economic operations such as bulk fertilizer purchase and

⁴³ Q: Do you think that your society could take on other functions in the next five years? [Selections and responses as per Table 22.]

consumer retail. Funds for electrification and roads can often be found from government, notably the IRDP.

When asked about what government programmes they were involved in, other than the Million Houses scheme, survey respondents answered as follows

Table 23
TCCS Participation in Government Programmes⁴⁴
(N=52, established societies only)

<u>Programme</u>	<u>Yes</u>	<u>% Yes</u>	<u>No</u>	<u>% No</u>
None	6	35	11	65
Integrated Rural Development Project	41	98	1	2
Agricultural Extension	22	88	3	12
Agricultural subsidy programme(s)	10	56	8	44
Multi-Purpose Cooperative Society	6	40	9	60

While participation in the IRDP cannot be taken as acting on the FTCCS "integrated rural development" plan, since the focus of cooperation is Self-Employment Programme grants, TCCS involvement in government agricultural programmes is a step in the right direction, particularly considering the poor land use pattern in Matara and the inability of government extension to reach many producers. TCCSs should exercise extreme caution in dealings with the quasi-governmental Multi-Purpose Cooperative Societies, since they are not only under heavy influence from MPs but have had their subsidies cut and consumer goods monopolies revoked and many of them are thus looking for financial crutches.

• **Officers and Managers:**

Who from the villages initiate and lead TCCSs? This is important for the credibility of the society in the village and can affect the discretionary bylaws, the relationship with the DU and CD, and the participation rate in the village. Once they are operating, who manages their affairs on a day to day basis? It is important that this person be competent and received some training in the necessary duties. The viability of the society depends upon it.

⁴⁴ Q: Does the society cooperate with any government programmes (you may choose more than one)?
[Selections and responses as per Table 23.]

It was difficult to determine the socio-economic position of TCCS leaders in their villages. It is fairly clear that the "elites" control most of them.⁴⁵ This is not surprising, given the wider exposure of this group to external ideas and their willingness and ability to experiment. However, "belonging to the village elite is not tantamount to being shortsighted and persistently self-interested."⁴⁶ A longer range study could reveal the influence, or lack of it, of "ordinary" members, notably the poor, in the decision-making process. It was impossible to identify focus group participation in the executive except on the basis of gender. Women form slightly more than half the membership of the Matara TCCSs, but only 27% of all executives are women.⁴⁷ In other words, there is one female executive for every 33.8 female members, compared to one male executive for every 9.7 male members.⁴⁸ Eleven societies had no female executives at all, the reverse was true of only one society and that was one whose members were all women.

In all meetings observed by this researcher, democratic processes prevailed. One could almost say that "Roberts' Rules of Order" were employed. Of course, the subtleties of influence and power were beyond the scope and ability of the study.

The 16% of leaders who held political offices are potentially significant. While the office might well be some minor post, political alignment is critical in the sharply polarized Sri Lankan polity. Party loyalties can cleave villages into hostile camps,⁴⁹ so party affiliation in the leadership can

⁴⁵ Q: Do members of the executive have other leadership roles in the village (you may choose more than one)? 1) no, they are mostly ordinary villagers, 2) they are mostly traditional elders or religious leaders, 3) they are mostly successful people in business and/or farming, 4) they are mostly larger land owners, 5) they are mostly better educated members of the village, 6) some are holders of political office. A: n=114[119]. Selections offered in the multiple choice were deemed in retrospect to overlap too much, or lack in specific definition (what is a "successful business"?). Therefore, responses were simplified into three categories: 1) ordinary villagers= 15(13%), 2) elite= 81(71%), 3) political office holders= 18(16%). The "elite" comprises all the other groups, which were chosen in the following order: better educated, successful people, and traditional elders. Larger landowners were not involved.

⁴⁶ Koenraad Verhagen, Cooperation for Survival, p. 178.

⁴⁷ Q: There are ____ men and ____ women on the executive committee. A: Cumulative: n=49[52], men=275 (or 5.6 per society), women=101 (or 2.1 per society).

⁴⁸ Ratio of female members to female executives: n=37[52], mean=33.8, min=6.7, max=120. Ratio of male members to male executives: n=47[52], mean=9.7, min=3.5, max=21.4.

⁴⁹ See Koenraad Verhagen, Cooperation for Survival, p. 179.

Indicate both political alignment of the general membership and, possibly, the exclusion of opposing party supporters. ⁵⁰ Nearly half the survey respondents reported a distinct political polarity in their villages. If the TCCS leadership is able to avoid partisan affiliation in a politically split village, then the TCCS may be able to draw members of both factions into the society and have them cooperate. It remains unknown how much the political affiliation of TCCS leaders affects their societies in Matara, though the political complications at the DU may also be reflected in many TCCSs given the highly politicized nature of Matara as a whole (see 7.1).

Overall, the leadership of the TCCSs seems to be good. While they are rarely from the poorest strata of the village, they are not from the wealthiest either. While the interests of the society are not necessarily those of the poor, since the poor comprise only the "bottom end" of the TCCS membership and since issues of financial viability dictate against concessionary policies which would favor the poor, the leadership seems to represent a village "middle class" majority. This is only a bad thing if the poor suffer from deliberate policies of exclusion, such as high minimum savings balances introduced as a discretionary bylaw by the society's own members. Poor members have a vote like everyone else and can exercise it in elections for executive and loans committees. However, the poor will never be represented in leadership positions in proportion to their presence in the village (because not all of the village poor will be able to afford a Rs. 100 share) or, perhaps, in proportion to their membership in the society (because the poor rarely have the status or financial skills to be elected to leadership positions).

Of all the TCCSs in the district, 34% claimed they had a "manager".⁵¹ Many societies said they had no manager, but that the volunteer Treasurer (an Executive Committee position) had some

⁵⁰ Q: In the area served by your society, what is the nature of political support? A: n=119(119). 1) a sizeable majority of the population supports one party =28(24%), 2) support is distinctly split between two or more parties =56(47%), 3) there are no distinct political alignments in the area =35(29%). Political affiliation was not requested because it was felt that respondents might be reluctant to answer, given the extreme animosity between political parties in many communities and the known alignment of the DU President. The claim that there is no distinct political affiliation, when there almost surely is, is an indication of the delicate nature of the question.

⁵¹ Q: Does the society have a manager? Yes ____ No ____ A: n=119(119), yes=41(34%), no=78(66%).

experience in management and oversaw day to day financial dealings. Clearly, someone must take responsibility for the records of the society and someone must be present at whatever facility is used to receive deposits and handle loan applications. If there is no "manager" (or active Treasurer, then responsibility must be devolved to more than one person, which runs the risk of errors and inadequate accountability. Furthermore, it is difficult for the DU to train more than one person per society in the proper performance of manager's tasks, given the inadequate resources of the DU.

There are only 17 paid managers, averaging Rs.245 per month in salary or honoraria.⁵² Significantly, four out of five managers are women.⁵³ This reflects upon the point made above about the common use of private homes for TCCS business offices. Given their usual occupational locality in the home, women are well suited to the manager's job. It is also significant that it is "the female farmer who often... holds the household purse."⁵⁴ That is, women are entrusted with financial management in their own homes and are noted for frugality when compared to men, so why not entrust a woman with the manager's job of the TCCS?

Although the recordkeeping and operations of the TCCS are relatively simple, there is still a need to train both executive officers and managers. This is especially important for purposes of managing the increasing amount of external funds which are being made available and to generate the information required by the DU for its management and supervision needs.

⁵² Q: Is the manager a volunteer or salaried? Volunteer ____ Monthly salary of Rs ____ A: n=49(119), volunteer= 32(65%), paid= 17(35%), mean salary= Rs.245, min.=Rs.50, max.=Rs.1200 The fact that 8 more managers appear here than in the last question indicates something of the ambiguity about "managers".

⁵³ Q: Is the manager a man ____ or a woman ____? (check one) A: n=21(52), man=4(19%), woman=17(81%).

⁵⁴ Koenraad Verhagen, Cooperation for Survival, p.68.

10.4. Education and Training

There are four groups of TCCS members who need different types of training or education (see 8.2) the general membership of the TCCSs, the executive members, loans committee members, and the managers. Most education and training is offered by the DU in collaboration with FTCCS. CD also offers generally longer courses for fewer people.

- Education of the Membership

One of the essential keys to a strong primary society is an educated membership. When the benefits of cooperation, saving, and borrowing are clear then the membership will understand the reason for the bylaws and procedures and abide by them. If no such awareness is present, and especially if external funds are available for borrowing, there may well be a tendency among some members towards purely self-interested behavior (cooperative behavior should also serve the individual member's self-interest, but just how this works often needs to be demonstrated). In credit programmes, non-cooperative self-interest is often manifested in overdues or defaults which can damage the society by eroding the trust among members, reducing the loan funds available, and consuming the time of officers (most of whom are volunteers) in loan collection efforts.

Fortunately, the Matara TCCSs have not suffered from serious defaults to date (see 11.4), but the rapid increase in the number of societies means that many of the individual members have not received any cooperative education. Coupled with low savings mobilization and injection of external funds from the Million Houses scheme and, possibly, from other sources, there is an vastly increased risk of members in such societies acting in an uncooperative way. This would be

consistent with the history of poor performance and short longevity among various rural organizations in Sri Lanka, especially in the wet zone of which Matara is part.⁵⁵

The first education effort should therefore be directed to the ordinary members of the society. In Matara, only 36% of TCCSs have had member education programmes.⁵⁶ Among those which did offer such programmes, usually through the DU or FTCCS, 85% covered cooperative values, 86% addressed the benefits of saving, and 71% handled credit.⁵⁷

The DU and FTCCS were the main sources of education sessions, together responsible for 61% of them. CD, which should be heavily involved considering the TCCS formation process it has been recently involved in, was solely responsible for only 12%. The DU/FTCCS and CD were involved in 18% of villages, though their sessions were separate.⁵⁸ The ability of the DU is severely constrained by the fact that it has only 4 employees and no motorized transport. One or two men, taking buses all over the district, simply cannot cope. CD, on the other hand, has a corps of field officers who are ostensibly responsible for supervising all types of registered cooperatives in

⁵⁵ See M.P. Moore, "Social Structure and Institutional Performance: Local Farmers' Organisations in Sri Lanka," Journal of Administration Overseas 18(4), 1979: 240-249. The Sinhalese are noted for their strong individualism. Cooperative forms of social organization have developed naturally in the form of *yayas* (a group of farmers using the same irrigation line), death aid societies, and *cheelu* (rotating savings) groups. However, other forms of mutual aid and socio-economic cooperation have not developed much. Intravillage reciprocity arrangements are often weak and even family links are not as strong as in other South Asian cultures. Moore notes that "sharing a common village environment and a common occupation, [villagers] tend to have a common culture." (In "Introduction" of M.P. Moore *et al* (eds.), The Disintegrating Village? Social Change in Rural Sri Lanka (Colombo: Lake House Investments, 1979). In the wet zone, villages are not very clustered and occupations tend to be diverse... social cohesion in Matara is not as strong as in established communities elsewhere. The basic conclusion is that the Sinhalese are not traditionally predisposed to cooperative forms of organization.

⁵⁶ Q: Does your society have a member education programme? Yes ____ No ____ A: n=119(119), yes=43(36%), no=76(64%).

⁵⁷ Q: If [an education programme is offered], does the programme teach...(you may choose more than one)... 1) cooperative values, 2) benefits and methods of saving, 3) benefits and methods of borrowing, 4) other (specify) ____ A: N=52, 1) cooperative values... n=41, yes=35(85%), no=6(15%); 2) saving... n=37, yes=32(86%), no=5(14%); 3) credit... n=34, yes=24(71%), no=10(29%); 4) other... n=11.

⁵⁸ Q: Who conducted the education? 1) TCCS District Union? 2) Federation of the TCCSs? 3) Cooperative Dept. of the government? 4) other? (specify) ____ A: N=52, 1) DU =32(57%), 2) FTCCS =1(2%), 3) CD =7(12%), 4) Other =3(5%), 5) DU and FTCCS =1(2%), 6) DU and CD =10(18%), 7) FTCCS and CD =0(0%), 8) all 3 =2(4%).

specified areas. CD has the manpower for education, but CD field officers are not highly motivated. If the conflict between the DU and CD escalates, CD may increase its education efforts.

• Training of Executives and Committee Members:

These volunteer groups have special duties which must be taught. Executive committee members must understand the bylaws of their society and of the DU; they need to understand cooperative and democratic principles involved in the group process they lead; they must be able to analyze the overall position of their society by monitoring the books; they need to acquire a knowledge of external resources and how to get them; and they must be able to plan for the long-term goals of the society.

The loans committee members require a narrower but crucial understanding of financial principles of lending. These primarily include investment counselling and loan assessment, seemingly easy tasks where a loan is intended for a traditional activity in the village, but very difficult indeed if a new activity is contemplated. For example, while the committee may be able to size up a paddy production loan without putting a pencil to paper, since several of the committee members may have been growing paddy for years, should a member approach them with a proposal to borrow for a bicycle repair shop, the committee would have to assess the local market for the service, calculate costs, estimate internal rate of return and capacity to repay and, finally, determine the overall risk to the society of making such a loan. Without such abilities, it is unlikely that the loans committee will make any non-traditional loans. This would be a great pity because, in Matara, traditional activities have very limited opportunities for increasing income.

A majority of executive members and loans committee members had received no training whatsoever.⁵⁹ Perhaps this is understandable, given the recent formation of the majority of Matara TCCs, the priority on member education, and the fact that there is (unmeasured)

⁵⁹ Q: Do any executives and committee members receive training? A: n=109[119], 1) none =68(62%), 2) less than 1 week =21(19%), 3) 1 to 2 weeks =5(5%), 4) more than 2 weeks but less than a month =4(4%), 5) a month or more =11(10%).

turnover of executives and committee members at the Annual General Meeting of each society. Strangely, 10% of them have received more than a month of training, which should make them very capable indeed. It is very significant that 7 of the eleven societies reporting this were trained exclusively by CD, only 2 exclusively by the DU, and 2 more by both the DU and CD.⁶⁰ It seems likely that societies who have CD field officers on their executive receive considerable training, or count the CD officer's own training in the response, but this connection is unsubstantiated. DU/FTCCS training sessions are quite short by comparison. Whether the emerging "CD clique" in the DU membership is connected to CD training of executive members is unknown, but would also seem likely. Content of the training for executives and committee members was not surveyed.

