COOPERATIVE CREDIT AND THE COOPERATIVE CREDIT INSTITUTIONS: BEFORE AND AFTER THE NEO-LIBERAL REFORMS IN INDIA

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DECLARATION

I declare that the dissertation entitled, **Cooperative Credit and the Cooperative Credit Institutions: Before and After the Neo-Liberal Reforms in India**, submitted by me, in partial fulfillment of the requirements for the award of the degree of Master of Philosophy from Jawaharlal Nehru University, is my original work. The dissertation has not been submitted for any other degree in this University or any other University.

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CERTIFICATE

We recommend that the dissertation be placed before the examiners for evaluation.

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Akanksha Pratik Sonker,

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LIST OF ABBREVIATIONS

ADWDRS	Agricultural Debt Waiver and Debt Relief Scheme
AIRCRC	All Indian Rural Credit Review Committee
AIRCS	All India Rural Credit Survey
ATM	Automated Teller Machine
B.R. Act	Banking Regulation Act
BC	Business Correspondent
BF	Business Facilitator
BSE	Bombay Stock Exchange
CAMELS	Capital adequacy, Asset quality, Management, Earning Capacity, Liquidity and Systems and control
CAMELSC	Capital adequacy, Asset quality, Management, Earning Capacity, Liquidity, Systems, Compliance and Control
CAS	Common Accounting System
CAS	Credit Authorisation Scheme
CBS	Core Banking Solutions
CDF	Cooperative Development Fund
CIC	Credit Information Company
CMA	Credit Monitoring Arrangement
CRAFICARD	Committee to Review the Arrangements For Institutional

	Credit for Agricultural and Rural Development
CRAR	Capital to Risk-weighted Asset Ratio
CRR	Cash Reserve Ratio
DACP	Doubling of Agricultural Credit Program
DCBS	Department of Cooperative Bank Supervision
DCCB	District Central Cooperative Bank
DICGC	Deposit Insurance and Credit Guarantee Corporation
FSS	Farmers' Service Societies
GDP	Gross Domestic Product
IPDI	Innovative Perpetual Debt Instruments
IRDP	Integrated Rural Development Programme
LAMPS	Large Area Multi-Purpose Cooperative Societies/ Large-sized Adivasi Multi-Purpose Societies
LTD	Long Term (Subordinated) Deposits
MACS	Mutually Aided Cooperative Societies
MFI	Micro Finance Institutions
MIS	Management Information System
MOU	Memorandum of Understanding
MSCS	Multi-State Cooperative Societies
MUDRA	Micro Units Development Refinance Agency
NABARD	National Bank for Agricultural and Rural Development

NAFSCOB	National Federation for State Cooperation Banks
NBFCs	Non-Banking Financial Companies
NDC	National Development Corporation
NDTL	Net Deposits and Time Liabilities
NEFT	National Electronics Funds Transfer System
NSE	National Stock Exchange
NGO	Non-Governmental Organization
NPA	Non-Performing Asset
OTCEI	Over-The Counter Exchange Of India
OTS	One Time Settlement
PACS	Primary Agricultural Cooperative Societies
PCARDB	Primary Cooperative Agriculture and Regional Development Bank
PDS	Public Distribution System
POS	Point Of Sale
PSL	Priority Sector Lending
PSU	Public Sector Undertaking
RBI	Reserve Bank of India
RRB	Regional Rural Bank
RSTCCS	Rural Short-Term Cooperative Credit Structure
RTGS	Real Time Gross Settlements

SAO	Seasonal Agricultural Operation
SBL	Self-Help Group-Bank Linkage
SC	Scheduled Caste
SCARDB	State Cooperative Agriculture and Rural Development Bank
SCB	Scheduled Commercial Banks
SFDA	Small Farmers' Development Agency
SGL	Subsidiary General Ledger
SHG	Self Help Group
SLR	Statutory Liquidity Requirements
ST	Scheduled Tribe
StCB	State Cooperative Banks
STCCS	Short-Term Cooperative Credit Structure
UCB	Urban Cooperative Banks

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INTRODUCTION

The concept of cooperative credit is not new to a country that has had a history of both formal and informal associations to provide help and mutual aid in the form of Chit Funds in Madras Presidency, "Kuries" in Travancore, "Bhishies" in Kolhapur etc.[1] India has for long remained a predominantly agrarian economy wherein credit is an important determinant of agricultural investment and production. It is also essential to meet the seasonal fluctuations in income and expenditure.

