



Proceedings
of a
Colloquium
on

AGRICULTURAL CREDIT

-PRESENT SITUATION AND FUTURE PERSPECTIVES-

held at the ARTI

on 19 September 1974

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F O R E W O R D

A one day colloquium on Agricultural Credit - present situation and future perspective was held at the ARTI on the 19th September, 1974. The discussion was based on a paper prepared by the Ministry of Agriculture and Lands.

The Secretary, Ministry of Agriculture and Lands opened the proceedings. The subject was then examined by representatives of institutions concerned with rural credit, the People's Bank, the Bank of Ceylon, the Central Bank, the Department of Co-operative Development, the Ministry of Plantation Industries, the Ministry of Plan Implementation, the Ministry of Planning and the Co-operative Management Services Centre.

The post-lunch session was presided over by the Director, ARTI. and took the form of a discussion where rural credit was dealt with under 3 heads - eligibility and disbursement of credit, institutional arrangements, and the recovery of credit.

There were many aspects of the problem that were not adequately treated for want of time. A follow-up seminar may be useful to deal with these matters in greater depth and to make good any omissions.

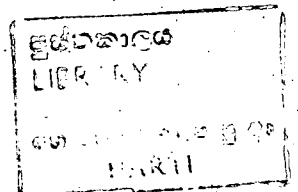
This publication sets out the contributions made by the participants in the pre-lunch session together with a summary of the proceedings of the second half of the seminar.

C. NARAYANASAMY
Director.

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Agricultural Credit - Seminar

Mr. Mahinda Silva,
Secretary, Ministry of Agriculture and Lands.

- Opening the Seminar

We have been working in the agricultural sphere over a period of years and have been grappling with the problems of agricultural and rural credit. Each step we took seemed to us correct and good at the time, but barely one year or six months later we found that the situation was a little worse than when we applied the remedy.

With the present changes in the agricultural sector the question of agricultural credit is of crucial importance. It is a problem for the farmer, for the Central Bank and for the Commercial Banks that have been involved in lending. It is a problem for the Ministry and a continuing problem in the agricultural planning of the country. We thought that the ARTI should at least bring together the key Institutions connected with this subject and have a one day discussion to see whether we can have some kind of agreed solutions even tentatively which we could pass on to the policy-makers and say that this is what the leading Institutions connected with the subject think.

Mr. D.W. Kannangara,
General Manager, People's Bank.

Agricultural Credit specially to the small scale farmer has a history going back to the 1940s. Schemes were started and credit was extended by government departments through the co-operative system. With the failure of each credit system a new scheme was devised. On the advice tendered by a Committee of officials in 1966 to look into the question of Agricultural Credit the New Agricultural Credit Scheme was introduced in 1967 by which credit was extended by the People's Bank to farmers through Co-operative Societies.

In order to understand the New Agricultural Credit Scheme and the special problems that have arisen in implementing it, it is useful to look into the original recommendations of the Committee which formulated the basic recommendations and the evils that they were attempting to correct. This Committee enumerated the following problems as requiring attention :

- (1) The rising trend in the incidence of loan defaults;
- (2) The use of loans for purposes other than those for which they were intended;
- (3) The misuse of monies repaid by members through Co-operative Societies and diverted by the latter for consumer and other activities.

In addition, there was the problem of non-provision of credit to the farmer in time. The Committee was also of the opinion that the loan and recovery procedures were inadequate to cope with the increase in the volume of credit, and that there was also a tendency for the beneficiaries to treat the grant of credit as a welfare measure. The mechanics of the New Agricultural Credit Scheme as recommended by this Committee required the co-ordinated activities of a number of Government Agencies from the preparation of integrated agricultural production programmes to the supervision of credit granted and the co-ordination of recovery activities.

These steps required that applications be called by Co-operative Societies three months prior to the date of actual cultivation. The authentication of the application and its relevance within the overall production plan, the supervision of the activities of Co-operative Societies and recovery programmes become imperative.

Credit was to be extended to all cultivators who were considered eligible under the rules enunciated by the Ministry of Agriculture. It was recognised that this area of lending involved high risks and the guarantee of 75% of all loans defaulted was extended by the government to the lending Bank. Actually when this scheme was thought of, the Bank itself considered the risk element extremely high. In spite of the precautionary measures such as the integrated schemes of supervision recommended by the Committee a guarantee of 90% was originally requested. However, it was agreed that the scheme be first implemented on the basis of a 75% guarantee and this question be reconsidered after a reasonable period. Unfortunately with the passage of time the supervisory mechanism originally instituted gradually fell into disuse, thereby reducing the effectiveness of the entire scheme.

Viewed from the standpoint of lending institutions, there were certain basic contradictions in the loan scheme itself which prevented the building up of an effective credit system. The most important shortcoming was the denial of the right of credit assessment to the lending organisation, i.e. the co-operatives. A lending authority would normally view any request for credit basically keeping in mind the following requirements :-

- (a) Is the applicant reliable? Is he one who will honour his obligations?
- (b) Has he the productive capacity to generate a surplus to meet his costs and expenses as well as his dues on the loan?
- (c) Has he the resources to absorb a contingent loss?

In this scheme the lending institution, i.e. a co-operative, is not free to apply the above basic tests. Instead it has

to issue loans mechanically without any credit analysis in accordance with government directives. As analysed and accepted in 1972 by the Working Group on Agricultural Credit and reported to the Cabinet by the Ministry of Agriculture it was really the government that made the credit decision and not the co-operatives. This would perhaps have been due to the government's view that increasing food production should take precedence over other considerations. The sole criterion of eligibility for credit under this scheme is that the applicant should not be a defaulter. In so far as the non-defaulter is a person who has repaid earlier loans, this is an acceptable criterion. But this non-defaulter classification conceals two types of sub-standard borrowers who are very bad risks -

- (a) there are firstly those who have registered themselves as cultivators of land worked by earlier defaulters in order to get round the eligibility requirements; and
- (b) secondly, there are the subsistence farmers who cannot generate a surplus adequate to repay the loan.

From the foregoing it becomes clear that the co-operatives are only the Agents for channelling credit and it is not required to build a system of assessing the creditworthiness of members. Most damaging of all is that they are not free to refuse a loan to a member who in their opinion is not creditworthy. This has diminished the authority vis-a-vis their membership, has had a demoralising effect on the co-operative management, and resulted in an indifference to the question of loan recoveries.

A welcome feature that was adopted with the operation of the New Agricultural Credit Scheme was the establishment of a body of officers to keep the progress of the scheme under constant review. This body which consisted of representatives of all agencies involved in the provision and supervision of credit as well as the marketing of agricultural produce, was able to maintain a close dialogue among themselves and, with the steadily

deteriorating situation, to suggest remedial measures to eliminate the defects of the earlier system.

In 1972, after discussions held between the representatives of the People's Bank, Co-operative Department and the Ministry of Agriculture, the adoption of what later came to be known as 'THE COMPREHENSIVE SCHEME OF RURAL CREDIT' was proposed and approved by the Cabinet. In order to obtain a proper understanding of the new scheme it is necessary to explain in greater detail what is meant by "Comprehensive Credit". A farmer, specially one living at subsistence level, has to sustain himself in order to carry out the productive process. In such an instance, provision of credit to meet the cultivator's totality of requirements such as consumer needs and incidental expenses as well as his housing needs, payment of debts, etc., was essential to maintain him as a unit of production. A feature which emerges is the paradoxical situation where a majority of the cultivators depend on non-institutional sources of credit. This is due to -

- (a) the ease of obtaining credit from village money lenders; and
- (b) the fact that the village money lender provided the farmer with credit to meet all his needs and thereby had a hold on him.

On the above basis the Bank has already advised Co-operative Rural Banks to extend credit to cultivators in order to meet all their credit needs.