• Training of Managers:

The third group in need of training are the society managers, paid or volunteer. Their main need is to master standardized bookkeeping practices and derivation of useful performance measures from the numbers. They also need to know the operational details of any savings and credit institution, such as processing deposits and posting interest on time, preliminary handling of loan applications, calculating interest on individual loan repayments, and responding promptly to overdues. Sometimes there is a person in the village who already knows how to do most of these tasks, but standardization, especially of bookkeeping, is critical. The survey questionnaire revealed that although the DU sells a standard set of books to the primary societies, bookkeeping practices are far from standard. As mentioned in the section on methodology, Sinhala terms for several types of accounts, offered by the DU's acting manager, were not understood by many respondents. This throws into doubt not only the manager training already performed by the DU and FTCCS, but also aggregate statistics gathered by the DU from the member societies.

⁶⁰ Q: Who conducted the training? A: n=40[119], 1) DU/FTCCS -23(58%), 2) CD -9(22%), 3) combined DU/FTCCS and CD -8(20%).

A slight majority of managers had received some training.⁶¹ The training was offered mostly by the DU or FTCCS (the latter had sole responsibility before the DU took on the task).⁶² Training was for short periods, two weeks or less in total.⁶³ Notably, four managers have received over two months training. With this amount, plus their experience on the job, they would probably be good trainers themselves. The DU should not overlook this resource, considering their own current lack of personnel.

The content and quality of training is, of course, critical. While it was beyond the scope of the survey to gauge the quality, except by secondary observations such as the lack of bookkeeping standardization, content was asked of survey respondents. As expected, bookkeeping was the most frequently taught topic, again failing to explain lack of standardization. The quality of bookkeeping training should be investigated. Other topics, in order of frequency, were cooperative issues, loan assessment, and investment counselling.⁶⁴ Fully 88% stated that the manager intended to take more training.⁶⁵

• Conclusions on Training and Education

There is widespread desire for more training and education. Only 2 societies out of 113 responding stated that they did not need any more of any of the above three categories.⁶⁶ The greatest

⁶¹ Q. Did the manager receive job training? Yes____ No____. A: n=41[49], yes=23(56%), no=18(44%). Established societies: yes=15(71%), no=6(29%). New societies: yes=8(40%), no=12(60%).

⁶² Q. Who trained the manager? A: n=23[23], 1) FTCCS=2(9%), 2) DU=12(52%), 3) CD=8(35%), 4) DU and CD=1(4%).

⁶³ Q. How long has the training lasted (total amount over different sessions)? A: n=22[23], 1) less than 2 weeks= 15(68%), 2) 2 weeks to a month= 3(14%), 3) 1 to 2 months= 0(0%), 4) more than 2 months= 4(18%).

⁶⁴ Q. Did training include (you may choose more than one). A: N=23, 1) bookkeeping? yes=19(90%), no=2(10%), 2) cooperative issues? yes=18(82%), no=4(18%), 3) loan assessment? yes=13(68%), no=6(32%), 4) investment counselling? yes=11(58%), no=8(42%), 5) other =8.

⁶⁵ Q. Does the manager intend to take further training? Yes____ No____. A: n=48[49], yes=42(88%), no=6(12%).

⁶⁶ Q. Do you think that more education and training is needed for your society (you may choose more than one)? A: n=118[119], 1) general membership =84(69%), 2) executive committee =94(80%), 3) manager =51(43%). Overlapping breakdown: 1) no =2(2%), 2) manager only =2(2%), 3) executive committee only =15(13%), 4) general membership only =17(14%), 5) manager and executive committee =15(13%), 6) manager and general membership =3(2%), 7) executive committee and general membership =33(28%), 8) all three =31(26%).

expressed need is for the executives and committee members, though there is no obvious reason why this should be so. It is the opinion of this writer that managers require at least enough supplementary training to standardize their bookkeeping, even though there is a substantial gap between the perceived need of managers for more training (43%) and that of general membership (69%) and executive members (80%).

The DU could concentrate more on using experienced members of established TCCSs as training and education resources. These include managers and executives of successful societies—large and small. Especially useful would be women and members of the rural poor who have gained the responsible office to serve as examples to other women and poor in order to stimulate an increase in the representation of these groups in managerial and executive positions. Some successful societies can also serve as beacons, where members from new societies or villagers who are contemplating forming a TCCS can see demonstrated benefits. In Matara, representatives of 65% of established societies have made visits to "model" societies or received visitors themselves.⁶⁷

10.5. Primary Societies and the Poor

The primary societies at the base of the TCCS movement are the institution where the poor can participate and receive benefits. It is vital that the village societies be structured and operated in such a way that the poor have access. While most societies are initiated and led by middle-class villagers, often schoolteachers, there should be no reason why the poor cannot participate by saving, borrowing, voting, and holding elected office. While anyone in the village can have a savings account, the poor cannot easily borrow, vote or hold elected office.

Borrowing and voting are both blocked by the Rs 100 share purchase. Borrowing is further inhibited by the necessity of holding a proportion of loan value (often 10%) in savings deposits. A

⁶⁷ Q. Do representatives of your society ever visit other successful societies or do representatives from other societies come to visit your society? Yes ____ No ____ A. n=51(52), yes=33(65%), no=18(35%)

few societies had very high share and savings restrictions (combined 50% and more), putting the loan facility beyond the grasp of the poor. There is a justification for this policy. If the society is new and undercapitalized, the capital being mostly that of middle-class people with initiative, the high savings limits restrict the use of the funds to those with large deposits. They, like other lenders, regard the poor as high risk borrowers who mostly borrow for consumption. They want to be very prudent lenders, so they lend to themselves and build up the capital base. Admittedly, this base is partially composed of the savings of poorer villagers who open savings accounts.

The best course of action to create access for the poor is to allow group shares and group loans. The Grameen Bank type of group, introduced at this level would work well. A group of no more than a dozen poor households could buy a share and open a savings account. Then one or two households would apply for loans. Once these first borrowers establish a good repayment record, more loans are permitted.

A second problem is security for loans to the poor. Under TCCS bylaws, two guarantors who are TCCS members in good standing are acceptable security. Under the Grameen model, the group members guarantee each other's loans. This puts a lot of pressure on the individual borrower households to invest productively and work hard. Default rates on this sort of scheme are very low in Bangladesh and should also be low if instituted in the TCCSs. It may require an amendment to the bylaws, which would hamper adoption of the idea as each society would have to debate the decision. DU monitoring should reveal which societies adopt the measure and which do not, suggesting to the DU where its education efforts are required.

Since the poor would not accumulate votes very quickly, there is little doubt that middle-class villagers would continue to dominate the society. In a good society, the poor would benefit from the financial experience of the middle-class members, but in a poor society, the poor could be ignored. Even if a considerable number of them were to show up at the monthly meeting to lobby for a loan, their voting power alone would not carry much weight. The middle-class members should accept group shares and group savings for the poor since it does not threaten their influence.

In the TCCS In the long-term, it is unlikely that the "poor" would ever dominate any TCCS they did not form themselves (and this has been done), but that successful borrowers would themselves become middle-class and carry-on middle class dominance

The primary societies are the best village level alternative for the poor in Sri Lanka. The access to savings and credit for the poor is already much better than any other institution. A better effort at including the poor would make them an ideal financial intermediary. Financial viability is the obverse of the access coin and is dealt with in the next chapter.

CHAPTER ELEVEN

FINANCIAL PROFILE OF THE PRIMARY SOCIETIES

Since the TCCS must survive and grow if it is to be of continuing utility to its members, it is necessary to adopt policies which promote financial strength and monitor performance. The flexibility to alter policy must also exist. Measures can be made of both institutional viability and services to the village population, using, among other things, some of the performance criteria described in Chapter 3, Section 5. While on a practical level these measures should be made and considered together for each individual TCCS, they are aggregated here to create broader profiles of new and established societies. Again, the caution must be made that some measures, as noted in the footnotes, suffered from low response rates and must be taken as general indicators only.

11.1. Savings

Member savings form the foundation of every strong TCCS. By offering different savings options to both members and non-members, the society builds its base of lending funds. All offer standard interest-bearing savings accounts, while some offer children's and/or fixed term accounts.¹ Most societies encourage account holders to make a regular monthly deposit. An average TCCS held Rs 54,777 in members' savings and Rs 10,574 in non-members' savings, for a total of

¹ Strangely, 23% of respondents claimed they had no savings facility. Q: Does your society have a savings facility located in the village? Yes___ No___ A: n=113[119], yes=87, no=26. It is likely that the question was misinterpreted by those 26 as physical facilities, that is, a building or other permanent office, whereas a savings facility can be operated out of a home or other temporary place.

Rs 65,351² Of these amounts, an average of 13.3% was held in reserves³ Commercial banks were the most used depository for surplus funds or reserves, though the District Bank is beginning to draw more and more due to the direct link to access to external loan funds⁴

● Standard Savings Accounts

The average Matara TCCS had 79 standard savings accounts,⁵ holding a total of Rs 26,862 The accounts were small, averaging just Rs 227 in established TCCSs (adjusted for missing data)⁶ This figure is not out of line with expected savings of the poor, if not the poorest stratum While respondents could not be questioned on how much was saved at other institutions, use of nearby banks by villagers (see 10.2) and the rapid growth of deposits in them would indicate that many villagers use banks as well as TCCSs for savings. At the time of the survey, it would have been prudent for TCCS depositors to spread their savings into other institutions since there was no guarantee fund to protect their savings. Now there is a loan guarantee fund which, by protecting against losses in the loan portfolio, also protects savings (see 8.2) The TCCSs are urging members to transfer all their deposits from commercial banks to TCCS accounts

² Q. What are the total savings of members? A: n=46[52], mean=Rs 54,777, min =Rs 1020, max =Rs.200,712 The Matara town TCCS was deleted from these figures because its very high figure skewed the average. The profile sought is for rural TCCSs. Q. What are the total savings of non-members? A: n=46[52], mean=Rs 6,883, min =Rs 0, max =78,601 Again, Matara town TCCS led with a figure of Rs 180,371 and was deleted from the averaging

³ Q. What percentage of savings must be held in reserve (not lent, but kept to cover withdrawals)? ____% A: n=32[52], mean=13.3%, min =1%, max =22% The one percent figure is extremely suspect, it is quite likely that CD would insist upon a higher figure. The DU thinks that reserves should ideally be between 15% and 20%

⁴ Q. Where are members' savings deposited? A: n=51[52] 1) reserves are deposited with a local bank =18(35%), 2) reserves are deposited with the District Union =7(14%), 3) some is deposited in both banks and the District Union =12(24%), 4) all funds are lent, so there is no surplus to deposit =14(27%) This last is very curious indeed, since some funds must be held in reserve Further investigation of this claim is required. Possibly, there is confusion about the interlending fund of the District Bank, in which case the last group could include onlending.

⁵ Q. Does your society offer savings accounts with interest? Yes ____ No ____ A: All societies offer interest bearing accounts Q: How many people have this type of account? ____ A: n=99[119], mean=79, min =4, max =330

⁶ Q. What is the total savings in this type of account? Rs ____ A: n=39[52], mean=Rs 26,862, min.=1020, max =Rs.110,172 Average Rs per account in those 39 societies =Rs 227 The adjustment for missing data occurs because all 119 respondents (new societies and old) were to answer the question on number of accounts while the amounts were asked only of the older societies The average Rs. per account is for the older societies only. Averages for newer societies would be lower still

TCCS interest rates are generally attractive if not the best locally available. It is fair to say that the National Savings Bank offers the best rates for both standard and fixed deposits, followed by the TCCSs and then by the commercial banks.

The average interest for standard savings accounts is 11.7%,⁷ slightly below the National Savings Bank rate of 12%.⁸ (Since the survey was taken, all rates have fallen, the general TCCS rate has fallen to 10%, compared to People's Bank at 9%.) Though the declared range of the TCCSs is from 2% and 20%, 2% is not a credible figure, even if there were no other savings institutions in the area, the rational saver would prefer real goods which may retain some real value (at 2% there would be a considerable loss to inflation - see Table 12), even in a good year. Similarly, 20% is not a credible rate either, for that means that the interest for lending those funds would have to be at least 24% to comply with GOSL regulations on minimum spread. People's Bank pawnbroking loans notwithstanding (30%), a 24% loan is at least 6% to 8% too high by current standards.

One problem which often occurs with commercial banks is a minimum balance restriction, since these deposit takers do not want to be burdened with the cost of administering a myriad of tiny accounts. Most societies maintain a minimum balance of only Rs.5 - 10, the nominal amount required to open an account in the first place. But when asked if a minimum balance restriction applied, some of the TCCSs surprisingly said yes.⁹ Three had minimums of Rs. 100, one of Rs. 110, one of Rs. 250, one of Rs. 300, one of Rs. 600, and one new society with a minimum of Rs. 1000! These are clearly contrary to the spirit of the TCCSs, since the larger minimums exceed the average overall balance, certainly blocking access to the poor. This contrasts sharply with the DU/TCCS declaration that anyone with ten rupees can open an account with the local TCCS.

⁷ Q: These accounts pay interest of ____% per year. A: n=108[119], mean=11.7%, min.=2%, max.=20%, mode=

⁸ National Savings Bank is the trend setter on savings rates, but there are very few branches, all of them in major towns and cities. Rate quoted is for June 1986. Central Bank of Sri Lanka, Bulletin (Colombo: Central Bank, July 1986), Table 11.