The Cooperative Credit Institutions were established as the existing colonial banking structure comprising of Commercial Banks, Presidency Banks, Exchange Banks etc. catered only to the needs of the imperialist government and British capital and largely bypassed the rural countryside. The high degree of dependence on informal sources of credit with the dominant role played by the moneylenders pushed the rural poor into debt and poverty and subjected them to an interplay of unfair and usurious practices.

The response in the form of the Deccan Riots of 1875 was an example of events that triggered the need for institutions that would not only protect the interests of the rural poor but also strengthen the rural economy. The Famine Commission of 1880 and 1901 too raised similar concerns over the rising indebtedness and marginalization in the rural areas. The sad state of agriculture, perpetuating agrarian distress and discontent forced the policy makers to devise a mechanism to address the problems of rural indebtedness, poverty and inadequate credit access to the poor. It was well recognized that any institutional arrangement to address this problem should promote growth and development of the rural areas and challenge the hegemonic position of the moneylenders. It was also recognized that such an arrangement aimed at addressing the rural needs should be well-equipped with the knowledge of the local people and the local conditions.

The Credit Cooperatives that emerged in India owe their origin to the success of the Cooperative movement in Europe and were fashioned along the British

[1] GOI.(2009). *Report of the High Powered Committee on Cooperatives*.

and German Raiffeisen model.[2] Cooperative Banking in India formally came into existence after the enactment of the Cooperative Credit Societies Act, 1904 and the Cooperative Societies Act, 1912 based on the recommendations of Edward Law Committee pioneered by the work of Frederick Nicholson and H. Dupernex. The co-operatives were envisioned as instruments to strengthen the rural economy as well as to link credit with the process of marketing and processing. It also aimed at encouraging mutual help and thrift among the rural poor.

The Maclagan Committee (1915) and the Royal Commission of Agriculture (1928) emphasized the State's role in promoting and supporting the Cooperatives.

Even after independence, the Cooperative Banks remained central to the strategy of equitable development and were the only source of institutional credit for agriculture till as late as 1969.[3] However the All India Rural Credit Survey (1951) observed that despite the expansion of cooperatives in the country, the credit provision to agriculture remained dismal. It was also felt that these Banks could not adequately meet the credit needs especially after the launch of the Green Revolution. This led to an adoption of a multi-agency approach for purveying rural credit. This was strengthened by a series of policy decisions like bank nationalisation, establishment of Regional Rural Banks and NABARD, creation of the lead bank scheme, specifying Priority Sector Lending norms, etc.

But the neo-liberal reforms adopted in India at the behest of the Bretton Woods Institutions in the early nineties shook the edifice of the Cooperative Banks. This coupled with the Narasimham Committee sounded the death knell of the "social and development banking phase". It was believed that the social control of the banks was adversely affecting their viability and worsening their financial performance. Thus, the economic reforms led to discarding of social banking in favor of marked-based polices of profitability and efficiency.

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[2] The Raiffeisen Model of Cooperative credit began in Germany in 1862 to protect the interests of small farmers from the moneylenders. These societies were mainly agricultural in nature and the farmers organized themselves to obtain cheap credit

[3] Although The Commercial Banks existed, they provided credit mainly to plantations.

Today, the Cooperative Banks face stiff competition from the Commercial Banks, Regional Rural Banks and the new entrants like the private and foreign banks for resources and customers. Data reveals that although the Commercial Banks' performance has improved when judged in terms of the fulfillment of Priority Sector Lending obligations as well as extending their geographical spread, this was partly the result of the dilution and redefinition of the "Priority Sector" and was accompanied by a disproportional shift towards larger borrowers. In the neo-liberal regime, the Commercial Banks and even the Regional Rural Banks (that were by purpose designed to cater to the rural areas) have largely overlooked the rural countryside as these institutions do not see them as profitable avenues for business.

In contrast, Cooperative Banking rests on the principles of growth and development through mutual help and cooperation and not on commercial interests and profitability. It is based on a closely knit-network of members bound by social relations or commonality of occupation or location in a contiguous geographical area. Such an association of members mitigates the risks arising out of asymmetry of information and lowers the transaction costs through peer monitoring.