Thus it would appear that institutional sources of credit which provide only the costs of cultivation is inadequate. Rather they should adopt themselves to provide the farmer with all his credit requirements at reasonable interest rates to rescue him from the grip of the money lender and bring him within their spheres of influence.

The provision of such a system of credit had been tried out by the People's Bank through the Co-operative Rural Banks

established in selected societies and was found to be successful. In view of the success, this scheme after discussion was extended to cover the entire network of Multi-Purpose Co-operative Societies and it was decided in 1972 to bring the scheme of cultivation credit also within its ambit. However, though this scheme was accepted in principle in 1972 its implementation has been held up due to a break in the hitherto close liaison that existed between the People's Bank and the Ministry of Agriculture. Prior to 1972 the dialogue between the Bank and the Ministry had been close. During this period all decisions by the Ministry of Agriculture concerning the scheme were made in consultation with the Bank. However, with the breakdown in communication the Bank faced difficulties in the implementation of the credit scheme.

In spite of the common agreement between the Bank and the Ministry to adopt this rational system of extending credit; the Ministry of Agriculture decided to continue with the existing scheme in Maha 73/74 with further relaxation in the eligibility requirements. This was most probably due to the grave food situation that prevailed in 1973. Eligibility standards were relaxed to provide credit to sub-standard borrowers like defaulting cultivators, firstly in kind and thereafter in cash at the rate of Rs.100/- per acre for a maximum of three acres. This category of borrowers was provided this credit after the extension of the repayment period on existing outstanding loans by three years. This was further augmented by a provision of credit to other categories such as temporary permit holders. The volume of credit thus extended has now reached such alarming proportions that the immediate overhauling of the credit system and the adoption of the Comprehensive Scheme of Credit becomes imperative.

The mechanics of providing credit under the New Agricultural Credit Scheme were based on the recommendations of the Committee on Agricultural Credit of 1966. At times the provisions thus made might have led to rigidities such as procedural delays in the entertainment and approval of applications and the continuation of the original application forms as drafted in 1967. However, the Bank with a view to bringing about greater flexibility has over a

period of time introduced the following changes :

- (a) A simplified Application Form to be submitted by farmers to Co-operative Societies.
- (b) The immediate provision of a percentage of the estimated credit requirements of a society and the processing of credit applications in convenient groups as they are submitted so that farmers are provided with their credit as they submit their applications to Co-operative Societies.
- (c) Co-operative Rural Banks have been advised, in implementing the Comprehensive Credit Scheme to approve an overall limit for a farmer in accordance with his production plans and to release funds within this limit on demand according to his needs thereby eliminating the cumbersome procedure inherent in the existing system. In view of the decision to continue with the existing system the progress made in the implementation of this scheme is minimal.

In addition, the reactivation of the integrated scheme of credit supervision and recovery by all connected Government Agencies as well as the active participation of the political authorities in the recovery process for the marketing season Maha 73/74 was suggested. It was expected to strengthen the recovery programme by the introduction of a system of incentives. However, the sense of lethargy and indifference that the present system has brought about among the Co-operative Societies is very difficult to dispel. In our opinion this would be achieved by giving such societies the responsibility of making credit decisions and bringing about a greater awareness of their responsibilities for the recovery of loans granted by them. It is significant that the loans scheme sponsored by the People's Bank through Co-operative Rural Banks where the responsibility for credit decisions is vested in the society, the results have been quite satisfactory.

Lack of credit supervision which is one of the primary reasons given for the failure of the cultivation loan scheme has to be remedied. Admittedly, it is the lending institution which should carry out the supervision of credit. However, in a situation where co-operatives have to grant credit to a large number of small cultivators as in the case of paddy, supervision of borrowers' activities on the scale needed becomes difficult as they are presently ill-equipped to do so. This fact which was recognised in the implementation of the New Agricultural Credit Scheme provided for, by involving the respective government departments employed in extension activities in this area, has to be streamlined. The supervision mechanism which during the first year of this scheme functioned fairly satisfactorily went into complete disuse. An awareness of the need for continuing supervision by these agencies at least till such time as the lending institutions could build up a supervisory machinery of its own requires emphasis.

In view of other causes of defaults as shown by the Central Bank Survey of 1972, 17.2% failed because of low income while 12% defaulters were those who had no intention of repaying. In a system where loans would be granted only on the consideration of creditworthiness these two categories would have primarily been left out. However, the question of providing credit to the low income group has to be viewed from a broader angle as their problem is not a matter of credit alone. It would appear that the provision of credit to this group by a lending institution becomes difficult. A solution to their problem would first be an elimination of the basic defect of a very low level of income. Under the Comprehensive Credit Scheme of the CRBs there is provision for a long-term solution to this problem by encouraging such individuals to diversify their activities and thereby increase their incomes to bring them within the category of creditworthy persons.

A reason given for the failure of credit schemes implemented by government departments was that the recipient had the tendency to view it as assistance from the government

which need not be repaid. It was expected that this position would be rectified with the People's Bank entering the scheme. However, this hope too was not achieved as the farmers soon came to realise where the actual discretionary authority was.

What should be the system for financing small farmers? This question was covered in the earlier remarks concerning those who obtained a very low income. Before the question of credit for such individuals was concerned, a wider problem of uneconomic land holdings and attendant problems should be resolved before the question of credit is taken up. No lending institution could afford to make advances to this category of farmer. This problem should also be viewed from the angle of the present high cost of production.

Any credit system in the future should also see that a degree of flexibility is given to the lending institution to decide on variations in the quantum of credit to be given to individuals depending on the area, the techniques adopted and the individuals' credit rating.

The Bank in its search for a flexible and a simple form of providing credit to the agricultural sector is now exploring the possibility of introducing a scheme of financing cultivators through Bills of Exchange under the Scheme of Comprehensive Credit operated by Co-operative Rural Banks. We hope to submit our proposals regarding this scheme to the Ministry of Agriculture once the details are worked out. This procedure as planned will help to further simplify the provision of facilities under the Comprehensive Credit Scheme.

There is a proposal for a new credit scheme to be operated by the People's Bank. According to this scheme the Paddy Marketing Board is to evaluate the crop production capacity of each farmer and issue him a seller's certificate. On production of this seller's certificate the People's Bank would issue a bill of exchange in the form of a post-dated cheque or a promissory note. This could be realised after a specified period of maturity

and would be guaranteed by the government. After maturity the bill of exchange could be encashed or discounted in full or part at any Bank. The bills would then be forwarded to the Paddy Marketing Board and the transactions would be reflected in the Paddy Marketing Board's Accounts. The collection of the paddy specified in the seller's certificate would be the responsibility of the Paddy Marketing Board.

The question of mobilising savings should be met by institutions through new devices sufficiently attractive to the rural population. These schemes should be such as to enable savings to be made within their income pattern. In this direction Co-operative Rural Banks have been requested to implement the Investment Savings Scheme now in operation in the People's Bank in a modified form. Further, in areas such as Padaviya, schemes have been introduced for the deposit of their sales proceeds into an account which should be subsequently drawn as and when required by the account holders. The performance of CRBs in mobilising rural savings has been most encouraging as is evidenced by the fact that as at the 30th of June, 1974 they had deposits amounting to Rs.54.2 million. Of these, approximately Rs.25.7 million had been granted as loans while Rs.30 million has been given in the form of pawning advances.

Mr. S. Suntharalingam, Manager,
Agricultural and Industrial Credit Dept., Bank of Ceylon :

Our system of rural credit takes us only as far back as February 1973. The thrust of the Government for financing the farmer is two-fold. One system already established has been described by the General Manager of the People's Bank. The other form of rural credit is based on the establishment of Agricultural Productivity Committee. In each APC area there will be an Agricultural Service Centre. Within the nucleus of this Centre, would be housed several sections of the Ministry of Agriculture as well as a sub-branch of the Bank of Ceylon. Out of the proposed 400 agricultural service centres, 200 have already been established.