⁹ Q: Is there a minimum balance requirement on standard (non-term) accounts? Yes ____ No ____ A: n=48[52], yes=26, no=22

• Fixed Deposits

Fixed accounts are offered by only a few societies. Of the 52 older societies which responded, almost half responded that they did not offer fixed deposits.¹⁰ Of those 13 that did, the average was 29 accounts of Rs 1,438 each.¹¹ The mean interest rate was 12.5%,¹² only 0.8% more than a standard savings account but not far below the National Savings Bank rate of 13% on one year simple interest deposits and above the People's Bank rate of 12%.¹³ Terms were mostly more than one year.¹⁴

• Children's Accounts

Children's savings accounts were offered by 58% of the older TCCSs, each having an average of 6.0 such accounts.¹⁵ The average interest paid was low, around 12%.¹⁶ Although the total amounts of savings mobilized are not very significant, and the average size of each account is but Rs 88, engendering children with a savings habit will definitely have long term benefits.^{17; 18}

¹⁰ Q: Does your society offer term or fixed deposit accounts? Yes___ No___ A: n=45(52), yes=18, no=25.

¹¹ Q: How many people have this kind of account? ___ A: n=18(52), mean=37, min=2, max=145. Q: What is the total savings in this type of account? Rs. ___ A: n=13(52), mean=Rs 34,254, min=Rs 200, max=Rs 200,000. In both of these calculations, societies reporting an average account of under Rs 100 were deleted, since term deposits under that amount are not practicable. There seems to have been a definitional problem about fixed accounts.

¹² Q: These accounts pay interest of ___% per year. A: n=22(52), mean=12.5%, min=8%, max=20%, mode=14%. While both 8% and 20% are not credible figures, for the same reasons outlined for standard savings interest, the modal 14% should be very attractive.

¹³ The rate quote is effective February 1, 1986. Central Bank of Sri Lanka, Bulletin (Colombo: Central Bank, July 1986), Table 11.

¹⁴ Q: How long is the term? A: n=21(52), 1) up to six months (one growing season) =1(5%), 2) six months to one year =4(19%), 3) more than one year =16(76%).

¹⁵ Q: Does your society offer children's savings accounts? Yes___ No___ A: n=51(52), yes=29, no=22. Q: How many children hold accounts? ___ A: n=29(29), min.=2, max =206, mean=60.

¹⁶ Q: These accounts pay interest of ___% per year. A: n=34(52), mean=12.9%, min.=6%, max =20%.

¹⁷ Q: What is the total savings in this type of account? Rs. ___ A: n=29(29), min =Rs 85, max =26,000, mean per society=Rs 5,533, mean per account=Rs 88.

¹⁸ The Sarvodaya Shramadana Movement in Sri Lanka has been very successfully promoting children's savings for years, usually through the voluntary efforts of primary school teachers. See CIDA, Sarvodaya Shramadana Movement. Report of the CIDA Review Mission, Vol. 1 (Hull, Quebec: CIDA, 1985), p.53 ff.

Savings remains a strong emphasis for the TCCSs and their competitive rates and local convenience should make them successful at mobilizing funds, especially when deposits are guaranteed and depositors feel more secure. There is a danger in newer societies of failing to encourage savings in view of the increasing availability of external loan funds. Some of these societies have very poor savings to lending ratios because of the injection of external funds, NHDA funds in particular. The DU should provide education and training to promote savings as soon as possible and monitor the savings to lending ratio. External agencies should be discouraged from supplying funds to societies with poor savings efforts, though low savings per capita is not a good indicator since it could indicate only that the savers are poor. External funds should be considered if the savers are poor but the deposits regular.

11.2. Loans

Lending money is now the main function and greatest challenge facing the TCCSs. Members' savings are no longer the sole source of funds, as was the case until 1985. Now there are NHDA housing loans, IRDP Self-Employment grants or loans, and, perhaps starting in late 1988, funds from the International Fund for Agricultural Development. It is therefore vital that TCCSs continue to guard their viability and credibility with strong lending policies. The temptation to loosen lending criteria to accommodate the increased flow of loan funds could seriously jeopardize the financial standing of some societies.

The survey results below suffer from small response size, but they may be taken as indicative of the state of lending among the TCCSs, though figures for the specific types of loans are for the older, more established societies only. The new societies are so new that it would be difficult to say anything about their lending except to make the general assumption that because of their low savings bases, relative lack of lending experience, and, in some cases, single-minded desire to belly-up to the trough of external loan funds, they stand in greater risk of financial peril than the older societies.

Loan processing in the TCCSs tends to be quick, with disbursement on approval within a week in 65% of cases.¹⁹ Compare this with the interminable delays of commercial bank lending, government agricultural loans used to have to be arranged up to two months in advance of expected disbursement. Furthermore, TCCSs tend to give the entire amount requested (up to 90% of the amount required for the given activity), since the expectant borrower may be personally questioned on his or her intended use. Government agricultural loans have "per acre" guidelines for eligible crops which do not meet the needs of most borrowers. Non-agricultural commercial bank loans frequently involve a game wherein the borrower asks for more than he or she needs and the lender discounts the requested amount.

Group loans, especially of the Grameen Bank type, can create access for the poor, overcoming the share holding and savings restrictions on loans. If a group of poor can by a group share in the TCCS and hold a group savings account, then they could, as a group, become eligible for group loans. Unfortunately, only three societies said that they made group loans. Clearly, there is room for considerable improvement here, the main obstacles being organization of the poor into groups and the allaying of doubts among the middle-class core of TCCS members.

Conversely, in a few societies, executives and committee members were privileged. The average society granted four loans to committee members (from an average seven members).²⁰ Four societies allowed higher loan limits for the manager and executives.²¹ While these privileges may reflect the obvious influence of these individuals in the society, they may also be a realistic reflection of the relatively successful station of the individuals in the village. They may be

¹⁹ Q: How long does it usually take to get a loan approved and disbursed to the borrower? A: n=52[52], 1) less than a week =34(65%), 2) a week to a month =14(27%), 3) more than a month =4(8%). This last figure is highly unusual, considering lending procedures in TCCSs.

²⁰ Q: In 1986, the manager and executive members got a total of ____ loans. A: n=52[119]; mean=4, min=0, max=16.

²¹ Q: Do the manager and members of the executive have higher limits on the size of loan they can take than general members do? Yes____, No____. A: n=52[119], yes=4(8%), no=48(92%).

relatively prosperous people with larger shareholdings and savings and strong investment plans, entitling them to loans

In government agricultural lending, the disbursements are as much in kind as possible. Ostensibly this is because the lender does not trust the borrower to use cash for the stated purpose. TCCS loans are mostly in cash; though 21% of established societies do disburse some loans in kind.²²

The TCCS method of lending is far less costly than the lending operations of banks. A large majority (76%) of established TCCSs estimated their lending cost at under 5% of their total loan portfolio.²³ On the other hand, it is significant that 18% did not know their cost of lending. Sometimes this cost does not seem real to the society, especially if officers are volunteers, office space is free, and overdues and defaults low. While the TCCSs may be forgiven for assuming that their costs will be very low, it is important to monitor these costs and figure them into the interest rate spread. Some costs should appear on the society's balance sheet. Lack of knowledge of the cost of lending indicates weakness in the accounting systems of those TCCSs.

One reason the TCCS cost of lending is so low is that overdues and defaults are relatively rare. There are several reasons for this. First, the loan and the borrower are screened by people who know the individual operation to be funded (size of holding, cropping methods, estimated local demand for a proposed service, etc.) and the individual borrower (character, management ability, willingness to repay). Second, the standard security for loans is two personal guarantors who are members of the society, who promise to pay if the borrower does not. A minority of TCCSs also take property titles as security, either for loans where no guarantor is offered or for longer term loans for large amounts.²⁴ No TCCS accepted jewellery or crop liens as security, unlike People's

²² Q: Are some of your loans disbursed NOT as cash, but as goods of production, construction, etc? Yes ____ No ____ A: n=48(52), yes=10(21%), no=38(79%).

²³ Q: What is the approximate cost of lending for your society? (This includes administration cost, the cost to the society of the money lent, the losses from default, etc.) A: n=38(42), 1) <5% of the value of the loans =29(76%), 2) 5-9% of the value of the loans =1(3%), 3) 10% or more of the value of the loans =1(3%), 4) do not know =7(18%).

²⁴ Q: Are property titles taken as securities on loans? A: n=114(119), 1) yes=21(18%), 2) no=93(82%).

Bank and the Rural Banks, who accept pawned jewellery for loans costing 30%, or informal lenders, who accept both land title and jewellery for loans bearing at extortionate rates of interest. Third, the TCCS is aware of when the borrower has income flows and the society can ask for repayment promptly, before the money is used for some other purpose. Most of all, there is tremendous peer pressure to repay, especially if loan funds have been raised from members' savings. A villager will not want to earn the animosity of his or her guarantors and fellow villagers by failing to make good on a loan.

● Source of Loan Funds

The most important source of loan funds of a financially strong lender should be the savings deposits it holds. The average TCCS claims to have lent Rs 12,229 of its members' savings in 1986,²⁵ covering only 40% of the total loans granted by those same societies.²⁶ A healthy society should have a higher percentage than that. Nonetheless, there was strong support, even among the established societies, for the idea of seeking loan funds from external sources.²⁷ Older societies received an average of 35% of loan funds from external sources in 1986.²⁸ If a large portion of loan funds come from external sources, the TCCS is compromising its autonomy, especially if the government is the main source.

²⁵ Q: What amount of the loan funds came from members' savings last year? Rs ____ A: n=76[119], mean=Rs.12,229, min.=Rs 0, max.=120,800.

²⁶ Calculated as total members' savings lent divided by the sum of all loan categories. n=69[119], mean=0.4, min.=0, max.=1.7. This maximum can only indicate loans not accounted for in the questions on lending.

²⁷ Q: Do you think your society should use outside funds for lending to members? (You may choose more than one.) A: 1) NHDA... n=43[52], yes=41(95%), no=2(5%); 2) IRDP... n=47[52], yes=44(94%), no=3(6%); 3) foreign sources... n=32[52], yes=25(78%), no=7(22%); 4) government agricultural schemes... n=35[52], yes=25(71%), no=10(29%); 5) other (including banks)... n=19[52], yes=8(42%), no=11(58%)

²⁸ Calculated from total external funds / total lent in all categories: n=41[64], mean= 35, min =0, max.=1. An outlier of 1.54 was deleted as the society could not possibly have lent more in external funds than it lent in total.

A majority of TCCSs thought the funds should be routed through the DU, but 36% of established societies thought that external funds should flow directly to the individual societies.²⁹ It is important that the DU act as a filter for disbursement to primary societies, lest weak societies damage themselves by getting over-committed to external sources. Most DUs have bylaws routing all external funds through the DU or District Bank.

Table 24
External Sources of Funds for Matara TCCS, 1986³⁰
(N=52, established societies only. Amounts in Rs.)

<u>Source</u>	<u>Number of TCCSs</u>	<u>Mean Amt.</u>	<u>Min.</u>	<u>Max.</u>
Matara IRDP	31	8,122	1,500	18,250
NHDA Million Houses	23	20,157	1,500	58,600 ³¹
Matara District Union	6	10,417	9,000	13,500
Commercial banks	6	6,796	2,900	14,875
Foreign donors ³²	3	16,333	1,000	46,000

Compared to the commitment of savings deposits, these amounts from external sources are significant. Furthermore, the amounts from the first three sources will rise by a large margin in 1987, as indicated by the external funds expected by newer societies (some of which were no doubt formed in the expectation of cashing in on the windfall).

The average new TCCS expects to get Rs. 140,893 in 1987, an absurdly optimistic figure, especially considering that that means holding 25% of the amount in shares (10%) and deposits

²⁹ Q. If you think that your society should use outside funds, should these funds... 1) go directly to your society from the funding agency? 2) go through the District Union? 3) go through a local commercial bank? A: n=44[52], 1) direct =16(36%), 2) through the DU =28(64%), 3) through local bank =0(0%).

³⁰ Q. What amount [of loan funds] came from the following sources last year [1986]? (Please fill in all the blanks.) A: Selections and responses as per table.

³¹ The society which received the largest Million Houses loan (more than Rs.20,000 larger than the next largest) also received Rs.100,000 via the *Gramodaya Mandala*, the local government development unit. Apparently, this society or some of its members have very good political connections.

³² The average for this category is meaningless. There were only three recipients of foreign funds, one of them for Rs.1000, a second one of Rs.2000, and the third, the society of the DU Vice President, for Rs.46,000 (from Australia's Community Aid Abroad). This lucky TCCS will pursue funds from the same source in 1987.

(15%) with the District Bank. Very few of the newer societies are going to have Rs 35,223 in shares and savings for the purpose in 1987

Table 25
Expected Sources and Amounts of External Funds, 1987³³
(N=67, new societies only Amounts in Rs)

<u>Source</u>	<u>Number of TCCSs</u>	<u>Mean Amt.</u>	<u>Min.</u>	<u>Max.</u>
NHDA Million Houses	43	78,828	45,000	200,000
Matara District Union	32	21,750	1,000	100,000
Government (incl. IRDP, not NHDA)	22	43,659	10,000	500,000
Foreign	23	44,130	10,000	150,000
Commercial Banks	12	35,000	5,000	10,000

● **Agricultural Loans in General:**

In view of the limited lending resources of most TCCSs and the wide, if unequal availability of NCRCS agricultural loans, one might expect to see only limited lending for agricultural purposes from the TCCSs. On the other hand, agriculture is the bedrock of the local economy for most societies, which should influence societies to support agricultural loans

Survey results indicate that agriculture is indeed widely supported, but with very small loans considering the needs of most producers. The average number of agricultural loans was 21, but the average size was Rs. 1157 and the modal loan was only Rs. 500³⁴ This does not approach the full needs of most farmers, but inputs such as fertilizer and chemicals are highly divisible anyway

³³ Q: Which external sources will your society approach for funds in the coming year? A: Selections and responses as per table.