These features have revived interest in Cooperative institutions. The need to revive the Cooperatives assumes greater relevance and importance in the age of globalisation with the reduced role of the State. The emphasis placed on the "invisible hand of the market" and the shrinking domain of the State to effectively achieve the goals of socio-economic equity results in stark and growing income and regional disparities. The withdrawal of the State from crucial sectors like health and education, inefficient Public Distribution systems and the lack of social security schemes along with other needs of working capital, seasonal fluctuations in income and expenditure and other social obligations leads to greater need for rural credit.

The Cooperatives have immense potential to channelize credit to the rural areas as these institutions are member-driven and are premised on growth and development based on mutual help. Unlike other institutions driven by the motive of garnering short term profits, the objective of the Cooperatives is to promote long term sustainability and inclusive growth.

Today, although the Cooperatives account for a small share in the overall financial system, their role in integrating the weaker and marginalized section with the formal banking system cannot be discredited. A study conducted by the Vaidyanathan Committee revealed that while the public sector banks accounted for over 164 lakh accounts with an average loan size of Rs 31,585, the Cooperative societies had 639 lakh accounts with an average loan size of Rs 6637. Further the banking sector exhibited a growing propensity towards large borrowers with the small borrower accounts (less than Rs 2 lakh)[4] decreasing from 5.88 crores in 1991 to 3.69 crores in 2003.[5] The Credit cooperatives account for almost 70% of the rural credit outlets and 45% of the total rural credit.[6] The Credit Cooperatives form a larger network than any other formal institution of credit and accounted for more than twice the rural outlets, four times more accounts and 50 per cent more customers than the aggregate of the Commercial Banks and the Regional Rural Banks in 2004.[7] The widespread network reaches out to the most remote and inaccessible regions with a membership of around 230 million. These figures reiterate that the potential and the relevance of these institutions does not cease to exist.

Despite all the criticism leveled against the Cooperatives, it is widely accepted that these institutions have played an important role in disbursing agricultural credit in the country. The Cooperative Banks were the primary source of institutional credit accounting for 93.22% of total agricultural credit in the early seventies. Their share fell to 58.9% in 1980-81 and 49.03% in 1990-91 with the expansion of the Commercial Banks and the introduction of Regional Rural Banks. The share of the Cooperative Banks rose to 61.34% in 1993-94.[8] But since then there has been a reversal of trends and a major reshuffling in

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[4] The "Small Borrower Accounts" were redefined in 1998 and the upper limit of credit for these loans was increased from Rs 25000 to Rs 2 lakhs.
[5] RBI. (2005). *Report of the Internal Group to Examine Issues Relating to Rural Credit and Microfinance*
[6] RBI.(2000). *Report of the Task Force to Study the Co-operative Credit System and Suggest Measures for its Strengthening*
[7] GOI.(2004).*Report of the Task Force on Revival of Cooperative Credit Institutions*
[8] Data from the website of NABARD, www.nabard.org.

their shares in institutional credit with the Commercial Banks becoming the dominant agency in disbursing credit and the share of Cooperative Banks falling significantly.

The Cooperative Credit institutions were once integral to the goal of financial inclusion, however due to their inherent structural and financial weaknesses, these institutions faltered in meeting these targets. But with the constitution of the “Taskforce on Revival of Cooperative Credit Institutions” (2004) and the “Vision Document of Urban Cooperative Banks” (2005), there is renewed hope for the Indian Cooperative Banking structure and a greater thrust imparted to achieve the goal of socio-economic equality. These initiatives aim at the revival of the Cooperative structure in the country and also to reinstate the faith and confidence of the public in these institutions.

The Taskforce on Revival of Cooperative Credit Institutions submitted its Report in 2005. Since then a decade has elapsed and it is the opportune time to assess the performance of the rural cooperative credit structure. Thus this Dissertation is an attempt to establish the relevance and the need of the Cooperatives in the age of global finance as a model of ensuring financial inclusion and also for reducing regional and income disparities. The main objective of this study is to evaluate the performance of the short-term rural credit structure after the revitalization package introduced by the Vaidyanathan Committee. The questions that I have tried to address in my dissertation are-

- Has the financial health and performance of the Cooperative Banks improved after the financial recapitalization introduced by the Vaidyanathan Committee?
- Have the Cooperative Banks been successful in reaching out to the weak and disadvantaged social groups?
- Have the rural credit Cooperatives fulfilled their primary mandate to disburse credit to agriculture?
- Have the Cooperatives succeeded in displacing the informal sources of credit after a century of their existence?