The total amount that we loaned by way of rural credit is not very substantial in terms of the national total. Our institutional device of the sub-branch is comparatively new, and many sub-branches are being set up on our own reckoning and feed-back, our performance has been quite satisfactory.

According to this new scheme, the Bank of Ceylon will be dealing directly with the farmer. The initial difficulty of identifying the farmer has been simplified by the issue of Agro-Identity Cards. These Identity Cards will enable the farmer and his farming enterprise to be identified and upto a point his record of part borrowings, performance and other relevant information. Our system of financing the farmer is tied up with these Identity Cards and the idea of credit rating is substantially covered by this method. Credit rating would require up-to-date information on the credit history of the farmer. The considerations that weighed with us for the establishment of these Centres was not only the giving out of adequate and timely credit but also the mobilisation of savings which incidentally, has turned out to be very impressive.

The need to examine further the credit-worthiness of the farmer does not have a place in our system of credit. In order to be eligible for a loan from the Bank of Ceylon, it would be adequate now for a farmer to have an account with this Bank and an agro-

identity card. He should also give the Bank an undertaking that he would not borrow from any other lending institution simultaneously. Disbursement of credit will be as decided by the Ministry of Agriculture and approved by the Ministry of Finance. The information given on the application form is required to be certified by the credit institutions of the area in which he cultivates. Our policy of disbursement is taken on the basis of a person's farm surplus and his repaying capacity.

The process of supervision starts even at the time of making the application and is constant and continuous. Farmer's tenurial rights are identified and the Agricultural Lands Law gives a lending institution considerable legal rights if enforcement becomes necessary.

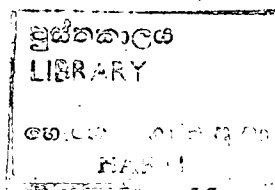
Of the payable advance, 75% is under guarantee of the Central Bank. This guarantee has not interfered with our form of financing nor with the form of recovery. The Central Bank guarantee is subject to review one year from now.

The supervision referred to will be with the co-operation and assistance of the Ministry of Agriculture and Lands and so far the assistance of Divisional Officers, District Officers and Extension Officers has been remarkable. As a new scheme this needs adjustments on various aspects. The sub-branch network under the Agricultural Service Centre I hope, will be successful over a period of time.

One other aspect of this system will be the need for flexibility which has a very important place in any form of credit. Flexibility of course, should be within a decided framework. This flexibility in our system makes room for payment in cash for certain types of crops. The Central Bank survey has revealed that 25% of the defaulters said that there had been no proper supervision by the co-operative societies who have not shown sufficient interest in the matter of loan recovery. For these reasons we have decided that our Managers in these sub-branches should pursue these loans. Some form of incentive for recovery should be built into the system and the procedure for borrowing should be simplified.

Dr. H.N.S. Karunatileke,
Director, Economic Research, Central Bank :

The Central Bank has been interested in agricultural credit mainly because of very high defaulting rate since 1967/68 and even before, and because of the 75% guarantee on loans for the cultivation of paddy and other subsidiary food crops. We look at this problem in a much broader way than the Commercial Banker who is responsible for disbursing this credit. We have to look at the budget on the one hand, our commitments with the I.M.F. and the World Bank, and the overall wellbeing of the economy. I.M.F. Missions always point to the high rate of defaults and we are expected to answer why these loans are not recovered. Between Maha 67/68 and upto 30th June 1974, Rs.368 million worth of loans had been given for paddy cultivation alone, excluding the subsidiary food crops, and the default amounts to Rs.166 million. There had also been loans given more recently for the current Maha season that ended in May-June 1974. Of course, this does not include loans given for subsidiary food crops like potato, chillies and onions. This has an effect on the total credit policy of the Central Bank and on our commitment with the I.M.F. Although production credits are outside the net domestic assets ceiling, the I.M.F. pays a lot of attention to the fact that loans given and not recovered implies that credit from the banking system, for other productive and semi-productive purposes may be reduced proportionately. Money that Central Bank provides as a guarantee really belongs to the Government. Every million rupees of default means that Government might have to find the additional money. At a time like this when the budget deficit has reached astronomical proportions even to find an additional Rs.75 million for each season will pose a problem. For this Maha season disbursement for paddy alone was about Rs.83 million and approximately Rs.15 million has been recovered. The prospects are that even during this season the recovery rate would not exceed 40%. In this context it is incumbent upon us to ensure that the recovery rate is stepped up tremendously. The Central Bank is also concerned about this Rs.166 million which is outstanding. Recovery of this money is absolutely vital in the national



interest because the Government has a severe problem with its welfare commitments to find the additional funds to meet the guarantee. The guarantee itself from our point of view amounts to a welfare commitment.

A further problem that arises from the non-payment of credit given for productive purposes is the inflationary pressure which is now generating in the rural economy. In one cultivation season the amount of purchasing power released, assuming that the farmer only keeps some 50% of his paddy with him, amounts to about Rs.840 million. This is from paddy alone. It excludes the purchasing power generated by other crops like chillies, onions, potatoes and so on. In addition to this, there are also further sources of inflationary pressures which emanate from the rural sector in the shape of loans which are taken and not repaid. For every season this is in the order of about Rs.50 to 60 million. Rural sector also has a higher level of real income because of welfare benefits which are correspondingly higher in the rural sector than that in the urban economy. Free education, free rice given to the farmer who is also a producer of rice, the free health services, non-payment of income tax by farmers despite the fact that they fall within the taxable limits, are all factors leading to inflationary pressures. We should not give them an additional subsidy in the form of non-repaid credit. At the present time even a Rs.50 million that is not recovered could aggravate the price levels as far as domestically purchased goods are concerned.

In the national interest all steps should now be taken not only to ensure that future credit given is recovered but that past dues which amount to Rs.166 million should be recovered since it is our feeling that the rural farmer has the capacity to pay even his past dues in terms of the present level of prices and his general prosperity.

No specific studies on this have yet been made on the relationship between credit and production.

The present price of fertilizer represents an increase of about 372% while the price of paddy has gone up by 10%. On

the assumption that possibly 80% of the area that is now under paddy is under HYVV, the thesis presented by Dr. Samuel points out that unless the yields are in excess of 58 bushels per acre the farmer cannot meet the present cost of fertilizer. The farmer with a lower yield will obviously find that it may not be economical to use fertilizer. In that context, what role can credit play in this situation? Will the availability of credit ensure that the farmer would in practice use fertilizer?

Would credit be adequately disbursed to meet his requirements of fertilizer at the present very high price? If the farmer wants to increase his yield he must use fertilizer. Will he have the capacity to buy the fertilizer? If the production is to be increased to 58 bushels per acre with new high yielding varieties, he must have adequate income. If he is deprived of adequate credit to buy fertilizer, his yield will be so low that even the little credit that he is given may not be repaid because of his subsistence requirements of paddy. This is an important aspect to be considered in the present context.

The capacity to repay is also largely bound up with the price of fertilizer that has now been fixed by the Government. If we have a lower yield there will be a national problem. If our productivity falls, we will have repercussions on the balance of payments, on the budget, and also the repayment problem will get more aggravated. The argument presented is not that fertilizer prices should not be increased but whether it should be increased upto 372%. The price of fertilizer should be fixed so as to balance the two, where all the other variables of the system, repayment, productivity of the paddy sector, our targets of self-sufficiency, and so on must be realised. It is a problem that must be grappled with right now.

Some of the problems with regard to recovery have obviously been highlighted in the two statements made by representatives of the People's Bank and the Bank of Ceylon. We have been largely concerned with the credit disbursed by the People's Bank, and the Central Bank has often wondered why recovery has been very

poor. We have found that the defects are largely with the Co-operative system.