³⁴ Q: How many loans were granted for agricultural production last year (1986)? A: n=42(119), mean=21, min.=1, max.=149. Q: For how much money [total for the TCCS]? Rs _____. A: n=67(119), mean=Rs.15,613, min.=Rs.250, max.=Rs.150,000. Average loan was calculated only for those 40 societies which offered the number of loans and a total amount: mean av.=Rs.1,157, min.av.=Rs.250, max.av.=Rs.10,000, mode=Rs.500 (10 cases), also Rs.1000 (7 cases)

The mean interest rate on agricultural loans was 15% per annum³⁵ The average credit limit on agricultural loans was Rs 2650³⁶ The lending base of the societies will have to grow much larger before agricultural loan demand can be met

• Specific Crop Loans

Table 26
Specific Crop Loan Averages, 1986³⁷
(N=52, established societies only)

<u>Crop</u>	<u>n</u>	<u>Average No. of Loans</u>	<u>Average Loan Amount (Rs.)</u>
Paddy	21	20	588
Tea	7	8	2,673 ³⁸
Minor Export Crops	6	3	688
Coconut	5	2	694
Rubber	1	1	500

In the above table, the established societies were asked to break down their agricultural portfolios into five specific crops or groups. This proved difficult for them, since they do not normally keep

³⁵ Q What interest was charged on agricultural loans? A: n=60[109], mean=15%, min=5%, max=24%. Although the mode was 18% (14 cases), 16% (13 cases) and 12% (10 cases) were also benchmarks, though the last is negative real interest for the societies in question

³⁶ Q What is the largest loan available (credit limit) for this purpose? Rs ____ A: n=23[52], mean=Rs 2670, min=Rs 500, max=Rs 25,000

³⁷ Q How many and how much were granted for the following crops

1) paddy? ____ loans for a total of Rs ____ Number A: n=22[52], mean=20, min=0, max=75. Amount A: n=26[52], mean=Rs 12,294, min=Rs 800, max=Rs 50,000. Average loan for this and subsequent categories calculated only from those societies which offered both number of loans and amounts n=21[52], mean av=Rs 588, min av=Rs 238, max av=Rs 1004

2) tea? Number A: n=13[52], mean=4, min=0, max=14. Amount A: n=7, mean=Rs 20,286, min=Rs 500, max=Rs 100,500. Averages: n=6[52], 8 loans for mean av=Rs 2118, min av=Rs 500, max av=Rs 8375

3) minor export crops? Number A: n=12[52], mean=2, min=0, max=6. Amount A: n=8, mean=Rs 2,494, min=Rs 1000, max=Rs 6000. Averages: n=6[52], 3 loans for mean av=Rs 688, min av=Rs 500, max av=Rs 1000.

4) coconut? Number A: n=10[52], mean=1, min=0, max=2. Amount A: n=8, mean=Rs 3,844, min=Rs 500, max=Rs 19000. Averages: n=5[52], 2 loans for mean av=Rs 694, min av=Rs 300, max av=Rs 1000

5) rubber? Number A: n=9[52], mean=0.1, min=0, max=1. Amount A: n=1, amount=Rs 500. Average 1 loan for Rs 500

³⁸ This average is skewed by a single society with 12 loans totalling Rs 100,500. If this is deleted, then the figures are an average 7 loans for Rs 824

this kind of records, hence response rates are low. The value of the results lies in determining the relative importance of the different crops.

• Livestock Loans

Livestock, especially poultry and cattle in Matara, are important sources of income for the landless and those with very small holdings. Consequently, one would hope to see a large volume of TCCS lending for this purpose. Survey responses were skeletal on the subject, but indicate that livestock loans are not a priority.³⁹ The average interest rate was 13.9%⁴⁰ and the average credit limit was Rs 2500.⁴¹

• Land Improvement Loans

Land improvement loans are used to open new land to cultivation, repair minor irrigation works or build new ones, and other preparations for productive use of the land. This sort of work is important in Matara because the land is not only densely occupied but, in most cases, inefficiently utilized. Unfortunately, most improvements are fairly costly and have lengthy pay-back periods. Most TCCSs do not have the resources to undertake relatively large medium and long-term lending, so most of what are termed "land improvement loans" are small amounts for small jobs.

Few societies made such loans. However, one stands out, having given 5 loans averaging Rs 12,000 each. This society is excluded from the overall figures because it distorts the general reality for this type of loan, which was 5 loans averaging Rs 945.⁴² The average interest was 14.3% per

³⁹ Q: How many loans have been granted for livestock in the last year? ____ A: n=4[119], mean=1.5, min=1, max=2. Q: How much money [went to livestock loans]? Rs ____ A: n=14[119], mean=Rs 2190, min.=Rs.500, max.=Rs.5250. Averages: n=3[119], 1.5 loans for mean av. =Rs.1500, min av =Rs 1000, max av =Rs.2500.

⁴⁰ Q: What is the interest on livestock loans? A: n=15[109], mean=13.9%, min =2%, max =20%, mode=16%.

⁴¹ Q: What is the largest loan available (credit limit) for this purpose? Rs ____ A: n=7[52], mean=Rs.2500, min =Rs 1000, max.=Rs 5000.

⁴² Q: How many loans have been granted for land improvement in the last year [1986]? ____ A: n=18[119], mean=5, min =1, max.=17. Q: How much money [went to land improvement loans]? A: n=22[119], mean=Rs.3793, min.=Rs.500, max.=Rs.12,000. Averages: n=17[119], 5 for mean av =Rs.945, min.av =Rs.250, max.av =Rs.2000.

annum.⁴³ The credit limit for land improvement averaged Rs 2286, excluding the single society mentioned above, which did not answer the question.⁴⁴

• Home Gardening Loans

These loans are used to encourage households to grow more of their own food and, perhaps, a little extra for market. The expenses are mainly for seeds and pesticides. It should be noted that the very poor need this type of loan the most in order to augment their diet and grow high-value cash crops such as cinnamon and fruit trees.

Again, the response was not good, with only a few societies averaging 5 loans for Rs 849 in 1986.⁴⁵ The interest rate averaged 14%.⁴⁶ The credit ceiling for these loans was Rs 1418.⁴⁷

• Fishing Loans

Fishing loans are, of course, only of importance to coastal TCCSs. Yet in about half of them, fishing is the most important economic activity. Fishing is a risky business which has suffered severe strains in Sri Lanka during the last few years, partly due to the rise in fishing expenses as GOSL has encouraged the purchase of larger engine-driven boats by wealthy "fishermen" (who don't actually do the fishing), partly due to heavy off-shore catches by foreign fleets, and partly due to the inability of poorer inshore fishermen to migrate to the east and north, following fish stocks, due to the ethnic conflict.

⁴³ Q. What is the interest on land improvement loans? A. n=20[109], mean=14.3%, min=9%, max=20%, mode=12%.

⁴⁴ Q. What is the largest loan available (credit limit) for this purpose? Rs ____ A. n=14[52], mean=Rs 2286, min=Rs 500, max=Rs 10,000.

⁴⁵ Q. How many loans have been granted for home gardens in the last year [1986]? ____ A. n=9[119], mean=5, min=1, max=10. Q. How much money [went to home gardening loans]? Rs ____ A. n=16[119], mean=Rs 4080, min=Rs 500, max=Rs 10,980. Averages: n=9[119], 5 loans for mean av=Rs 849, min av=Rs 500, max av=Rs 1500.

⁴⁶ Q. What is the interest on home gardening loans? A. n=13[109], mean=14%, min=6%, max=19%, modes=16% and 18%.

⁴⁷ Q. What is the largest loan available (credit limit) for this purpose? Rs ____ A. n=11[52], mean=Rs 1418, min=Rs 500, max=Rs 5000.

Although the average was 12 loans for Rs 1590,⁴⁸ there seemed to be two distinct sizes of loans, 139 small ones (overall) averaging Rs 381 and 21 large ones averaging Rs 2381. While this latter amount is not enough to become a mechanized fisherman, the single Rs 7000 loan granted by the DU President's home society is enough to buy a traditional catamaran sailboat. None of the commercial banks would contemplate large loans to traditional fishermen. Mean interest rate was 16%.⁴⁹ The average credit ceiling was Rs 3750.⁵⁰

• Non-Agricultural Loans

"Non-agricultural" is a catch-all term defined to survey recipients by example ("coir processing, trading, carpentry, masonry..."), though it is very definitely restricted to productive loans. This category is the one in which the landless and near-landless make most of their income and it is also the category with the greatest potential for income enhancement, much higher than loans for any agricultural activities.⁵¹

The responding societies averaged 20 such loans, for a mean amount of Rs 1083, though some of the loans were very small.⁵² Interest rate mean was 15%.⁵³

⁴⁸ Q. How many loans have been granted for fishing in the last year [1986]? ____ A. n=12[119], mean=12, min=1, max=50, mode=1. Q. How much money [went for fishing loans]? Rs ____ A. n=12[119], mean=Rs.8867, min=Rs.500, max=Rs 24,000. Averages: n=12[119], 12 loans for mean av.=Rs 1590, min.=Rs.200, max.=Rs 7000.

⁴⁹ Q. What is the interest charged on fishing loans? A. n=7[109], mean=16%, min=14%, max=18%, mode=16%.

⁵⁰ Q. What is the largest loan available (credit limit) for this purpose? Rs ____ A. n=8[52], mean=Rs 3750, min=Rs 500, max=Rs 10,000.

⁵¹ IFAD, Appraisal Mission Report, p. 45.

⁵² Q. How many loans have been granted for non-agricultural production (examples given) in the last year [1986]? A. n=42[119], mean=20, min=1, max=147. Q. How much money [went to non-agricultural loans]? A. (outlier max. of Rs.350,000 removed) n=56[119], mean=Rs 12,149, min=Rs 500, max.=Rs 57,000. Averages: (same outlier reinserted) n=42, 20 loans at mean av.=Rs 1083, min.av.=Rs 99, max.av.=Rs.8333.

⁵³ Q. What was the interest rate charged on non-agricultural loans? A. n=48[109], mean=15%, min=4%, max=22%, mode=16%.

● Housing Loans

Figures for housing loans are somewhat confused by the fact that, although the large majority of them are from NHDA at 6%, individual societies sometimes offer their own housing loans for a much higher rate of interest (usually 16%). Reflecting the strong attachment to the home, loans for house construction and improvement are in high demand, so much so that some societies are threatened by holding too many housing loans relative the rest of their lending portfolio.

TCCSs gave an average of 18 of them for Rs 2212.⁵⁴ The combined NHDA and TCCS interest rate was 13%, with two modes: NHDA's 6% and the TCCS's 16%.⁵⁵ The credit ceiling for housing loans averaged Rs 4595.⁵⁶

● Consumer Loans

These non-productive loans are supposed to be a low priority according to TCCS ideology and recommended practice, but they proved very popular. They cover a wide variety of uses, but a common pattern appeared wherein small amounts were borrowed for very short terms at either very high or very low interest rates. Non-essential consumer purchases bore high interest, whereas household emergency or family crisis loans were low interest and sometimes interest free.

Q How many loans have been granted for housing in the last year (1986)? A: n=52[119], mean=18, min=1, max=258. Q How much money [went to housing loans]? A: n=71[119], mean=Rs.23,246, min=Rs 500, max=Rs 255,300. Averages: n=52[119], 18 loans for mean av =Rs.2212, min.av =Rs.270, max.av =Rs.6311. Note the difference between the average total housing loans for these 52 societies (18 X 2212 = Rs.39,816) and that of the larger sample of 71 (Rs.23,246). Apparently these other 19 societies, which did not respond to the question on the number of housing loans, have fewer or smaller loans.

⁵⁵ Q What was the interest charged on housing loans? A: n=59[109], mean=13%, min.=4%, max =24%, modes=6% and 16% (15 cases each).

⁵⁶ Q What is the largest loan available (credit limit) for this purpose? Rs. _____. A: n=40[52], mean=Rs 4595, min =Rs.500, max =Rs.20,000. This maximum is very large for a TCCS, even if it reflects the cost of building a house.

The societies granted an average of 40 consumer loans for Rs 756⁵⁷ Interest rates varied from 0 - 60%, but averaged 16%.⁵⁸ Credit ceilings also varied widely, from Rs 100 to Rs 10,000, but averaged Rs 1846⁵⁹

• Other Loans

This is an open category which contained such responses as health and medical loans, education loans, accident loans, electrification loans, debt redemption loans (release of obligation to usurious private lenders), insurance loans, and celebration (consumption) loans⁶⁰ None of them seemed to be directly productive

The average society granted only 11 of them, for an average Rs 1107⁶¹

The TCCSs perceive themselves to be well on the way to meeting members' demand for loan funds, although the gross amounts required for housing and agriculture are far in excess of the capital base of most societies. Of the top four categories in the table below, 55% of survey respondents suggest that housing loan demand is being met, while 57% feel the same about consumer loans,

⁵⁷ Q: How many loans have been granted for consumer purchases or family crises in the past year [1986]? A: n=41[119], mean=40, min.=1, max.=477. Two TCCSs granted over 400 such loans, and another granted over 200; all the rest granted 60 or fewer. Q: How much money [went to consumer or family crisis loans]? A: n=62[119], mean=Rs.13,787, min.=Rs 200, max.=Rs 149,800. Averages n=41[119], 40 loans for mean av. =Rs.756, min.av.=Rs.100, max.av.=Rs.5167. As with the housing maximum, this maximum is very high for a non-productive loan, contrary to usual TCCS policy because a repayment capacity is not built into the loan. The borrower would likely be one of the village wealthy

⁵⁸ Q: What was the interest rate on consumer or family crisis loans? A: n=51[109], mean=16%, min.=0%, max.=60%, mode=16%

⁵⁹ Q: What is the largest loan available (credit limit) for this purpose? Rs ____ A: n=40[52], mean=Rs.1846, min.=Rs.100, max.=Rs.10,000, mode=Rs.1000

⁶⁰ Q: What other categories of loans did your society grant (SPECIFY)? A: see text above

⁶¹ Q: How many of these loans were granted last year [1986]? A: n=21[52], mean=11, min.=1, max.=40. Q: How much money [went for these other loans]? A: n=21[52], mean=Rs.11,327, min.=Rs.900, max.=Rs.38,025. Averages. (A single loan for Rs.20,000 for an unspecified purpose was deleted as an extreme outlier) n=20[52], 11 loans for a mean av. =Rs 1107, min.av.=Rs.200, max.av.=Rs.3100.