- And finally, in the attempt to improve its financial performance (profitability, efficiency, productivity, asset quality) have the Cooperative Banks lost sight of the vision and objectives that they had been established with? Are the goals of achieving socio-economic equality sacrificed to conform to the neo-liberal parameters of performance?

AN OUTLINE OF CHAPTERS

The study is organized into various Chapters.

The first Chapter provides a historical overview of the cooperative sector. The chapter is divided into three sections. The first section delineates the various issues of relevance to Cooperatives and the need for such institutions. The second section traces the evolution of the Cooperative Banks since independence while the third section provides a review of literature on the Cooperatives.

The second Chapter discusses the structure of cooperative credit institutions in the country and the regulatory framework governing them.

The third Chapter discusses the Vaidyanathan Committee Report. It spells out the Committee's recommendations, the progress in implementation and the implications of these recommendations.

The fourth Chapter makes an analysis of the financial performance of the rural cooperative credit structure in the country after the financial recapitalization introduced by the Vaidyanathan Committee Report.

The fifth Chapter looks into the role of the rural cooperative credit structure in disbursing rural credit. It seeks to examine whether the Cooperatives are fulfilling the mandate that they were established with. This Chapter is divided into four sections. The first section examines whether the Cooperatives have been successful in reaching out to the weak and disadvantaged sections of the society. The second section examines the role played by the Cooperatives in disbursing agricultural credit. The third section examines the claim whether the Cooperatives have been successful in displacing the informal sources of credit. The last section is a short commentary on the growing popularity of microfinance and why it is not an alternative to the formal institutions of credit.

The last Chapter summarizes the results of the study and makes concluding remarks on the future of the Cooperative Banking sector in the country.

CHAPTER-I

EVOLUTION OF COOPERATIVE CREDIT INSTITUTIONS IN INDIA

The International Co-operative Alliance Statement[9] of co-operative identity defines a co-operative as "An autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise." The Cooperatives are governed by the principles of self-help and cooperation among the members of the community. These institutions are characterized by voluntary and democratic member participation, autonomy in operation and are guided by the objective of growth and development of the community as a whole.

The early proponents of the Cooperatives were the Rochdale Pioneers, Robert Owen, Charles Fourier, F.W. Raiffeinsen, L.Luzzatti and H.Schulz, who envisioned these institutions as an alternate model of growth that was more inclusive as opposed to the exploitative capitalist regime. The cooperative movement rose to prominence in response to market failure and the dominance of capital. The Cooperatives remain closely linked to the socialist principles of equitable distribution of the fruits of labor and through collective action against poverty, inequality and exploitation. The Cooperatives were viewed as instruments for bringing about social transformation by organizing people with limited means like small farmers and rural artisans into Cooperatives. It sought to uplift the rural poor from the quagmire of debt and poverty by providing cheap and easy access to credit and resources to help them rise from their unfavorable economic position. (Pitre, 2003; Shylendra, 2011; Kshetrimayum, 2011; Mitra, 2014)

The Cooperative Banks are financial institutions organized along the principles of cooperation. These banks are generally owned and managed by

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[9] Accessed from http://ica.coop/en/whats-co-op/co-operative-identity-values

their members and provide them with cheap and easy access to credit. The surplus generated by such an enterprise is shared amongst its members.

Unlike other institutions, the Cooperatives are not guided by commercial interests of garnering quick profits but aim at achieving larger socio-economic goals. The overriding objective of the Cooperatives is the economic empowerment and promotion of the interests of its members. The Cooperatives provide an alternate economic organization that could safeguard the interests of the weak and disadvantaged social groups against an exploitative capitalist regime.

1.1 NEED FOR THE COOPERATIVES

Like its brethren abroad, the emergence of the Cooperatives in India was in response to distress and discontent among the marginalized sections of the society. The Cooperative movement began in nineteenth century Europe as a movement led by the working class against capitalism and the precedence attributed to capital over labor. In India too, the Cooperative movement emerged in the backdrop of agrarian disturbances as an outburst of the rural peasantry that was deeply entrenched in poverty and debt against the unscrupulous and exploitative moneylenders.