The Central Bank has given thought to this at various times and various suggestions have been made. Very often the defects in the system of recovery of loans has been attributed to the co-operatives. The defects are: that there is no collective responsibility; that the management is deficient; that the type of people appointed are not geared for the disbursement of monies and recovery. Then again, latterly the reactions of the Banks to this proposal might be considered because what we have in mind may also agree with the experience of the Bank of Ceylon. The suggestion of giving incentives for making recoveries may help to reorient our policy in this direction. We have had in mind either a system of paying commission to the members of the co-operatives themselves or giving commission to outsiders where, in each district a person is appointed by the bankers in the area in conjunction with the APC and the political authority, who would be paid a commission on past dues collected. We have this Rs.166 million that is due to the Government from the farmers and efforts may be made to recover it even paying upto 25% commission. This will generate employment possibilities to 2,000 to 3,000 persons in the island and at least 50 or 60% of the total amount outstanding could be recovered. If it is not possible to make the incentive payment to complete outsiders who are not connected either with the banking system or with the co-operatives, it will be worthwhile to pay it to the employees of the co-operatives themselves.

Some system of recovery must be worked out in spite of the difficulties involved. In the alternative, credit supplies will have to be cut off which in turn means cutting down of production by almost 50% in the present context of the high cost of fertilizer. What will be the repercussions in the country? We have a growing population and according to population estimates, to provide people with an extra 1½ measures of rice, we must every year produce an extra supply of 27,000 tons of rice. We have to view this problem in this context.

If the credit recovery is to be continued through the co-operative system, what kind of changes should be effected? There are about 15 - 20% of the co-operatives that are functioning very well and we must find out why and how these co-operatives are functioning successfully.

The newly created Co-operative Management Services Centre should be more concerned with the financial aspects of the co-operatives. Co-operatives will have to be organised at village level. There seems to be a barrier between the co-operatives and the farmer. Co-operatives should be equipped with the correct type of people who can stress the need for closer collaboration in the national interest between the farmer and the giver of credit. This type of reorientation will be possible if we study the merits of co-operatives that are functioning well.

The Central Bank has also considered the idea whether the Banks themselves cannot have direct access to the people without going through the co-operatives. The People's Bank's Branch system is such that it has fairly substantial ramifications which help the Bank to do it in this fashion.

As an experiment the system of giving credit through the co-operatives as well as giving credit directly to the farmers may be tried out in a selected area.

The basic problem is the question of yield. Our default surveys have shown that 17.2% of the farmers could not repay because their incomes were far too low. 12% of the farmers did not pay anything at all. Roughly 30% of the farmers do not have the capacity to pay, Even among the 12% we do not know whether they are well-to-do or whether they fall among the other categories.

It is not the size of the holding but the size of the yield that counts. If the yield is to be stepped up with HYVV, then the question of adequate credit arises.

There had been other theories put forward elsewhere that fertilizer is not so important and that water control and other

factors contribute to a higher yield. But increase in output in such instances is only marginal.

We do not know whether the present pricing policy on fertilizer will actually improve or worsen the present repayment situation in the season to come despite the fact that we might be able to create the correct kind of institutional arrangements to collect them. We might sometimes depress their income to such a level that even with a finest collection mechanism the whole purpose might be defeated. If we have farmers whose incomes are so low it may be impossible to make them repay. There will be losses from year to year.

What are the practical steps that should be taken to recover the credits that are outstanding? Is it feasible? Should credit be channelled to loan defaulters as well?

We have a tremendous conflict on our hand. A strict banker might say that a defaulter should not be given credit. From a banker's point of view there may be a justification in it. But from the national point of view we have the problem of maintaining a higher level of productivity in paddy and also reaching self-sufficiency.

The level of default had been very high in the past, that if the strict banking principle is applied, 60 - 70% people might be disqualified from credit eligibility. The best farmers might also be among those ineligible for credit.

This calls for a thorough investigation of the assets and liabilities of each farmer. The Central Bank takes the view that defaulters should not be given credit. Will that be a solution? The question will be whether the defaulters are to be debarred at the risk of production.

Mr. R.B. Rajaguru,
Commissioner, Co-operative Development:

The involvement of the People's Bank in rural credit started in 1967, while the Bank of Ceylon came in only last year (1973).

The basic position of the co-operatives as far as the rural credit scheme is concerned is a little doubtful. The system of credit operated by the co-operatives is called the 'Integrated System of Credit'. In the Palugama experiment and integration of activities associated with credit, consumer needs and marketing was attempted. Arising out of the Palugama Scheme, the Multi-Purpose Co-operative System originated in 1957. At that stage, an effort was made to integrate all these activities through one organisation, the M.P.C.S. whereas earlier there were three separate co-operatives, one each for credit consumer supplies and marketing.

Where the co-operatives had been left to this kind of exercise, the repayment has been good as they were working in close association with the government. By and large, the repayments were good and the system was considerably satisfactory because the loan scheme was integrated with marketing schemes and marketing enabled the co-operatives to recover the monies.

With the Paddy Lands Act, crop lists were introduced into villages. The farmers were identified and they worked through their cultivation committees and the co-operative societies to get their requirements of fertilizer and other inputs and their credit needs. Eventually, because of the crop list, it was possible for the farmers and the society and the cultivation committees to work in collaboration with each other. Their produce was sold to the government and the recoveries were made from their sale.

In the co-operative sector this aspect of integrated credit is quite necessary because, it was imperative to know whether the farmer will honour his marketing contract with the

co-operative and whether the co-operatives could eventually recover the loans given to him through the marketing scheme.

In the aspect of marketing one of the most important points is whether the price offered for the farmer's produce is adequate and whether the surplus that generates from his sales is adequate to meet his loans. In this context, we have a guaranteed price of Rs. 35/- per bushel for paddy, but there is also the outside market price and by and large the farmer who sells his paddy to the open market would not normally come to the co-operative society to repay his loans. However, if the guaranteed price is sufficiently attractive for the farmer to sell their paddy to the government, repayment of loans should not pose a problem.

When we started the new Agricultural Credit Scheme, we had a close system of collaboration between various departmental persons at the village level and also a close system of supervision of the farmer. It was thus possible for us to see how the farmer used his money and thereafter to see that the monies loaned were recovered.

From the figures it can be seen that the recoveries have been very good after 67-68 for about two or three years. The present problem is this shift of emphasis of supervision. Now two separate Banks are operating in this sphere. One of the Banks has no discretion in the matter of credit disbursement, whereas the other Bank has the discretion of identifying the farmers, assessing their credit worthiness and have the support of APCs staffed by the personnel of the Ministry of Agriculture and other institutions.

This is the dilemma that we are faced with at the moment. In this context there are two standards of values. On the one hand there is the People's Bank which is expected to give credit whether the farmer is creditworthy or not. Political authorities and District Agricultural Committees decide on credit but not the co-operative or the People's Bank.

In this context we have to identify whether the two standards should operate together or in the alternative whether the co-operatives which are functioning in collaboration with the People's Bank should also be given the same discretion of identifying the creditworthiness and processing of credit like the Bank of Ceylon.

The People's Bank gave about Rs.67 million as credit during one season in 67-68, while the Bank of Ceylon on its first impact has given only Rs.1.5 million.

What is the supervisory support that will be available to the co-operatives as they are now available to the Bank of Ceylon? Where the co-operatives were functioning using their discretion notwithstanding the decision of the government that everybody including defaulters should get loans, the recoveries were over 70%. The possibility of Banks handling the entire credit operations in the agricultural sector may be explored.

Even the co-operatives experienced the difficulty of identifying the farmers and his lands. Our basic difficulty is that by and large, there are number of areas where the same plot of land gets loans through various persons. We have no register whereby it is possible to identify the ownership of land.