93% about agricultural loans, and 46% about non-agricultural loans.⁶² Satisfaction of agricultural demand is perhaps understandable, considering that these mostly middle-class farmers have access to more farm credit schemes in Matara than any other farmers in Sri Lanka. At the other extreme, non-agricultural productive loans are not adequately supplied, possibly due to lack of loan committee confidence in the viability of some of them, especially for non-traditional activities.

Table 27
1986 Average Lending Summary
(Ranked in order of Overall Importance N=119)

<u>Purpose</u>	<u>n</u>	<u>Av. No. Loans</u>	<u>Av. Amt. (Rs.)/Loan</u>	<u>Av. Total (Rs.)</u>
Housing	52	18	2212	39,816
Consumer/Family Crisis	41	40	756	30,240
Agriculture (Crops)	40	21	1157	24,297
Non-Agricultural (Productive)	42	20	1083	21,660
Fishing	12	12	1590	19,080
Land Improvement	17	5	945	4,725
Home Gardening	9	5	849	4,245
Livestock	3	1	1500	2,250
Other	20	11	1107	12,177

Clearly, the trend in lending is away from the TCCSs' traditional bedrock of productive loans and into non-productive uses, namely housing and consumption/family crisis loans. In terms of overall portfolio, this is quite dangerous. Assuming for a minute that a fictional TCCS had the above portfolio. Further assume that that "other" types of loans were non-productive (which is usually the case) and that home gardens were market-oriented (productive). The ratio of non-productive to productive loans would be about 1.7 to 1. There are more rupees lent for non-productive purposes, uses which will not be earning repayments, and therefore a reliance on earning capacity

⁶² Q. Do you think that your society is able to meet members' demand for loan funds... 1) for agriculture (crop), livestock, land improvement, and home gardens? Yes____ No____; 2) for other productive purposes (non-agricultural)? Yes____ No____; 3) for housing? Yes____ No____; 4) for consumer and family crisis expenditure? Yes____ No____. A: 1) agricultural... n=29[119], yes=27(93%), no=2(7%); 2) non-agricultural... n=82[119], yes=38(46%), no=44(54%); 3) housing... n=55[119], yes=30(55%), no=25(45%); 4) consumer... n=83[119], yes=47(57%), no=36(43%).

from other sources. Fortunately, the nature of the TCCS lending and monitoring process means that, unlike banks, the loans committee has good reason to believe that the borrower of an unproductive loan indeed possesses the capacity to repay.

11.3. Interest Rates

Interest rates were for the most part competitive and reasonable in the context of the cost of lending. There were some very unusual rates set by individual societies for various loans however, as noted in the footnotes of the discussion on loan types (above).

Table 28
Summary of Interest Rates, Matara TCCSs, 1986

	<u>Av. TCCS Rate</u>	<u>TCCS Range</u>	<u>Competitive⁶³</u> <u>Commercial Rate</u>
<u>Savings</u>			
Standard Savings Accounts	11.7	2 - 20	12
Fixed Term Deposits	12.5	8 - 20	13
Children's Savings Accounts	12.9	6 - 20	--
<u>Loans</u>			
Agricultural	15.0	5 - 24	9
Livestock	13.9	2 - 20	12
Land Improvement	14.3	9 - 20	18
Home Gardening	14.0	6 - 19	--
Fishing	16.0	14 - 18	18
Non-Agricultural	15.0	4 - 22	18
Housing	13.0	4 - 24	6
Consumer/Family Crisis	16.0	0 - 60	30

⁶³ Several caveats must be placed on the commercial rates. Deposit takers, such as the National Savings Bank (NSB) and the commercial banks are not very interested in children's savings because of the cost of administration of small accounts. Low rates for agricultural, some livestock, and housing loans are all subsidized under GOSL programmes. Commercial lenders are not interested in home gardens or consumer loans because they are non-productive; nor do they grant many non-agricultural loans to the poor because of perceived risk and cost. There are only two channels for a poor rural person to borrow for such reasons. First, a fortunate few can borrow from NSB's or Indian Overseas Bank's pilot lending programmes (for home gardens or small non-agricultural enterprises). Second, anyone with jewellery to pawn can borrow from the People's Bank or cooperative Rural Bank at 30%.

If we look at the spreads for individual societies in a couple of major lending categories, we note that the average spread on agricultural loans is 3.6% and on consumer loans 4.9%.⁶⁴ The classic TCCS, as described by FTCCS, pays deposits 12% and lends at 16% (before the recent decline in rates), close to commercial rates and complying with the Central Bank's guideline for minimum 4% spread. While the composite rate paid to TCCS savers is indeed about 12%, the composite lending rate is only 14.9%.⁶⁵ The composite spread is merely 2.9%, which would be enough to cover only the leanest of lending costs. However, relending of external funds allows a larger margin. The average TCCS is going to have to raise lending rates or lower interest paid on deposits a point or two.

11.4. Overdues and Defaults

The FTCCS has long claimed that overdues and especially defaults are rare in the TCCSs. Though there have been no aggregate figures available to substantiate this, the lending practices stipulated in the bylaws of primary societies and visits to "model" TCCSs would seem to confirm the veracity of the claim.

The survey also asked about overdues and defaults and revealed a few cracks in the record as well as confusion about the definition of "overdues" and "defaults." Definition is absolutely critical, since different definitions can make the rates look excellent or horrid, depending upon what message is desired. GOSL's measurement, for example, minimizes the default rate by measuring it as cumulative recoveries versus cumulative disbursements.

⁶⁴ In each case the interest paid to standard savings was subtracted from interest charged on the loans, society by society. For agricultural loans, $n=57[119]$, $\text{mean}=3.6\%$, $\text{min.}=-9\%$ (strongly negative... the society in question needs the change this destructive rate), $\text{max.}=12\%$. For consumer loans, $n=46[119]$, $\text{mean}=4.9\%$, $\text{min.}=-15\%$, $\text{max.}=46\%$. The wide range is indicative of the two major sub-types of loans in this category, explained in the section on loans.

⁶⁵ Composite rates are calculated by weighting the various rates for the actual volume of funds. For example, the lending rates for all a society's loans are multiplied by the amount lent in each category to yield total annual interest due for each. These figures are summed to get total overall interest, then divided by total lending to yield the composite for the society. In this case, $n=89[119]$, $\text{mean}=14.9\%$, $\text{min.}=6\%$, $\text{max.}=50.6\%$.

• Overdues.

The most useful definition of overdues identifies them the day they go unpaid, since prompt action is called for. The overdue rate, then, is the proportion of the total amount due which remains outstanding the next day. Some financial intermediaries attempt to cover this up by rolling-over the overdues into new loans, this can continue indefinitely until the lender is burdened with an enormous portfolio of sluggish loans. This not only slows the turnover of funds and the financing of fresh productive enterprises, but ultimately risks the collapse of the lender.

While the limited number of complete survey responses prevents drawing of comprehensive conclusions which refute the FTCCS claim, there is enough evidence to indicate a serious problem ^{66,67}

Table 29
1986 Average Loans Due, Amounts Recovered and Overdues
(N=52, established societies only Amounts in Rs.)

<u>Term</u>	<u>n</u>	<u>Amt. Due</u>	<u>Amt. Recovered</u>	<u>Overdue</u>	<u>Declared Overdue</u> ⁶⁸
Short	18	31,453	22,377	9,076	773
Medium	10	41,772	37,358	4,414	750
Long	6	15,667	6,497	9,170	1,096
TOTALS		88,892	66,232	22,660	2,619

If the figures in the third column (due minus recovered) are accurate then these TCCSs are experiencing an overdue rate of 25%, a serious problem indeed. Should the declared overdues be

⁶⁶ Q. What is the total amount which should have been recovered in the last year [1986]? (Please fill in all the spaces.) 1) Short-term loans? (up to one year to repay) Rs _____. 2) Medium-term loans? (one to three years to repay) Rs _____. 3) Long-term loans? (more than three years to repay) Rs _____. A: 1) short-term... n=18[52], mean=Rs.31,453, min.=Rs.1200, max.=Rs.203,824; 2) medium-term n=10[52], mean=Rs.41,772, min.=Rs.9000, max.=Rs.163,676, 3) long-term... n=6[52], mean=Rs.15,667, min.=Rs.6000, max.=Rs.24,000. Many cases were deleted due to missing responses

⁶⁷ Q. How much was actually recovered in that time? (Please fill in all the spaces.) 1) Short-term loans? Rs _____. 2) Medium-term loans? Rs _____. 3) Long-term loans? Rs _____. A: 1) short-term... n=18[52], mean=Rs.22,377, min.=Rs.1000, max.=Rs.72,335; 2) medium-term... n=10[52], mean=Rs.37,358, min.=Rs.800, max.=Rs.159,960; 3) long-term... n=6[52], mean=Rs.6497, min.=Rs.300, max.=Rs.20,000.

⁶⁸ Q. How much was overdue at year end? (Please fill in all the spaces.) 1) From short-term loans? Rs _____. 2) From medium-term loans? Rs _____. 3) From long-term loans? Rs _____. A: 1) short-term n=18[52], mean=Rs.773, min.=Rs.0, max.=Rs.3680; 2) medium-term... n=10[52], mean=Rs.750, min.=Rs.0, max.=Rs.4500; 3) long-term... n=6[52], mean=Rs.1096, min.=Rs.0, max.=Rs.6327

accurate, then the rate would be only 3%, quite an acceptable rate. More research would be necessary to discover what the actual figure is.

What should be a simple arithmetical calculation has caused some difficulty. Two possible explanations seem possible: 1) that overdues are not immediately classed as such when payments are not made on time, possibly while renegotiations are underway (the survey was taken shortly after the end of the period in question), or 2) that many overdues were rolled-over into new loans. Since some amounts were quite large, the individual TCCSs in question should be observed more closely, their CD audit examined, and, possibly, an investigation launched by the DU. Failure to insist on prompt repayment could lead some societies down the well-worn Sri Lankan path to eventual lender insolvency. Fortunately, the most common response to overdues was to attempt to reschedule the loan, often with pressure applied to the guarantors.⁶⁹

Regardless, there is surely a problem of definition, because the opposite event also appears. For example, one society claimed to have had Rs. 11,100 in short-term loans due as of Dec. 31, 1986, but had received payments on short-term loans totalling Rs. 56,601. The same society claimed overdues of Rs. 1100. If TCCS training includes rigorous definition of standard accounting measures, then this sort of anomaly should not occur.

• Defaults:

The most useful measure of default is even more depressing. Since a lender can arbitrarily assign any duration of late payment as officially in default (one year, three years, five years), the temptation is to class loans as overdue for as long as possible to avoid writing them off.

Hypothetically, since the vast majority of Matara TCCSs are under five years old, a "five-year-definition" of default would yield rates close to zero even under a tidal wave of true defaults. In

⁶⁹ Q. How does the society usually deal with overdues? A: n=44[52], 1) the society just waits and hopes the borrower will pay = 3(7%), 2) the society will send a representative to the borrower to find out what the problem is and try to reschedule the loan = 21(48%), 3) the society will quickly go to court in order to take securities which were offered by the borrower = 7(16%), 4) the guarantor(s) will be approached directly = 7(16%), 5) rescheduling and court = 2(4%), 6) rescheduling and guarantor(s) = 3(7%), 7) guarantor(s) and court = 1(2%).

reality, loans should be classed as defaults the moment that negotiations for rescheduling fail. Over the entire lending portfolio this is quite ambiguous, so the best measure of defaults is all overdues plus all unpaid loans where no rescheduling has occurred and no negotiations are under way (i.e. truly defaulted loans) compared to the total outstanding. The result often looks very bad indeed, but it prevents the lender from performing cosmetic definitional changes to the rate. A bad rate can be subjectively tempered by removing "overdues" from the calculation and examining the difference in light of the perceived honesty and competence of the lender. The true default rate is somewhere in between the two calculated rates, possibly towards the lower end. The nasty high rate remains useful for prodding the lender into rescheduling or court action it might otherwise be reluctant to take.

Survey respondents were asked whether defaults were a problem. Although the question is subjective, a large majority said no.⁷⁰ Then they were asked to declare defaults, defined as "all overdue loans plus all unpaid loans". This still does not counter the evasion technique of rolling-over overdue loans, though there is no direct evidence that the TCCSs indulge in the trick. Still, some of the respondents failed to count the overdues they had just declared in the question on overdues. These were added to the list of declared defaults.

If declared overdues are included in the definition of defaults, the average society had defaults totalling Rs.2810.⁷¹ The default rate, then, calculated as rupees in default (overdues plus unpaid) compared to total outstanding amount, equals 13% (much worse if the overdues alone are around 25%, as above).⁷² Fewer respondents declared the number of loans in default: these averaged 3

⁷⁰ Q: Has there been a problem with defaults? Yes ____ No ____ A: n=45(52), yes=7(16%), no=38(84%)

⁷¹ Q: If default is measured as all overdues plus all unpaid loans... how many loans are now in default? ____ A: n=25(52), mean=2.5, min.=0, max.=32, mode=0. Q: How much money is in default? Rs ____ A: n=18, mean=Rs.2810, min.=Rs.100, max.=Rs.11,969.

⁷² Rs. in default / cumulative outstanding Rs: n=12(52), mean=.13, min.=0, max.=.42. Two more cases obviously had definition problems; they had rates of 1.0 and 1.54... the latter having more in default than outstanding!

loans of Rs 870 each ⁷³ The lower measure, with overdues excluded, had too few cases to derive any figures ⁷⁴

The main reason offered for defaults was failure of the investment for which the money was borrowed ⁷⁵ About one in four was blamed on wilful refusal to pay. The TCCSs main response to default was to attempt rescheduling ⁷⁶ While this may well be flogging a dead horse, it rather depends upon how long the horse has been dead. Although the Central Bank rescheduling scheme for NCRCs loans suffered a poor response rate, TCCS defaulters can be assisted or coerced by guarantors and general social pressures in the community

What cannot be denied is that the high recovery rates claimed by FTCCS cannot be supported by Matara's established societies. There is at least a problem of definition of "overdues" and "defaults" and maybe some fudging of accounts by rolling-over of overdues. The overdue and default rates, rigorously defined, are certainly higher than the national average FTCCS claims. While the rates are still considerably better than those of other intermediaries, corrective action is definitely in order

11.5. The Focus Group

Although the Rs 100 share price limits the access of the poor to loans from the TCCSs, there is, of course, no barrier to anyone opening a savings account. The average standard savings account of

⁷³ Q: How many loans are now in default? _____. A: n=10, mean=3, min.=1, max.=7. An outlier case of 32 defaults has been removed for averaging. If it is included, the average number of defaults is 6 of Rs.803 each.