The main objective of establishing Cooperatives was to strengthen the rural economy through the integration of the marginalized and weaker sections and through the development of agriculture. The Cooperative Banks help in pooling the limited resources of a community and uses these resources for income generation through loaning them to its members for purposes like production and investment. Credit is an important determinant of production and its easy availability empowers the rural population by providing opportunities for employment, asset creation and income generation.

The “invisible hand of the market” perpetuates income and regional disparities by favoring allocation of resources like credit to the better off sections. To make matters worse, the rural credit market is an imperfect market and does not function like the classical competitive markets. It is characterized by failures, segmentation-with the informal sector (like the moneylenders) charging exorbitant rates of interest, interlocking of markets like credit, land and labor and rationing of funds. There also exists the problem of asymmetry of information (adverse selection and moral hazard), the high costs of monitoring and the problem of incentives and enforcing repayment. (Stiglitz & Hoff, 1990; Ray, 1998; Shah, Rao & Shankar, 2007). These features deter entrants into the rural credit markets. The credit cooperatives help alleviate some of these problems like information constraints through peer monitoring as these institutions are held by a close knit group of members belonging to a particular community or region which also helps reduce the transaction costs.

In the global scenario, where the Indian economy is increasingly getting integrated to the world, any global setback is bound to have a backlash on the economy with serious repercussions on the unorganized and informal sector. The small and marginalized sections of the society are the most vulnerable segment as global events can have serious implications for their livelihood and purchasing power. In contrast, the rural credit Cooperatives have for long remained insulated from speculative global finance and hence proven to be havens for the lower strata of the population. Thus, in a world dominated by global finance and profitability, the Cooperatives driven by the interests of their members could provide a secure niche for the marginalized sections by guaranteeing them opportunities for self-employment, income generation and access to resources. It also enables them to maintain a foot-hold in the unfair global playing field with a stake in the development process through easy access to credit and resources.

Thus, these institutions can be useful instruments for empowering the vulnerable sections of the society by strengthening their bargaining position and can serve multiple purposes like poverty alleviation, employment generation, achieving self-reliance of the weaker sections and serving the larger goals of inclusive growth and development.

The Cooperatives with their unparalleled network have become central to channelize any Government programme or scheme aimed at benefitting the rural population. Besides acting as conduits for credit, the Cooperatives also supply basic agricultural implements and inputs and act as an agency for facilitating the services of the Public Distribution System (PDS). (Patil, 2005)

The Cooperative credit institutions are central to sustaining the larger cooperative movement in the country through backward and forward linkages. They not only provide credit as an input in the production process but also help promote and market their finished product. Thus the health of the Cooperative Banks has deep rooted consequences for the economy.

1.2 EVOLUTION OF COOPERATIVE BANKS IN INDIA (POST-INDEPENDENCE)

The Cooperatives in India have had a long history of over a century. The Cooperative Credit Societies that we see today are a result of many events and legislations spanning several decades. The cooperative movement gained momentum after independence as every aspect of community development began to be reorganized along the lines of the cooperatives like housing cooperatives, consumer cooperatives etc. At the time of independence, India inherited a cooperative structure comprising of 14 provincial banks, 5 central land mortgage banks, and 271 primary mortgage banks and primary societies.[10] From this humble beginning, the Cooperative movement in the country has grown to become the largest in the world covering the highest number of beneficiaries. Today, the Cooperatives have an impressive network of 32 state cooperative banks with 992 branches, 371 district central cooperative banks operating through 14907 branches and 92,996 Primary Agricultural Credit Societies (PACS)[11] The evolution of the Cooperative Banks can be classified into three broad phases. The first period from independence to the period before nationalisation saw the Cooperative movement take root under the support of the State as means of furthering the goals of socio-economic development. The second period known as the "social and development banking phase" saw concerted efforts to promote the growth and spread of Cooperatives to different spheres and to backward areas and the weak and marginalized sections. The third phase was characterized by

[10] The Economic Weekly (1950).*Co-operation Still Primarily Agricultural Progress in 1947-48*