We worked out a very comprehensive incentive bonus system both for recovery of outstanding credits and for purchasing of paddy. The incentive for paddy was an extra -/25 cts. per bushel, an additional income of about Rs.200/- to 300/- to those who were engaged in recovering loans. This system has not worked well except in the districts of Polonnaruwa and Amparai.

One concept that we must accept is that the farmer generally tend to believe that the government writes off loans given to them. To ensure recovery the only alternative is to identify the creditworthiness of the farmer and debar the defaulters.

We suggest that the entire aspect of marketing should be tied up with credit and a definite attempt be made to introduce a crop list, so that, by 73/74 Maha harvest we could identify the farmer who had borrowed and get him to sell his paddy to the co-operative.

In the present context of increasing population and the need for stepping up production, would it be advisable to deprive the defaulters from getting loans? With the increase of the rising cost of fertilizer, tendency may be there to use less fertilizer. Even now fertilizer is not purchased by the farmers, because they expect an increase in the quantum of credit. The average farmer is not certain whether he could meet the current fertilizer prices with the proceeds of the sales of his produce at the present guaranteed price. It may be necessary to raise the G.P. so that it would be attractive enough for the farmer to use fertilizer at least to an extent where he could be able to break even with the production cost.

The co-operative is involved in the production programme and in the five year plan.

It may be proper to examine the new concept of Agricultural Productivity Committees. We are not sure whether the government is setting up government-supported lending schemes through the APCs and the Bank of Ceylon and gradually working towards by-passing of the co-operatives.

The functions of the APCs are likely to overlap with some of the functions of the co-operatives. It may be worthwhile to define the areas of operation of both APCs as well as co-operatives.

Mr. W. Gunasekera,

Senior Asst. Secretary, Ministry of Plantation Industries :

A dismal picture has been drawn on the credit operations for so many years. The situation is that farmers have been able to obtain their credit easily, made use of it and they were unable to or reluctant to repay.

This problem should be viewed from a different angle. According to the 1962 General Census which was conducted on a holding-wise basis, the category was as follows :

1 - 2½ acre
2½ - 5 acre
5 - 10 acre
10 - 25 acre holding

These holdings constitute 57 p.c. of the total agricultural area of the country which is about 4.6 million acres. In this category there are about 62 p.c. of farmers who are the most viable and small farmers.

The composition of the holdings would be categorised as paddy, plantation crops, other crops, grasslands and temporary crops. Under these categories this group of farmers represent 90 p.c. of the paddy, 85 p.c. of subsidiary crops, 30 p.c. of grassland. 40 p.c. of plantation crop and about 77 p.c. of other crops.

Definition and identification of the farmer are extremely difficult. It has been said that a piece of land has been used by many persons but sometimes it is the other way about. A farmer may have a plot of paddy land, a highland with subsidiary crops. The totality of the crops of a farmer was never taken into consideration. All our credit schemes in the past had been on a crop-wise basis and the heavy emphasis

was on paddy. But it should not be forgotten that the farmer is not only a paddy cultivator. 40 p.c. of the plantation crops in the form of village gardens also become part and parcel of a farmer's assets. One base on which agricultural credit should be looked at, is the totality of agricultural resources of a farmer. This particular census mentioned that the average number of parcels of a farmer is 2.6 or 3 parcels. If credit is injected only to a particular crop and ignore the farmer as a whole, it may not contribute to his development.

Credit should be given on the basis of national requirement and on the basis of a requirement of a particular farmer. That is why there is an over-emphasis on certain crops and an under-emphasis on others. If the credit is taken as a necessary ingredient for development, the totality of this group of farmers should be looked at, which constitute about 2.2 million acres of holdings. What would be the quantum of credit required to uplift or improve the development of these farmers?

If we view the whole question of credit from the angle of developing the total income of a farmer, the whole picture changes. Credit has to be tied up with marketing and extension.

He does not fulfil his obligations because of certain economic forces at work. If the credit system is operating effectively the farmer might want to get more and more credit.

Mr. Michael Scott,
Chief Advisor,
Co-operative Management Services Centre :

The paper that is prepared stretches over quite a wide field but in many areas over-simplifies and really doesn't tackle the problems of the sub-marginal farmers.

The solutions that have been put forward and have been tested in agricultural credit have been over a macro basis rather than on a micro basis. This is a very well made study at this particular level rather than at the institutional level. A number of dilemmas have been highlighted. The Central Bank made a suggestion that the newly formed CMSC should carry out a study at the field level to determine why certain co-operatives are successful in achieving a high degree of recovery and why others are not.

The whole institutional set up of the Co-ops and the new institutional set-up of the APCs should be studied with a view to making these areas becoming **complementary** rather than competitive. A clear line of function could be defined to achieve this objective. We are very much anxious to solve this problem because it may be detrimental to the plans of the country to feed itself.

Mr. B.P.V.A.J.P. Senarathne,
Secretary, Ministry of Plan Implementation :

Ministry of Agriculture and Lands is concerned with a scheme whereby all the farmers get as much credit as possible to increase the productivity of the land.

Credit is looked at as one of the inputs that are required to achieve this objective.

A possible framework can be suggested for the entire credit structure. Before this it would be necessary to have a classification of lands.

1. Lands in which cultivation has to be undertaken at considerable risks.
2. Lands in which the risk is not so high such as colonisation schemes, major and minor irrigation schemes where there is a fair certainty of a considerable return.

Productivity in any land-holding varies according to the performance of the individual farmer. Even in case of lands which do not have any risks, there are cultivators who could be classified as successful or unsuccessful. As far as the development of the country is concerned, much depends on the quality of farmers.

Another phenomenon which should be taken note of is that the possibility of unsuccessful farmer leasing his land

to a second person even if the water supply is assured.

It is better if the land is cultivated by persons who have the initiative and who can apply fertilizer and get the high level of productivity than should be left in the hands of people who do not make that effort.

When we consider that we have considerable areas of land, where cultivation risks are minimal, it may be possible to transfer the unsuccessful farmers to those areas and get to do intensive, extensive work under close supervision so that they may be raised from their subsistence nature to a level from which they may be able to repay their loans. In the areas where there are no risks much more extension work is necessary in order to increase their production.

Dr. Mrs. P.C. Rodrigo,

Asst. Director, Ministry of Planning & Economic Affairs :

One important issue of interest is the current price of fertilizer. Another important issue of relevance is the impact of the Agricultural Lands Law on the rural credit problem.

In the context of an integrated scheme where recoveries are made from sales proceeds, often one important aspect of the problem is overlooked. What percentage of the cultivators actually produce for the market? A good number of tenant farmers in particular, could hardly have any surplus for the market and presumably in a good number of cases their output falls short of their family consumption needs. Further, fragmentation of holdings aggravates the problem. Increase in fertilizer prices is also justified by reference to the increased G.P.S. price.

It is clear that the terms of reference of this seminar does not include the export sector. The issue of long-term credit has not so far figured in the discussion presumably because the credit requirements of the paddy sector are basically of a short-term and medium term nature. It would be worthwhile to survey and find out whether the credit taken from Co-ops over two years has marked a decline or not.

According to the paper, the farmers in the Dry Zone makes greater use of lending agencies than those in the traditional Wet Zone villages where friends and relatives form major source of loans. Perhaps we would relate it to the greater disparity of income in traditional villages compared to colonies where settlers come from the same income group and had received allotments of identical size.

The question is making credits available to those with an uncertain repaying capacity or to be more specific, whether the credit should be channelled to loan defaulters in future as well.

As more and more get into default, the numbers that qualify for loans will progressively dwindle. In the present context of the food crisis, one important issue is what con.

sequences this would have on the production drive.

Diversification of a farmer's income is one of the ways of building up his creditworthiness.