⁷⁴ If declared overdues are removed, allowing only the "unpaid loans" of unknown duration to stand as defaults, then only 3 societies declared an average of Rs.3704 in defaults and only two can be used to calculate default rates of 14% and 42%, the same rate they had in the more comprehensive measure, and higher than the average at that.

⁷⁵ Q: What seems to be the major reason for defaults? A: n=21[52], 1) failure of the borrower to use the funds for the intended purpose =7(33%), 2) failure of the intended investment to return and adequate amount =9(43%), 3) wilful refusal to pay =5(24%).

⁷⁶ Q: How does the society usually deal with defaults? n=43[52], 1) the society just writes them off and disqualifies the borrower from further loans =2(4%), 2) the society tries to rehabilitate the borrower by rescheduling the debt =31(77%), 3) the society will go to court in order to take securities which were offered by the borrower, who is disqualified from further loans =8(19%).

only Rs.227 does not seem beyond the ability of many of the poor. Similarly, most categories of loans were of average amounts which were not excessive for the poor, provided the loans were for productive purposes.

Several questions dealt specifically with loans to women or the landless. TCCSs were, in general, hard pressed to disaggregate their loan figures to derive loan numbers and amounts for these two groups, so the number of responses is low, valid for indicative purposes only. These figures are available, with a little work, since the TCCS respondent can recognize from the loans ledger who is a woman and who is not and generally has knowledge of who owns land and who does not in the village. The survey did not ask for loans to food stamp recipients since this knowledge is not readily available to TCCS, although it would have been the most accurate reflection of the focus group. Only the established TCCSs were asked about loans to women and the landless.

• Women

It should be remembered here that although women, especially female heads of households, are a needy subgroup within the poor, figures for loans to women also could include the wealthiest families in the village. This should be borne in mind when interpreting the figures below.

Slightly more than half the membership of all respondent TCCSs were women. The average TCCS has 54 women and 53 men.⁷⁷ Most managers are also women.⁷⁸ However, women are underrepresented on the executive committees, which averaged 2.1 women and 5.6 men. There were no women at all on the committees of 11 TCCSs.⁷⁹ Only one TCCS, composed entirely by and for women, had no male executives or members.

⁷⁷ Q: How many members are men ____ and how many are women ____? A: n=51[52]. Men: min=0, max=150, mean=53, sum=2725. Women... min=8, max=180, mean=54, sum=2754

⁷⁸ Check first

⁷⁹ Q: There are ____ men and ____ women on the executive committee. A: n=49[52]. Men: mean=5.6, sum=275. Women... mean=2.1, sum=101.***more

Those societies which granted agricultural loans granted an average of 7.5 loans to women, out of an mean total of 21.⁸⁰ This is significant given that, traditionally, procurement of agricultural inputs is a male preserve in Sinhalese society. The average amount was Rs 1136, just under the overall average of Rs 1157.

Very few livestock loans were given to anyone, but in those societies which did say they granted them, women received an average 2.8 loans for Rs 848, far below the overall average of Rs 1750.⁸¹ This could be because women are more involved in poultry than men, who show more interest in cattle, but there is no way to substantiate this from the data.

Women received land improvement loans averaging 2.3 loans (out of 5) for Rs 1092 each, somewhat above the overall average of Rs 945.⁸²

Home gardening is a significant activity for the poor to raise their own food on very small plots. The average society granted 2.3 home gardening loans for Rs 904 each, compared to 4 for Rs 849 overall.⁸³

The TCCSs were not asked about fishing loans for women because fishing is an exclusively male occupation.

Non-agricultural loans are another matter; women's cottage industry is a major way for the poor to earn income. Women's non-agricultural loans averaged 1.6 for Rs 922 each, compared with 1.8

⁸⁰ Q: How many [agricultural loans] and how much were granted to women? ____ loans totalling Rs ____.
A: Loans... n=29[42], mean=7.5, min=0, max=24. Amounts... n=22[42], mean=Rs.6067, min=Rs.425, max=Rs.31,000. Averages... n=21[52], mean=Rs.1136, min=Rs.212, max=Rs.7750.

⁸¹ Q: How many [livestock loans] were granted to women? ____ loans totalling Rs ____.
A: Loans... n=8[52], mean=2.8, min=0, max=14. Amounts... n=4[52], mean=Rs.1958, min=Rs.750, max=Rs.3000. Averages... n=4[52], mean=Rs.848, min=Rs.143, max=Rs.1500.

⁸² Q: How many [land improvement loans] and how much were granted to women? A: Loans... n=10[18], mean=2.3, min=1, max=7. Amounts... n=11[18], mean=Rs.2451, min=Rs.500, max=Rs.7800. Averages... n=10[52], mean=Rs.1092, min=Rs.400, max=Rs.2000.

⁸³ Q: How many [home gardening loans] and how much were granted to women? A: Loans... n=6[11], mean=2.3, min=0, max=5. Amounts... n=5[11], mean=Rs.2520, min=Rs.500, max=Rs.4500. Averages... n=5[52], mean=Rs.904, min=Rs.500, max=Rs.1500.

for Rs 1083 overall.⁸⁴ It is apparent from this that women receive most of the non-agricultural loans but that the few which men receive are considerably larger.

On the other hand, women receive much larger consumer and family crisis loans, taking 24 out of 38, averaging Rs 1213, compared with Rs 756 overall.⁸⁵ Part of this might be explained by female headed households which suffer income shortfall and need basic survival money. The smallest loans in this category, between Rs 100 and Rs 300 are very short term "instant" loans, apparently favored by men.

In sum, women are very active borrowers, leaning more to consumption loans than men, but receiving a large, though not equal share of loans and loan funds. In light of the slight majority of members who are women, this points to slight discrimination against women. Possibly, the strong male majority in most TCCS executive committees explains some of the difference. On the other hand, the traditional roles of women in Sinhalese society tend to be less "economic" overall than men's occupations, though this is certainly changing. Many of the non-agricultural activities which women may undertake hold promise for income generation in Malara, since the opportunity for increased agricultural income are quite limited. Women's strong participation in household financial decisions also points to increasing participation of women. Finally, FTCCS is urging societies to increase the participation of women at the executive level and, ultimately, in the DU (where there are presently no women board members).

• The Landless

The same caveat which applies to women, also applies to the landless. While some of the landless may be the poorest of the poor, some of them will be salaried government servants and other

⁸⁴ Q: How many [non-agricultural loans] and how much were granted to women? ____ loans for Rs ____ A: Loans... n=28[52], mean=16, min.=0, max.=119, mode=1. Amounts... n=22[52], mean=Rs 19,593, min.=Rs.500, max.=Rs.250,000. Averages... n=20[52], mean=Rs.922, min.=31, max.=2639.

⁸⁵ Q: How many [consumer and family crisis loans] and how much were granted to women? ____ loans totalling Rs ____ A: Loans... n=25[52], mean=24, min.=0, max.=256. Amounts... n=25[52], mean=Rs 14,182, min.=Rs.100, max.=Rs.140,000. Averages... n=23[52], mean=Rs.1213, min.=Rs 100, max.=Rs 10,000.

members of the village elite. Although the "landless" were defined in the first question (on agricultural loans) as "tenants or sharecroppers" this caveat must be considered when examining the figures for other loans.

The test run of the survey questionnaire suffered very poor response to questions on the landless, so the main questionnaire asked only for those categories of loans where it seemed response would be adequate.

The landless took 8 out of 21 agricultural loans, which is not a bad number, but the amounts, averaging Rs 599, were just over half the overall average of Rs 1157.⁸⁶ Size of operation may have had much to do with this. Another consideration is that sharecroppers often have part of their input requirements supplied by the landlord and would not need to borrow as much per acre.

The other major category of loans important to the landless is non-agricultural loans which includes cottage industries, construction, trading, and other income earning activities which require no land. But of the 42 societies which said they offered non-agricultural loans, only 13 then went on to affirm that they offered them to the landless. The average in these was 7 loans for Rs 707 each.⁸⁷ There seems to be considerable room for expansion of loans to the landless.

11.6. Conclusions on TCCS Finances

The main overall impression left from examining the financial structure of the Matara TCCSs is that there is wide variation in the financial viability of individual societies and an increasing

⁸⁶ Q. How many [agricultural loans] were granted to persons owning no land (tenants or sharecroppers)? ____ loans totalling Rs ____ A. Loans: n=14[52], mean=8, min.=0, max.=50. Amounts... n=8[52], mean=Rs 14,402, min.=Rs 900, max.=Rs 40,000. Averages: n=7[52], mean=Rs 599, min.=Rs 300, max.=Rs 1250.

⁸⁷ Q. How many [non-agricultural loans] and how much were granted to persons owning no land? ____ loans totalling Rs ____ A. Loans: n=13[52], mean=7, min.=0, max.=25. Amounts: n=9[52], mean=Rs 4193, min.=Rs 300, max.=Rs 13,500. Averages: n=9[52], mean=Rs 707, min.=Rs 100, max.=Rs 1688.

number of weak new societies which could be in danger of failure if they do not build their savings bases and concentrate their lending in productive uses. A uniform progression from humble origins may have been the usual sequence when each society had to rely on its members for 100% of loan funds. Now that external funds are available, the built-in safeguards have gone by the wayside in many new societies and the whole process of evolution has speeded-up. Like an old car that rolled along smoothly and dependably at 50 km/h, but starts to shake and shimmy violently at 100 km/h, the acceleration in loan volumes without long experience at lending or a solid foundation of savings can over extend weak societies and lead them to insolvency.

Fortunately, there are many established societies with solid foundations and experience who effectively control the DU. DU monitoring of individual societies is not yet adequate to discern weaknesses quickly, but routing external funds through the DU can help regulate uncontrolled lending since a society must have savings and shares with the DU to qualify for most loans. Unfortunately, NHDA loans are not easily controlled and they are the largest single source of external funds.

CHAPTER TWELVE

THE TCCSs A MODEL FOR RURAL FINANCIAL INTERMEDIATION?

In this point we have created a general model of rural financial markets (RFMs), shown the roles of financial intermediaries in them, focused in on the Sri Lankan situation, and analyzed the structure and activities of the Thrift and Credit Cooperative Societies in Matara District. The question then becomes whether this form of institution has solved the problem of access to financial services for the poor and, if so, whether the TCCSs can serve as a model for use elsewhere. We shall take the TCCSs back to the general RFM and determine what lessons and examples they have to offer and what weaknesses could doom the model to failure in other RFMs.

Returning to our generalized RFM, we find a substantial portion of the population, mostly at the lower end of the income scale, without adequate financial services. In some cases, a bank or government financial agency will not physically exist within a reasonable walking distance. If one is available, it may not be interested in managing numerous tiny savings accounts. Informal savings groups may or may not exist, but even if they do (like the *cheetu* groups in Sri Lanka), there is no group pressure to use the accumulated funds on productive investment and consumption spending is common.

On the credit side, the poor need loans for productive investment (and consumption) but cannot borrow from formal institutions such as banks and government agencies, since they are "rationed-out" on the basis of being high cost and high risk. Informal credit in sufficient amounts to make adequate productive investments may be unavailable from relatives and friends. Shopkeepers, middlemen and professional moneylenders will likely be accessible, but the cost of borrowing will be exorbitant.

Where is the poor household to turn? Enter the savings and credit cooperative, modelled on the TCCSs

12.1. The Cooperative Process in RFMs

Cooperation is a sophisticated social process and is not automatically suitable for every village or even homogenous groups of poor. While this thesis does not purport to cover the psychology and sociology of cooperation, the nature of the cooperative process limits its applicability.

Cooperation in institutions like the TCCS is not necessarily a natural reflection of village, tribal or household social structures and may not come easily. The cooperative bonds developed in the village, tribal group or family by centuries of social evolution are highly specific to the survival adaptations of each particular group, are imbued in the individual from an early age, and are seldom questioned or altered. A new cooperative form must be demonstrated to enhance everyday life with little risk, it must be easy to operate, and it must not be subject to arbitrary measures from outside the member group. Therefore, in any situation in which the TCCS model is contemplated, the change agent (external or internal to the focus group) must consider how the model, depending as it does upon the cooperative effort of at least several dozen individuals, will be introduced. Will a considerable education campaign be required? Will potential members need to visit a successful cooperative to see for themselves? Will vested interests actively oppose the formation of a cooperative?

Clearly, some social structures can adapt the TCCS model very easily and others cannot. Each socio-economic system must be analyzed separately. To cite a totally speculative example, it may be that in Sri Lanka the Tamil social structure is better suited to cooperative organization than the Sinhalese structure. Another untested example might be an African tribal group, which may at first glance seem to have a wide array of cooperative arrangements already in place, but is ill

suited to a TCCS type of organization because it usurps the traditional patronage system of tribal elders.

A cooperative may indeed be the most efficient and equitable financial intermediary for a certain group, but, if the group members have never seen or experienced a successful cooperative, the merits will not be self-evident. In Sri Lanka, the best known "cooperatives" are the government-sponsored Multi-Purpose Cooperative Societies, which enjoy a great deal of notoriety for political interference, patronage and inefficiency. In light of the bad connotation of "cooperatives," the Federation of TCCSs and the DUs have realized that early education is imperative. Cooperation must be taught.

The TCCSs heavily emphasize education of members and training of officers. The FTCCS and the DUs expend a very large portion of their energy on education and training. However, the field survey reveals that some basic concepts and procedures are not getting through, either because the DU in question did not have the resources to reach all the members or the quality of the sessions was inadequate to ensure that all the participants learned basic materials. There has not been an independent evaluation of the training and education programmes of the TCCSs, but there should be. Applying the TCCS emphasis on education and training in other situations is certainly recommended, but those administering the programmes must honestly evaluate their resources (probably sparse) against the perceived demand (certainly heavy). They must also test materials and instructors to evaluate the quality of the work. The structure of TCCS programming may be of interest to cooperative financial intermediaries elsewhere.