[11] NAFSCOB.(2014).*Basic Data on Performance of State Cooperative Banks, 2013-14*

the New Economic Policy regime of the nineties that saw a systematic neglect of the Cooperatives that led to a deterioration of these institutions that necessitated the revitalization plan. Some of the important events and Committees that have contributed in shaping their current form are listed as follows:

1.2.1 THE PERIOD: 1950-1969

The period after independence saw increased emphasis on the Cooperatives to fuel the growth and development process. This period was characterized by a thrust on industrialization and although agriculture accounted for more than two-thirds of the GDP and almost half of the workforce, it was devoid of funds. This was because the Commercial Banks were private entities and diverted public funds to their business houses and affiliated companies. (Chandrasekhar & Ray, 2005). Thus the onus of purveying credit to agriculture lay with the Cooperatives. The Cooperatives remained the sole channel providing institutional credit to agriculture but due to lack of resources, the reliance on informal sources of credit (primarily the moneylender) continued.

The All India Rural Credit Survey Committee (AIRCS) that was constituted in 1951 under the Chairmanship of A. Gorawala was the first attempt to take account of the rural indebtedness and the role of Cooperatives in disbursing rural credit. The Committee summarized its findings as “cooperatives have failed; cooperatives must succeed”, because despite the rapid growth of the cooperatives, the share of Cooperatives in disbursing agricultural credit remained dismal at 3%. However, it also accepted that the Cooperatives were the only institutions that were in a position to dispense rural credit. Thus, it recommended a greater role for the State in extending support to the Cooperatives in terms of equity, management and governance and emphasized the need of transforming the Cooperatives into vehicles of development. The Committee also recommended strengthening the primary structure of the Cooperatives, forming inter-linkages with marketing and processing cooperatives and expanding their area of operation. Acting on the recommendations of the AIRCS, the State extended financial, managerial and technical assistance to the Cooperatives.

The Committee Report brought to light the sad plight, in actual practice, of the cooperative credit structure that had fallen into disrepair because of the indifferent attitude of the British rulers and the autocratic Registrars of these societies who failed to extend the requisite support to facilitate its growth and geographical spread. Despite the existence of the Cooperatives for almost fifty years, these institutions had failed to challenge the monopoly of the moneylenders. This occurred due to the familiarity of the moneylenders with the rural population and their tendency and flexibility to adapt to the rural credit needs.

The Cooperatives had failed to gain prominence among the rural masses due to their exclusionary membership policy and their practice of lending based on ownership of land and other assets instead of the repayment capacity. This coupled with the control of the Cooperatives by the ruling elites and landed gentry ensured that labourers, rural artisans, the poor and the landless who had a weak economic position and who perhaps were in most need of credit were kept out of the ambit of Cooperative credit. The Cooperative movement also failed to transcend geographic boundaries as both finance and power seemed to favor the urban and semi-urban areas.

Following the recommendations of this Committee initiatives were taken to link the credit and non-credit cooperatives and to ensure that every family of a village was affiliated to atleast one cooperative society. It also led to the creation of the State Bank of India in 1955 from the erstwhile Imperial Bank of India and the Land Mortgage Banks for providing long-term finance for agriculture.

In order to curb the autocratic powers enjoyed by the Registrars of the societies, the **Committee on Cooperative Law (1957)** under the Chairmanship of S.T.Raja suggested a simplification and rationalization of the existing Cooperative laws. It also accorded autonomy to State governments to enact their respective Cooperative laws and recommended a decentralization of the powers of the Registrar. The initiation of land reforms in 1958 prompted the establishment of multi-purpose cooperatives.

The **National Development Council Resolution (1958)** and the **Working Group on Credit Policy (1958)** both focused on the need to organize the cooperatives at the village level and to promote agricultural development by the provision of credit and other farm inputs and equipment through the cooperatives. The NDC also recommended the provision of taccavi loans through the cooperatives to encourage membership. In order to encourage the participation of tenant cultivators and the landless labourers, the **Committee on Cooperative Credit (1959)** headed by V.L. Mehta recommended a re-orientation of loan policies to be based on the repaying capacities of the borrowers instead of ownership of assets.