Mr. Olcott Gunasekera,
Chairman, Co-operative Management Services Centre :

The Central Bank has made a suggestion that the entire co-operative sector should be examined to see why certain co-ops achieve a high rate of recovery of loans and while others fail to do so. I made a study in Hambantota District on a query raised by the Secretary to the Treasury about the performance of Hambantota fertilizer programme vis-a-vis the recoveries, I found a very interesting co-relation in two societies in Ambalantota and Tissamaharama where average holding was 3-5 acres and the yield was over 70 bushels per acre. The recoveries from societies were over 70% whilst in Beliatta, Tangalle and other areas where holding was below 2 acres, and 1/4 - 1, the average yield was between 40 and 50 bushels. Although the average yield was high in Hambantota and Hungama, the recovery rate was low.

The main hypothesis is that the sub-marginal and uneconomic farmer has a very low capacity for repayment. The ARTI and Central Bank research points to the existence of this segment of farmers for whom some kind of solution will have to be worked out. Even the increased guaranteed price will not affect them because they do not have surplus for the market.

In the case of sub-marginal farmers whose holding is 1/4 - 2 acres, the State should take an interest to step up his productivity. That type of farmer will not have any excess to sell outside and get a return. The default rate may be high among the sub-marginal farmer.

In case of any agricultural credit scheme, it may not be necessary to have some sort of macro plan or scheme where we work out procedures to recover the monies from that particular segment - sub-marginal farmer who cannot repay.

Polarisation of institutions may not be good from the farmer's point of view. There are two lending institutions, namely the People's Bank and the Bank of Ceylon. Earlier, there was some kind of relationship as farmers play an important part in agricultural production and there should be some co-ordination between him and the credit institutions. It should be very necessary to develop a strong agricultural sector. The entire skills of the village bodies such as Cultivation Committees and MPCSSs should be put to better use. The procedural difficulties in the issue of loans have posed many problems to the farmers.

The recovery position of loans is not so bad because over the past 35 years more than 80% of the loans issued have been recovered. The total amount that is over-due is less than what the Government spends for over an year on the food-subsidy.

We are working out a system to see whether the subsidy scheme can be linked with the sub-marginal subsistence farmer to help him.

The price of paddy and rice should be fixed in a very scientific manner. The credit system should help the subsistence farmer until other factors like Land Reform and so on made his holding an economically viable one.

Dr. Shirley Samuel :

Fertilizer is a critical input and the whole green revolution strategy was based on the abundant availability of this resource at a low price. Now world prices have increased by something like 200 p.c. in the last 6 months and the fertilizer price increase to the farmers is about 373 p.c., meaning that the farmer has to spend over 4½ times as much on the same quantity. There are two elements in the price increase. One: the removal of the subsidy and second: the passing on of the accumulated price increase which has been absorbed by Fertilizer Corporation in the short run. From a purely fiscal stand point it means that had the fertilizer unit price been maintained at a constant unit price to farmers, the subsidy to the paddy sub-sector alone would have increased from Rs.40 million to nearly Rs.200 million.

From the actual point of view of cost, fertilizer price increase means an increase of the cost of inputs from 52 p.c. to 85 p.c. and an increase of 32 p.c. in the overall cost of production assuming that the other prices do not change. The cost of agro-chemicals has in fact increased by something like 66 p.c. The critical statistic on which to compute the yield above which the guaranteed price offsets the increased price of fertilizer is the amount that farmers using fertilizer spent on fertilizer. It transpired in several studies that under rainfed conditions farmers spend Rs.42/- on fertilizer, Rs.49/- under major irrigation and Rs.59/- under minor irrigation. Taking the weighted average under these three water supply conditions for the whole country, it transpired that the weighted mean cash outlay was Rs.49/- per acre on fertilizer.

The guaranteed price has also been increased by 10 p.c., from Rs.30/- to Rs.33/- per bushel. This must offset a part of the higher fertilizer cost for those having a marketable surplus. Since the fertilizer cost increased from around Rs.49/- to Rs.223/- it will theoretically take a yield of about 58 bushels per acre on the assumption that nothing is retained for domestic consumption,

for the increased G.P. of Rs.3/- to offset the increase 373 p.c. in the cost of fertilizer. If a part of the yield is retained for domestic consumption, the off setting yield may need to be higher, depending on the size of the holding and family subsistence level. This average rate of 58 bushels per acre has been achieved only in 5 districts. Assuming that the national average yield is 45 bushels, it means that a majority of farmers would experience declines in their profit margins at previous level of application.

The demands for fertilizer from farmers has been somewhat in elastic i.e. it is not responsive to changes in prices within certain ranges. There is evidence to this fact from India, Bangladesh and so on. Price change of this magnitude is completely outside this range because the incremental benefit from using an additional unit of fertilizer will be 3 to 4 rupees per rupee under optimum conditions. So this nearly 400 p.c. increase wipes out this incremental benefit.

The two price changes are highly biased against the lower-income smaller farmer. Some larger farmers would experience higher profit margins in spite of the fertilizer price increase because they would be able to generate a sufficient output surplus to benefit from the increase in G.P.S. price. But it is very difficult to assess how much the national yield will fall, because there are so many variables. Firstly certain farmers are going to be better off and they might well increase the application of fertilizer despite the price increase. They might in fact, bid away fertilizer from those farmers who might feel it is not worth using it. In case of other farmers whose yield is below the critical theoretical level of 58 bushels per acre, they may be able to prevent significant decreases in the yield, despite reduced levels of fertilizer applications by switching to various paddy varieties that are less fertilizer dependent. The policy advocating a selective switch to HYVV implies that fertilizer, technical knowledge, managerial know-how, agro-chemicals, water control, etc., are really complementary inputs in a package. If any one or more elements of this package is

lacking or deficient, fertilizer can be economised by shifting to H4 without significant yield losses. But, the whole green revolution strategy was to give this complete input package to make it worthwhile to adopt the HYVV. The switch to H4 is best in a holding strategy. Its managerial capacities and water control are really deficiencies to be corrected in the future, then switch to older varieties are beneficial only in a very static or temporary sense. Also, output potential will be affected by fertilizer prices that lock the non-users into the status-quo. Those who have used it will have an idea whether the increased prices would enable them to generate sufficiently increased returns to offset the high cost. But in the case of non-users they will have to face the possibility of having to pay a higher penalty for error.

On the credit question, even large holdings which yield above the off setting yield level that are not required to switch back to less fertilizer dependent varieties, may experience lower yields because of inadequacy of cash capital for investment in fertilizer. The present credit requirement for an average farmer for fertilizer is Rs.246/- per acre. But present allocation is about Rs.82/-.

The possible floor level of application is really about 65% below the recommended dosage level. If the present credit allocations contribute to a mass switch back to less HYVs, decrease in yields is probable and a decline in yield potential is certain.

Removal of fertilizer subsidy and increase in fertilizer and paddy prices are likely to contribute to a great increase in the income disparities in the agricultural sector. Larger farmers who market a larger proportion of the produce would gain in relation to small farmers and at the expense of lower income consumers. Small farmers whose

holdings are below 2 acres use only slightly less fertilizer per acre than large farmers; it is 88 p.c. vs 92 p.c. as is the evidence from Kandy and Hambantota. Given the fact that there is no significant correlation between productivity and the farm size, small farmers who use as much fertilizer as large farmers will find that his fertilizer cost has increased 373 p.c. but he is unable to benefit commensurately from G.P.S. price increase because his surplus is so much smaller. This factor increases the income disparities. The farm size factor is also important to explain the marketable surplus. Even if a small farmers' yield exceeds the theoretical rate of 58 bushels per acre, he must sell it in order that the increase in the G.P.S. offsets high fertilizer cost. But whether he could sell depends on the size of his holding, productivity and family subsistence needs.