The value of proper education and training cannot be overemphasized. If members do not understand the principles and process of cooperation and see how it can benefit themselves and the community, they will not cooperate. If managers and elected officers are not trained in their functions, they will probably fail to perform their duties adequately.

12.2. The Rural Poor in the TCCS Model

The rural poor are broadly defined as those whose incomes fail to provide for basic household needs or those whose source of subsistence is both low and insecure. How are these people to be included in the saving and borrowing activities of a RFM? They most often have little or no financial resources to contribute and inadequate security to convince any formal lender. Further, they may not have the skills or markets for an income-earning activity. Worse still, they may be deeply in debt to formal and/or informal lenders already. How does the TCCS model address these problems?

The poor are, unfortunately, less inclined to organize themselves and more difficult to organize from outside. The Thrift and Credit Society is essentially a middle-class phenomenon, but it can include the poor if the society has the social consciousness to be deliberately inclusive. It is not surprising that the leadership of most TCCSs, as with most new organizational forms in any country, comes from the more educated strata of society. Those with exposure to an idea from the outside will be the ones to introduce it and those able to afford any risks involved will be the first to adopt it. The poor tend to be highly risk-averse (a proven survival strategy), and are rarely organized along class interests. However, they can be persuaded of the benefits of TCCS-type organization and can at least be included in societies organized by better-off people in the village. While experience from Bangladesh and India suggests that socio-economically homogenous groups of the poor have a better record of success, the membership of TCCSs tend to parallel the socio-economic profile of the village as a whole. This is not a bad thing if the poorer members of the village can become members and benefit from loans.

However, the TCCS model possesses one obstacle that effectively excludes the very poor: the stipulation in most societies' bylaws that all borrowers must have at least one paid share and must hold a proportion (usually 10%) of their loan amount in savings with the TCCS. This rule is a very sensible method of creating a lending base and protecting the society. It provides a test of borrower discipline and commitment. However, if the model is to create access for all of the poor,

the society must somehow reduce or eliminate the barrier without creating a precedent for the collapse of protective measures

The simplest solution, suggested at the end of Chapter 10, would be to allow groups of the poor to purchase a share or shares, permit them to hold a group savings account and grant them group loans. The initial loan to one of the group members would have the share-savings stipulations outlined in the bylaws. Running on the Grameen Bank model,¹ once the first borrower proved his or her ability and willingness to repay, a second would be allowed to borrow on the same share-savings base. This might require an amendment to the bylaws, but would not necessarily reduce the protection sought by the society; since the entire group would be guarantors, providing peer pressure for the borrowers to repay.

Subgroups within the low income population deserve special attention because their access to services is even worse. In Sri Lanka, as elsewhere, these include women (especially female heads of households and middle-aged and older women), the spatially marginalized (those living in remote locations, away from transportation arteries), and those without good connections to the dispensers of jobs and resources (often government jobs and resources). These groups are largely overlapping. The poorest of the poor could well be a female-headed household in a remote mountain village with no family or patronal connections to external resources.

The TCCS model serves women well though there is certainly room for improvement. They can open their own savings accounts, become members and take loans. Women make up half the membership in Matara, take somewhat less than half the loans and are quite underrepresented in the executives of the TCCSs. They do, however, make up the majority of society managers. The

¹ This Bangladeshi "bank" is a very popular model for rural financial intermediation for the poor. Bank amateurs organize the poor into small groups of five or seven individuals. The bank encourages regular weekly savings (no matter how tiny), and offers productive loans to individuals, secured by the group. If the first borrower proves his or her ability to repay, a loan is offered to a second and then a third member of the group, until all members have had a turn. This method has shown remarkable strength, with high levels of borrower discipline and low default rates. Group formation and administration is, however, very labour intensive. See Muhammad Yunus, Grameen Bank.

model may work better or worse, depending upon the culture in question. An orthodox Islamic village would probably frown upon women acting independently of their menfolk. On the other hand, there could easily be more societies like the Kottegoda TCCS, a society composed entirely by and for women. In most cases, though, where there are mixed-gender societies, education and advocacy on behalf of women should be encouraged, even to the point of setting quotas for women on the executive (as in some societies in the northern Tamil zone of the country) and quotas of loan funds for women.

The spatially marginalized are among those who could benefit most from the TCCS model, since the remote villages are the very ones worst served by the existing banking system. In Matara, a large majority of societies are located near to major towns and transportation routes, while the uplands in the north of the district are only sparsely served by TCCSs. Again, a special effort should be made to introduce the idea to remote settlements. The model, although not practiced to perfection in Matara, could serve well in other situations where remote settlements require services.

Those with poor access to jobs and resources can also benefit from a TCCS. Until recently, the TCCSs were entirely on their own, without any external resources for support. This self-sufficient spirit reflects the lack of external connections of many poor people. Lack of personal connections for employment, bank loans, and government services creates a need for the relatively egalitarian and democratic structure of the TCCS. In this structure personal connections are less likely to affect a loan application, since the application can be discussed in an open meeting of members. Further, low borrowing limits, unlimited liability and restricted distribution of profits discourage wealthy villagers from trying to control societies for personal benefit. Now there are external funds coming through the TCCS system and people whose other connections might be poor still stand to benefit from their membership in the TCCS.

Regardless of its shortcomings, the TCCSs offer the best access for the poor of any national programme in Sri Lanka. The model, with noted modifications, could serve well in other RFMs.

12.3 Financial Functions, Lender Behavior and the TCCS Model

The behavior of lenders, depending upon government policy and economic environment, was analyzed in Chapter 3, Sections 2 and 3. The net result of most situations is that the poor are rationed-out of the credit market. The TCCSs avoid many of the rationing measures while maintaining fairly strong financial policies ensuring their continued prosperity. Although there are indeed weaknesses in the system, the TCCSs perform much better than other formal financial intermediaries in the Sri Lankan RFI. The keys are solid financial policies, local knowledge and local control. Depending upon the conditions encountered elsewhere, the TCCS model, especially with group shares, savings, and loans attached, would be a good model to replicate.²

The discipline forced upon the TCCSs by decades of self-sufficiency offers a stern but invaluable example to potential cooperators in other countries. Until recently, there was no shower of external funds upon the TCCSs and they were forced to rely on the savings of their own members for all their loan funds and overheads. A lean, almost starving organization and extremely cautious lending practices resulted from this necessity. Now that external funds are being offered so freely that the TCCSs' absorptive capacity is taxed, the lesson is gone. The question now becomes one of institutional independence, which is further discussed below.

Since the TCCS limits its lending operations to its own locality, it is not the most efficient investor of savings deposits. While providing convenience for savers, the search for the highest yield would drain funds to the urban financial market. In Sri Lanka, finance companies in Colombo can provide returns of 20% per annum and more, whereas the depositor at the TCCS made about 12% (before the recent national decline in rates). Nonetheless, returns to investment compare favorably with other formal lenders and interest paid to depositors is better than commercial banks and only slightly less than the National Savings Bank (which is not very accessible to rural savers).

² Again, attention is drawn to the Grameen Bank model from Bangladesh.

All these other institutions invest most deposits in the urban market. Although returns to TCCS investment are not maximized, the investment is entirely local and can produce linkages and spin-offs which improve the local economy.³ If returns to investment are defined on a broader, community level, then returns from TCCS investment are without doubt the very best for the villagers, even if the exact multiplier effect is unknown. This is one of the main benefits of the model and should be encouraged in other settings.

On this point, however, it would seem that the TCCSs are vulnerable because they invest in a small locality and tend to concentrate on a few productive activities, notably paddy. Combined with their proclivity towards lending for consumption purposes, a crop failure could put the entire lending portfolio of the TCCS in danger. In other words, in many societies, the risk is not spread over a wide enough array of investments to protect the portfolio from severe damage if one major category of loans should fail. Fortunately, there are two countervailing measures. First is the local knowledge of the loans committee and the extreme caution they exercise when lending members' money. This alone would cut the failure rate of productive investments. Second, the Federation of TCCSs has introduced a nation-wide loan protection scheme which would cushion a society against some types of loan losses. (At writing, this system is too new to evaluate.) A full deposit guarantee fund is not yet in place, but is recommended. If and when such a mechanism is in place, the TCCS model can minimize risks associated with saving to the point where no depositor loses a rupee. This will encourage savers to move their deposits from other savings vehicles into TCCS accounts, enlarging the lending base of the society.

A spread of 4% between interest paid to depositors and that taken from borrowers is supposed to be maintained, though the research suggested that 2.9% overall was the actual figure. No spread should be carved in stone, but it is mandatory that the lender at least cover costs and preferably make a small profit. The tendency in cooperatives funded by government is for loans to be made at

³ Excess deposits are now being gathered by the District Bank of the TCCSs for lending to individual societies in the district or, ultimately, to other District Banks. However, most deposits are invested in the village where they were mobilized.

subsidized rates of interest. The capital pool erodes continuously and must be replenished by government, creating complete dependency. Any such lender cannot pay positive interest rates on deposits, so deposits are not taken. TCCSs encourage savings and pay interest over inflation. Yet the TCCS cost of lending is lower than any other formal lender: opportunity cost is local, not national, administration cost is close to zero, and risk premium is minimized by superior lender knowledge and by peer pressure on borrowers to repay. Therefore, the TCCSs, with their linkage of savings and loans, and with positive real interest rates on both, are a good example to others.

TCCS loans, restricted to shareholders with savings, went largely to middle-class people. Most loans were short-term, medium and long-term loans, apart from housing loans, are rare. The accumulation of capital in almost all societies is not large enough to lock large amounts into medium-term loans, let alone long-term loans. The money must move rapidly enough to satisfy demand from members. The size of most loans, from about Rs 600 - Rs 1500, is not large and would be sufficient to finance only a narrow range of very modest income-earning activities or middle-class consumer items. Housing loans were in a category by themselves, averaging Rs 2212 (C\$1110). Most of them are highly subsidized 6% per annum medium-term loans from the National Housing Development Authority (GOSL), about which more below. The TCCSs have by far the smallest average loan size (indicative of access for the poor) of any national credit programme in Sri Lanka.

Diversions of loan funds to activities other than that for which the loan was made are easily detected by the TCCS because the loans committee members live in the same village and have an intimate knowledge of their borrowers. Substitution is not quite so easy to catch, but, again, the local knowledge of the TCCS is superior to that of any external lender.

The tendency of intermediaries to make few large loans to keep costs and risk down is also minimized in the TCCSs. Low loan ceilings and pressure to spread the benefits results in many small loans. The distributional effect is far superior to any other lending mechanism and is another strong reason for replicating the TCCS model.

The dearth of adequate security has blocked the poor from borrowing from other formal lenders, but all the TCCS demands is two guarantors who are members of the society. Thus a borrower need not have any equity at all, as long as two willing guarantors can be found. Nonetheless, some of the poor cannot manage even that. The Grameen type group loan, with its internal guarantee, would help overcome this problem, but the TCCSs do not yet employ it.

The TCCSs have low overdue rates and very low default rates. Again, this is due to local knowledge, caution of the loans committees and strong pressure to repay within the community. Loans are very easily monitored. Should a borrower be unable to meet his or her obligations, the TCCSs are quite flexible on rescheduling the loan. These aspects of the TCCS model are greatly superior to any other formal loans system in Sri Lanka and could be emulated elsewhere.

In short, there is much to recommend the financial policies of the TCCS model for adaptation to other RFMs. Although some policies are so conservative that the poor may be excluded, the survival of the society in its early years must take precedence over inclusive access, should that choice need to be made. The researcher again reiterates that with the Grameen type adaptations, the poor need not be excluded.

12.4. External Influence and Local Autonomy

A common problem in the RFMs of developing countries is the interference of external forces which distort markets and prices, thereby retarding the growth and distribution of wealth. Most often the external force in question is the national government, though lower tiers of government, banks, trans-national corporations, and foreign aid donors are also contributors.

As noted in Chapter 3, Section 1, governments have a variety of reasons and means for intervening in the RFM. This is not necessarily a bad thing, especially if policy stimulates growth and promotes more equitable distribution. Unfortunately, the effects of government regulation of the

RTM are all too often regressive. The motives are power and tax money. Wealth is drained away to outside (urban) markets, better-off rural people capture the benefits of any enticing programmes, and the poor benefit not at all. Ironically, unrestrained laissez-faire can produce similar effects.

Depending upon the context, the TCCS model can serve to create a more powerful economic unit for the poor and middle-classes. This is particularly true if the cooperatives are organized into a three-tiered national organization, paralleling the tiers of government (village, district, and nation), allowing national-level advocacy. At least the cooperatives will then be able to speak with a unified voice at the cabinet level, although in some countries that may count for nothing.

Context is set by laws regulating cooperatives, by any applicable laws governing financial institutions, by the oppressiveness (or lack of it) of the bureaucracy, and by the overall strength of the economy (more particularly the agricultural sector). The financial powers of the cooperatives are usually strictly circumscribed.

Quite often, any "cooperatives" which exist are government-supported, if not government-initiated. So called "cooperatives" have been a favorite government policy vehicle in many developing countries, but the failure rate is extremely high. Why? Because members are only members as long as they stand to gain something from the government. When the benefit flow slows or ceases, their interest wanes and, with little or nothing of their own invested, they allow the cooperative to die.

The TCCS model thrives on relative freedom. As long as the markets are not too unstable nor the government too intrusive, the TCCS can succeed as a private institution. All the strengths of the TCCSs arose from the decades when GOSL ignored them. Now that government funds are flowing through the TCCSs, the independence of the movement is compromised. The heavy subsidy of GOSL housing loans, 10% below what the TCCSs charge for housing loans from their own collected savings, creates the potential for considerable political interference on a local level, since cheap

loans make wonderful patronage for local government party officials and possibly even the local M.P. The next few years will be a revealing test of how well primary societies' bylaws and FTCCS/DU advocacy protect the democracy of the membership from political interference. Not only are the financial risks increased, since large volumes of government money are particularly vulnerable to default, but the Ministry of Housing, the Prime Minister, and the Cooperative Department are all shepherding the money and might prove inflexible in their zeal to have a valuable sop to the middle-class in full working order.

While it is too soon to write-off the TCCSs as another independent organization swallowed by GOSL (like Multi-Purpose Coops in the late 1950s), there is a definite risk of it over the next ten years. This aspect of the TCCS model should be avoided. Emulators should be forewarned about any collaboration with government, no matter how beneficial the offer might look to the members. If government involvement cannot be deflected, extreme caution is imperative. As a general principle, cooperatives should try to avoid involvement with governments, since the legislative powers, personnel pool and financial resources of the government dwarf the power of the cooperative and seriously compromise the latter's ability to act independently. Loss of democratic structure and local control, usually by reliance on external funding, changes the essential nature of the organization to an uncooperative, hierarchical system, much like any other government programme. The cooperative will be on the road to failure.

TCCS involvement with external donors is another matter. The movement has had a glowing reputation in recent years and donors have beat a path to the FTCCS door. Some foreign agencies act as partners in increasing institutional capacity of FTCCS or the DUs. Another helps individual primary societies. These efforts are constructive. However, yet other foreign "assistance" consists of pouring more external loan money into the TCCS system at a time when the TCCSs need to consolidate their membership and operations. Additional loan funds are not at all helpful at this point in time. While the TCCSs are not overtly suffering from foreign assistance, their capacity is being strained. The lesson might lie in close observation of how much external funding, from both

the government and foreign sources, the TCCS system can absorb before something cracks and a society falls. Those seeking to assist the development of financial intermediaries like the TCCSs in other countries need to assess the institutional capacity of the intermediary to determine what sort of assistance is appropriate. Analysis of loan portfolios, management strength and support services would be fundamental, since a small savings base, poor loan recovery, negative real interest rates, inadequately trained managers, lack of member education and weak support services from secondary and tertiary levels of the cooperative system are basic indicators of an institution in difficulty.

The final form of external influence is the potential symbiotic association of non-financial cooperatives with the TCCSs. The TCCSs cannot serve as an example because none of the societies in the field study was involved in such a collaboration. The possibility would be that the non-financial cooperative would offer deposits to the TCCS, while the TCCS would offer financial services, including credit, to the sister cooperative. The potential for mutual benefit is quite high, provided the TCCS is mature enough to manage it.

12.5. Overview: The TCCS as Development Institution

The philosophy of the TCCSs is to orient the membership towards "total village development", including local economic control, secure income, and social and physical infrastructure. Although they rarely say as much in so few words, the TCCSs are out to eradicate poverty. Left to their own devices for a decade or two, some villages might manage to upgrade their entire population of poor into the middle-class. Overall change will occur very slowly, but constant modest improvement is the way to improve the quality of life in crowded, resource poor, rural Sri Lanka.

Starting with the premise that one must know how to financially manage whatever productive assets one has, the TCCSs build a base of financial competence. Members buy a share and save. Then they borrow for productive purposes, make a profit, repay the loan and save some more. The TCCS

membership and financial base grows and the influence of the TCCS in the village increases. Other business functions are taken on, such as supply of fertilizer for the farmer members or group marketing of coir rope made by member households. Social and physical infrastructure enter the picture whenever the TCCS can organize it. Death aid societies are formed or roads improved, a regular clinic is established or lobbied for, electricity may be brought in, a new well may be dug, the irrigation channels could be cleaned.

Ultimately, it is clear that the ideal TCCS, with members in almost every household in the village, would become the effective village government, complete with Rs 100 democracy. The TCCSs' three-tiered structure, parallel to that of GOSL, suggests that, should they survive the travails of political interference and the inevitable economic shocks Sri Lanka will experience, the TCCSs could both advance development of the rural society and restore a form of democracy to the Sri Lankan polity.

The Thrift and Credit Cooperative Societies are not an ideal example for similar development efforts in other RFMs. Weaknesses in the TCCS model are nonetheless instructive. Inadequate initiative to create access for the poor, faltering ability to stave off external interference, and insufficient capacity to handle rapid growth all fall short of desired standards. Yet the TCCSs' decentralized democratic structure, deepening penetration of the countryside, strong financial policies and performance, expanding range of member services, and long-range development goals combine to form an enviable model of institutional development which can contribute significantly to rural development work elsewhere.

APPENDIX

METHODOLOGICAL NOTES

A Field Placement and Components of the Work

Field work was performed in the context of the writer's attachment to GOSL's Matara Integrated Rural Development Project (MIRDP), an arrangement made in advance through the Swedish International Development Authority (SIDA) Planning Advisor working on the project. MIRDP required analysis of the TCCs and their District Union (DU) in order to see whether the DU would be a good implementor for MIRDP's Self-Employment Programme. This programme is intended to promote self-employment through the offer of small loans for start-up capital. MIRDP had been running the loans through individual TCCs and several other local groups already, but the administrative burden was proving to be too much. An implementing agency was needed.

There were two major subcomponents to the field work: 1) interviews, field trips, and collection of data from sources such as government offices, the Federation of TCCs, and several District Unions, and 2) a postal questionnaire to all the 140 TCCs in Matara District which were registered with the Cooperative Department as of December 31, 1986. While there were some methodological difficulties in the latter, the combination of (1) and (2) provide the basis for Chapters 8 through 11.

• Problems

The first problem was the diminishing position of the ~~SIDA~~ Planning Advisor. She was nearing the end of her contract (February 1987) and, due to disputes with office staff and Ministry people in Colombo, lacked the influence to allocate the resources this researcher had been led to believe would be available. Most important of these were translation services and field trip assistance. The Planning Advisor ended up spending only about a fifth of her time in Matara and the rest in Colombo. As a result, supervision was taken up by the MIRDP Project Director and the second SIDA

representative on the project. This arrangement was satisfactory, although these two were not as strongly committed to the research as the original supervisor. In early December a directive arrived from GOSL Treasury informing the IRDP that its budget was summarily cut by 10% for the current fiscal year, despite the late date and substantial short-term liabilities. This placed considerable constraints upon IRDP resources, reducing the ability of the writer to carry out the programme of research, although the personal supervision remained in place. The researcher's lack of a formal appointment coupled with a new commitment from SIDA to pay for a Swedish consultant to perform essentially the same research in 1987 (though in much less detail) also diminished the researcher's resources.

Interviews in Matara, Colombo, Ratnapura, and Nuwara Eliya were easy to arrange at upper levels, since most of the subjects spoke English and were prepared to cooperate. At the village level translation was often necessary, but the Matara IRDP only occasionally provided translators, for the reasons elucidated above. Only once was an IRDP vehicle available for a (five day) field trip, other field trips were accomplished via public transit, which considerably limited the range and number of on site interviews possible.

Financial data was extremely difficult to get. Many TCCSs have only the most rudimentary record keeping and do not calculate aggregate figures for such important measures as total loans outstanding or overdues. All bookkeeping and accounting is, of course, done manually and always in Sinhala (except in Tamil areas, of course). The numbers are in Arabic script, but column and row headings were in Sinhala. Translation was arranged for some documents from the DU, but most information from primary societies had to be distilled from the postal questionnaire.

The rationale for performing a survey by postal questionnaire was that MIRDP required information on which individual TCCSs should receive funds from the Self-Employment Programme. Therefore, a broad survey was needed, but without the human resources to conduct it manually, a postal questionnaire, run at MIRDP expense and with DU cooperation, was the second-best method. Questions for the thesis which were not necessarily of interest to the IRDP were

appended to the questionnaire. The Sri Lankan Post Office is extremely quick and efficient, so there was no anticipated problem with delivery and return. Stamped, self-addressed return envelopes were included. In order to provide added motivation for respondents, MIRDP paid them an honorarium of Rs 50 (C\$2.50) for completing and returning the questionnaire before the stated deadline. This is good remuneration for the work involved and probably contributed heavily to the 84% response rate. Societies which failed to respond were reminded to do so by the DU, which received Rs 10 for each response. Those which ultimately failed to respond were judged to be weak, *ipso facto*.

There were actually three questionnaires, all composed in English by this writer and translated by MIRDP staff: 1) a long test questionnaire which was run as a pilot and amended to yield; 2) a final long version for TCCSs registered before June 1986, and 3) a shorter version for TCCSs registered from June 1986 to the end of December 1986. There are two justifications for the short version. First, the societies were so new that they did not have their operations (or bookkeeping, it turns out) in full order. Second, CD had been organizing new TCCSs since April 1986 following a directive from the Ministry of Housing (see 8.3, 9.3). Some questions on the short version were intended to discover who organized the TCCS and what sort of training, if any, the new society had received. Financial questions were limited.

There was a problem in processing the questionnaires for mailing which reduced the amount of data returned. While this researcher was on field trip, MIRDP staff were to duplicate and mail the final long and short questionnaires. The Chief Clerk, whose English was excellent, was verbally briefed on this and given precise written instructions as to number of each questionnaire and type for each society on the list. Apparently he then delegated the work to a subordinate who duplicated short questionnaires only and sent them out to all the TCCSs on the list. Upon discovery of this large error, the long questionnaire was duplicated in sufficient numbers and sent out. However, 13 TCCSs targeted for a long questionnaire returned the short one only, despite additional honoraria from MIRDP and urging from the DU.

The questionnaires were designed so that most responses would be multiple choice or filling numbers into blanks, minimizing the amount of translation required on the responses. The test questionnaire contained a final open category in the multiple choice questions so as to reduce the possibility of omission. Several adjustments were made to the final version, but some questions retained the "Other (specify)" option.

The responses still required considerable translation. Unfortunately, by that time the only personnel MIRDP could spare were recently graduated social work student volunteers whose English left much to be desired. The work was completed and questionable translation double checked before responses were coded into a computer file.

The quality of the responses was very uneven. Some respondents skipped whole sections, which was taken to demonstrate lack of data and often, by extension, inadequate record-keeping. Worse, much of the financial data was dubious or unacceptable because of definitional problems. For example, although the DU manager provided the categories of society assets ("share capital", "reserve fund", "group fund", etc.) in Sinhala and although two open categories were provided, there was repeated misunderstanding of what these terms meant. The resulting hodge-podge responses for this question and several others obviates the compilation of aggregate statistics for the district, a serious omission in the overall financial analysis.

Actually, data collection does not seem to be a TCCS movement strong point at any level. The few other available studies on the TCCSs repeatedly note the lack of corroborating quantitative data for otherwise favorable conclusions.

Normal survey procedure has a follow up visit to some of the respondents, either randomly selected for reasons of statistical validity or deliberately selected in order to pursue a particular anomaly. However, given the delays in running the survey, much less tabulating it and analyzing the data, it was impossible to perform follow-ups based on survey results. Both visa and financial restrictions prevented the researcher from staying on to carry out this important function. Since

there are many points which would have benefitted from the clarification yielded by follow-up visits, the researcher regrets the lack of opportunity to carry out this stage of enquiry

B. Data Handling

The first point which must be clearly made is that questionnaire responses do not comprise a random sample and are therefore not subject to parametric statistical analysis. Since a primary objective for MIRDP was to identify individual TCCSs which should be targeted for the Self-Employment Programme, questionnaires were sent to the entire population of registered TCCSs. Response to a postal questionnaire is self-selecting so no assumption about normal distribution of results can be made.

Potential for error is skewed in favor of the TCCSs. It is a safe assumption that societies which failed to respond to the questionnaire, having had a pecuniary reward, considerable time and written reminders to do so, are weak societies. They are either unwilling or incapable of cooperating in a survey endorsed by their own DU. This may suggest that their operations are too embryonic to have anything to report, that they do not have persons capable of answering the questions, that they did not perceive cooperation to be worth the effort, or that they are deliberately trying to avoid scrutiny of their structure and operations for unknown reasons.

Observations in the field confirm that obviously strong and successful TCCSs had good basic record keeping while newer, smaller societies were not so diligent. The assumption made, then, is that the 119 respondents form a generally better quality of TCCSs than the 22 societies which failed to respond.

If the responses are taken in the national context, then they are only 119 out of more than 4000 societies islandwide. Are they representative of the "better" societies throughout Sri Lanka? Statistically this is a dubious proposition because the sample is geographically clustered in Matara District and is therefore biased by the quality of TCCS development in the district. It is, for example, not as well developed as Kegalle District, but much better developed than Nuwara Eliya

District, both of which the researcher was able to visit for comparison. However, it would be fair to assume that problems encountered by TCCSs in Matara are being encountered elsewhere. It would also be fair to assume that if a majority of TCCSs in Matara face a certain difficulty, such as non-standardized record keeping techniques, that a large if unspecified proportion of TCCSs elsewhere are also suffering the same problem. In other words, the results may be taken as indicative, but not with any quantitative value attached.

With these reservations in mind, such simple statistics as means, modes, maximums and minimums have been taken not for their predictive value, but for their descriptive value. Exceptions to this are duly noted and number of responses relative to number of societies asked are given. Some questions, such as the one asking how many home gardening loans were made to women, have only five or eight responses out of a potential 52 (in this case) for the "long" questionnaire, out of 67 for the "short" questionnaire, or out of 119 for the combined total. Of course, this ignores the 22 non-responding TCCSs. If only 5 responses were received to a question, the validity of the results must be questioned. It could be that only 5 of 52 TCCSs gave home gardening loans to women, but it is likely that at least several more did so but did not take the time, for whatever reason, to disaggregate their data, which does not normally differentiate on the basis of gender. In such cases, the results can be indicative only.

In hindsight, the research methodology would have been altered. Attachment to MIRDP was more of a liability than an asset and should have been severed. More funds would have permitted hiring private translators, renting vehicles for field trips, and removing other obstacles which caused delays. A longer stay would have been very difficult due to visa restrictions. The sample would have been randomly selected from the total population of societies and the questionnaire applied in person. Follow-up visits would have been performed. These reflections do not repudiate the value of the data herein, but would have yielded better quality data to which more statistical tests could have been applied.

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