Subsidising inputs like fertilizer ensures that the Government expenditure is directly proportional to the use of the input, technology, while the increase in the guaranteed price benefits farmers in proportion to their marketings. Hence the former rewards farmers because they are progressive while the latter rewards farmers merely because their holdings are large.

Mr. Olcott Gunasekera :

Rationing and subsidising of basic consumer needs has been in operation for over 30 years in Sri Lanka. Apart from changes in quantum of commodities, basic system has remained unchanged and unchallenged for this period. This paper outlines a completely different system which should simplify and reduce administration cost, eliminate unnecessary food subsidies and drastically reduce present malpractices. It is desirable that any ration and subsidy scheme should be short-term and not lead to any kind of habit formation or significantly distort economic values. Immediately the conditions which necessitate the scheme disappears, it should be terminated.

1. Proposed Scheme :

Under the proposed scheme, it is suggested that :

- (i) All individual entitlements of rationed commodities be converted to maximum family entitlement.
- (ii) Both tax payers and non-tax payers be grouped upon to family units.

For example if it is decided to base the family group among the grouping used in the calculation of income tax there could be four groups as follows :

- (1) Single individual
- (2) Husband and wife
- (3) Husband and wife with one or two children
- (4) Husband and wife with three or more children

In the case of non taxpayers the family entitlement should continue to include non-paid rice component to be issued on a family coupon and a paid rice component which is not on a coupon. It has been suggested that the issue of non-paid rice be continued as the benefit of a social relief scheme to a food subsidy. It is more effective in a developing nation which has to safeguard against malnutrition than the granting of a cash allowance. However, such a scheme should be directed towards

those who are in need of such assistance. Tax payers be entitled to only paid rice on family basis. The maximum entitlement be determined according to the size of family unit as aforesaid.

2. Paid rice :

In the case of both tax-payers and non tax payers there should be no element of subsidy and the component of rice be priced from time to time according to market fluctuations, by the Food Commissioner or any other appropriate authority.

Two key factors for the success of the scheme are :

- (1) The quantum of the maximum family weekly, monthly entitlement of the rice and,
- (2) The price that should be determined for paid rice.

The plan would be drawn on the basis of the co-ops drawing the maximum weekly, monthly entitlement if they so desire. However, the discretion should be with co-operatives to draw lesser amounts if they already have ample stock.

The plan may not eliminate completely the illicit draw of rice from co-operatives to the outside market but it could be minimised. Even if there is an illicit draw the effect would be to stabilise the outside market price for rice. By constant price adjustments this could be further reduced. However, it is not worthwhile to have an elaborate control system for paid rice as there is no loss to government on its sale.

It is recommended that there should be a continuing study of production cost, local and world market trends, the availability etc., by a special unit of the Central Bank supported by an efficient monitoring service to advise the appropriate authority of the price that may be announced monthly by the Food Commissioner along with monthly family entitlement. Non-tax payers should be allowed to encash the family rice coupon. The

encashable fee should be substantial enough to encourage farmers or artisans to convert the food subsidy into a production capital investment subsidy. For example, having a marginal or subsistence level from a holding, he should see the advantages of increasing yields and returning his consumption needs, than spend his paddy and depend on free rice. It is suggested that the encashable fee should be 5 to 10 cents above the market price. If a person wants to encash a coupon for fertilizer, a premium price at a still higher rate should be given. Encashment of the rice coupon should be allowed to be done at any time. However, the encashment should be irrevocable and the total balance coupons should have to surrendered. Other items that have been brought under the ration should be made available to co-ops at market prices within maximum family entitlement if national stock levels requires fixing of such upper limits. For this purpose family ration cards should be maintained. The family coupon cards for unpaid rice should be printed in different colours for easy identification and each coupon would entitle a family to a stipulated weekly ration.

These are the advantages of this scheme :

- (1) Saving in print cost and stationary including the foreign exchange element.
- (2) Saving of time of co-op stores and the significant reduction in the waiting time of consumers.
- (3) Reduction of food regulation malpractices like pawning of rice ration books.
- (4) Substantial saving in the food subsidy vote as there would not be a subsidy on the paid rice and the non-paid rice would be distributed on family entitlement.

Besides the initial advantages the scheme will have additional benefits. Trafficking in rice, sugar and other commodities through co-operative branches and the consumer, would be minimised due to the price factor and there will be family excesses for resale. Yet the social benefit accruing

from the ration scheme will be maintained as non-paid rice would continue to be given to non-tax payers according to the size of the family unit.

3. It could act as a discouragement to have bigger families and helping in family planning.

4. The variation of the paid rice components would be an education to masses on the phenomenon of price fluctuation according to the world market trends.

5. The scheme would operate as an incentive for production for all farmers whether the holdings are uneconomical or not. In the case of the farmer with an uneconomical holding who has encashed his family coupon, the penalty for not utilizing the subsidy for production purposes would be the high price he will have to pay for his rice he purchases.

6. Any increase in the G.P.S. price would not benefit either the marginal farmer or the sub-marginal farmer unless there is recycling of his paddy wherein the farmer could sell his paddy and depend either on non-paid rice or paid rice from the co-operative. Since this process would be costly and wasteful to the nation in the ultimate analysis, the proposed plan would prevent this.

7. The scheme would help in maintaining the productivity of the sub-marginal subsistence farmer who may not be able to oppose the high price of fertilizer etc., as he would soon understand direct benefit of increasing the productivity of his holding.

8. The scheme would help the nation to attain self-sufficiency in food as it is likely to affect the food habits of the people.

Mr. Mahinda Silva (Summing up) morning session

I would like to make some observations on some of the issues raised by several speakers, not really as matter of settled policy but as a kind of ways of thinking which we are at the moment engaged in at the Ministry of Agriculture.

We are strongly inclined to the view that there is room for more than one lending institution to operate in the rural sector of the country. In addition to the Bank of Ceylon and the People's Bank that if there are any other banks that are interested, we think there is room and we think it would be very worthy to bring these several institutions into the picture. When we are thinking of rural credit we are thinking of the totality of rural credit including for consumption and for infrastructure development. Hitherto we have been of the view that the function of rural credit should be passed over within a certain period to the banking system of the country i.e. the total banking system as opposed to the institutions of the government. A proposal of this nature was submitted to the Cabinet and has been approved in principle. In view of the very firm fiscal policies government introduced about two years ago, there is an economic and social climate now healthy for a very rapid diversification in the agricultural sector. We feel that it is not necessary that the techniques of lending, methodology of lending should be uniform. We feel that each institution should have its own freedom to develop its own initiative and if necessary its own areas of specialisation. May be that certain institutions might like to handle certain types of crops and develop an expertise in that way. Certain types of people may like to go in and help particular regions because the concept of regional development is also one which is strongly emerging particularly in trying to give some kind of order to the land reform programme, where large number of land is now vested in areas like the Wet Zone and the Intermediate Zone.

We are also very appreciative of the very enormous problem the country is facing now - that is the increase of ferti-

liser prices. Before the price increase of fertilizer there was a great deal of deliberations to the effect whether the 50 per cent subsidy should be continued. Financial advisers of the government obviously felt it otherwise. Consideration was also given to the possibility whether subsidy should be retained at a lower level i.e. 25 p.c.

One of the things that strongly contributed to the removal of subsidy altogether was that it was becoming increasingly difficult to maintain a subsidised sector and an unsubsidised sector co-existing. We were constantly having this problem. Statistics regarding the use of fertilizer show a very high element of error. It is the fertilizer drawn in the name of paddy or in the name of whatever the subsidies, one possible argument is that we should have a subsidy for the whole sector. Even this was felt too high or burden on the government resources. With the increase in the price of fertilizer it seems that the demand for it has declined to a great extent. It is not certain whether this is the initial reaction to the price increase. However, we made recommendations to the Minister of Finance to enhance the credit limits. We insisted that the credit limits be increased to meet the realistic cost of fertilizer and that credit be given only to those who are not in default.

There should be at the official level a Standing Committee reviewing all the policy problems regarding agricultural credit and it should include the two banks, respective planning ministries and trade and the Central Bank.

The question of credit which has already been given serious consideration is not a problem that can be easily ignored either by the Central Bank or by the Government. Any suggestions to offer incentives to co-operatives or to any commission agents or anyone else where at least 25 - 30 p.c. of this can be recovered, would be a healthy precedence.

FAO itself has launched an Asian Survey and Ceylon too has participated in it by a closer study of one APC i.e. Kandupalatha in the Manikdiwela APC. One of the highlights of this survey is that the importance of the marginal farmer should not be forgotten. We have not paid enough attention to the marginal farmer. Credit should be extended in such a way to help those farmers who are having uneconomic holdings or holdings in high risk areas.

LW.

POST-LUNCH SESSION

The Discussion

The main points made are arranged under :

1. Eligibility and Disbursement of Credit

(i) Place of Institutional Credit :-

Institutional credit assumes a significant role during a state of technological advance in agriculture when farmers' requirements for purchased inputs begin to increase at a rapid rate, necessitating a corresponding increase in the volumes of credit available to them. This will be important both in terms of the physical inputs like fertilizer, agro-chemicals, etc., and in terms of service inputs like land preparation, etc. In these circumstances it would also be more profitable to invest further in agriculture thus increasing the demand for more credit.

It was pointed out that a great proportion of borrowing in the dry zone colonisation schemes was from institutional sources.

(ii) Place of Non-Institutional Credit :-

Credit should be viewed as a means of increasing production. 90% of rural credit is said to be from non-institutional sources and the view was expressed that non-institutional sources have a significant role to play in the rural economy. It was felt that there was a greater dependence on non-institutional sources in the wet zone due to :

- (a) small size of holdings which did not make it worthwhile for small farmers to undergo the inconvenience of bureaucratic procedures for obtaining credit, and,
- (b) the fact that traditional relationships enabled farmers in the wet zone to borrow a large proportion of credit from friends and relatives.

The view was expressed that the private lender may not be the usurer he was generally made out to be. Taking into consideration all aspects of the matter it could even be stated that the interest rates charged by private lenders were not all that much in excess of those charged by credit institutions. One of the participants pointed out that it was not often appreciated that there was a hidden subsidy in the interest rates charged by institutional sources. It was also stated that as large amounts of loans remain unrecovered the social cost to the government was not reflected in the interest rates charged by the institutional sources. There were however, some others who stated that some of the studies pointed to non-institutional sources charging high rates of interest which were very much higher than that charged by institutional sources. It was agreed that the data available on this subject was inadequate to arrive at any firm conclusions.

It was also said that for non-institutional credit courses to play a supplementary role, the farmer's crop must be available to the lender as security in case of default. Where the PMB became by law the sole buyer, the private lender was deprived of his security.

(iii) Creditworthiness of the Subsistence Farmer :-

The subsistence farmer did not generate a surplus for repayment of loans. The question arose as to whether credit should be extended to this category of farmers. The view was expressed that since a substantial foreign exchange allocation was spent on the import of rice, it may be worthwhile subsidising the low income and subsistence farmer so that he could maintain production until such time as his enterprise became viable. One way of increasing his income was providing off farm employment. It was pointed out that the Japanese farmer, in spite of small holdings (below 1 hecter ie: 2.27 acres) has a fair standard of living. In this connection, it was suggested that employment opportunities for subsistence farmers be organised by Cultivation Committees, by means of seed farms, etc., Organisation of cultivation on a "tract or block basis" suitably assisted by Cultivation Committees, Government

grants or Bank loans may become necessary. However, the utilisation of this assistance should be properly and adequately supervised.

(iv) Supervision of Credit :-

It was felt that credit supervision could be done by Agricultural Productivity Committees and Cultivation Committees and Co-operative Societies. The distinction was made between supervising and 'policing' of loans. Real supervision should aim at training and educating the farmer. Reference was made to the experience in the Hambantota district where credit was supervised and the farmer given the necessary facilities and know-how through the co-operatives. It was felt that future credit supervision projects could benefit from the Hambantota experience. It was felt that the Extension Service could play a more effective role in this connection. It was recognised that the APCs have the legal powers of supervision under the Agricultural Productivity Law.

(v) Fertilizer Prices :-

The allocation of credit for fertilizer was far less than what was needed to purchase fertilizer at the present prices. Fertilizer was moving slowly and only 25 tons had moved out of CASS Stores in August. The question was asked whether this was due to the unprofitability of using fertilizer at present fertilizer and G.P.S. prices. The slow movement of fertilizer might be due to : (a) the expectation of the farmers that fertilizer prices may be reduced and/or (b) that the credit limits for the purchase of fertilizer may be increased.

The present fertilizer subsidy of 50% to the plantation sector came under severe criticisms. It was felt that this was a serious anomaly particularly in the case of the small farm sector which makes an important contribution to food production.

2. Institutional Arrangements :

It was pointed out that the Bank of Ceylon procedures for credit were simplified since only one form was used. The pro-

cedure for getting credit through the MPCs however, was more complicated requiring over 2 months from the date of application to the time of granting of credit. The criteria of determining the eligibility for loans were different in the Bank of Ceylon and People's Bank. The possible danger of a polarization of the rural institutions in granting credit was referred to, and the need for the institutions becoming complementary was specially emphasised. There should be closer co-ordination between the MPCs and its branches, the APC and the Cultivation Committees in serving the farmers and the two Banks should serve both the farmers and the institutions in a complementary manner each developing its own speciality.

3. Recovery :

The view was clearly expressed that past loans should not be waived. Although loans were not repaid, it did not necessarily imply that the farmer was without credit in future seasons. It was possible that the capital component that should have been used for repaying loans was instead directly invested in agricultural operations without the defaulting farmer having to go through the motions of repaying credit to the MPCs and borrowing once again. In fact, even though there were low rates of credit disbursement, credit might still be circulating in the rural economy.

Default may be an index of the non-creditworthiness of a farmer. A scheme of crop insurance properly implemented may reduce the incidence of default in bona fide cases.

One way of reducing defaults might be by re-introducing the idea of corporate responsibility for recovery of loans. This was said to have been successful in Comilla, Bangladesh and in Sri Lanka between 1954 and 1963 where the default rate was only 4.4%. In Sri Lanka loans to co-operatives were made available by the People's Bank and the co-operatives as a whole took responsibility for the repayment of these loans. This procedure enables the development of a system of social sanctions whereby non defaulting farmers bring social pressure on defaulting members to repay their loans.

The point was made that recoveries were more successful when credit was tied to marketing arrangements. (It is relevant however, that at the time referred to, the guaranteed price for paddy was higher than the open market price).

Conclusions :

1. Past dues should not be waived.
2. Credit was not a means of rehabilitating the subsistence farmer. Instead, a Small Farmer Development Agency should be established to make viable this category of farming through a system of grants and infra-structure development. Also by providing off farm employment and supervision of cultivation through the Cultivation Committees and Agricultural Productivity Committees.
3. Credit should be granted on the basis of the borrower's capacity to repay from both his farm and off farm earnings, rather than limit his creditworthiness to his paddy holding.
4. There was room for a number of credit institutions to operate in the rural areas, each developing its own speciality. However, there was need for better communication in particular between MPCSSs, APCc and the Commercial Banks at village level.
5. Institutional and non institutional sources of credit both have a place in the small farm sector the relative importance of each depending on the various situations pertaining to the different cultivation practices, crops, etc.
6. Present high prices of fertilizer seem to act as a definite disincentive to its use.

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