The sixties saw Cooperative Banking gathering momentum and acquiring a concrete structure as opposed to its rudimentary state and fragmented growth during the previous decade. Each state had its own apex Cooperative Bank (StCB) and almost every district had a central cooperative bank (DCCBs). The PACs too assumed importance with the implementation of land reforms to provide credit to the beneficiaries of these reforms (primarily the small and medium cultivators) to prevent them from slipping back into the clutches of the moneylenders. (Pandey, 1994)

During the Third Five Year Plan (1961-66) the RBI too stepped up its role to facilitate the growth of the Credit Cooperatives through greater supervision and, training and disbursal of credit to State Banks.

In 1962, the RBI conducted the All India Rural Debt and Investment Survey that suggested that the share of household borrowings from the cooperatives had increased from 3.1% to 15.5% but without challenging the authority of the moneylenders. In 1962-63, the StCBs were reported to have disbursed Rs 5.7 crores in loans to individuals and Rs 208.4 crore to other societies while the corresponding figures for the DCCBs stood at Rs 3.4 crores and Rs 288.7 crores respectively. The PACs too had proliferated in number to an impressive figure of 211,000 with a membership of 21,700,000.[12]

During this period, the **Mirdha Committee (1965)** was constituted that made significant amendments to the Cooperative legislation to check political

[12]The Economic Weekly. (1965). *Big Advance in Cooperative Banking*

domination of the Cooperatives and also recommended weeding out “non-genuine societies”.

With the growth and the expansion of the credit cooperatives, there was a need to bring these institutions under the regulatory purview of the Banking Regulation Act in 1966. This also brought the Cooperative Banks (other than the PACs) under the Deposit Insurance scheme to instill confidence in people and to help in mobilizing deposits. This period also witnessed an intensification of the cooperative movement and its expansion to other spheres like marketing, farming, housing etc. Thus, Cooperatives became the lifeline of millions of people. This further attracted the local politicians and rural elites to use the Cooperatives to garner electoral support. The rich and the powerful elites often exploited their positions to exact benefits from the Cooperatives in the form of cheap farm inputs like seeds, water, power and tax concessions. (Shetty, 1975)

By 1968 it was widely accepted that despite the efforts of the policymakers and the legislators, the Cooperatives had failed to adequately contribute to agriculture due to feudalism, the faulty tenure system and the political unwillingness to implement land-reforms. It was also well recognized that the benefits of the Cooperatives failed to permeate to all the sections of the society. This happened because of the failure to implement land-reforms, due to which the village oligarchs continued to dominate the Cooperatives and misappropriate the funds. (Thorner, 1962; Narasimham, 1971) Others attribute the failure of the Cooperatives to poor management, flawed loan policies and absence of a mechanism to inspect the utilization of funds.

1.2.2 THE PERIOD: 1969-1990

The droughts of the sixties exposed the institutional failure and the gross neglect of agriculture. The exclusionary credit policy of the Cooperatives that effectively ruled out the poor, landless agricultural labourers and marginalized farmers from accessing credit and the domination by the ruling elites had drawn sharp criticism of the Cooperatives. The funds of the Cooperatives were often siphoned off to benefit large cultivators while the tenant cultivators received only 2.7% of the total credit advances in 1973-74. The failure to advance institutional credit to the lower strata of the society in turn threatened to further aggravate income and regional disparities. These tendencies lay in sharp contradiction with the vision of the Cooperative movement and hence demanded a quick redressal.

This led to the enactment of many policy reforms and measures that sought to make the Cooperatives more inclusive and pro-poor institutions. The State governments also intervened by initiating measures like universal membership, reservations for the weaker sections in the Boards of the Cooperatives, concessions and relaxations for lending to the poor etc. (Shylendra, 2011).

The All India Rural Credit Review Committee (AIRCRC) (1969) noted how despite the impressive network of the PACs, these institutions were not aligned to the production needs of the people and catered to only 30% of the credit needs of the cultivators. It accepted that most of the Cooperative societies were saddled with heavy overdues and lacked resources to meet the growing credit needs especially with the initiation of the Green Revolution. Thus, taking cognizance of the weakness of the Cooperatives it recommended that the commercial banks should play a complementary role to the cooperatives in disbursing credit. Similarly the **Banking Commission Report (1972)** under the Chairmanship of R.G.Saraiya also recommended a coordinated development of the commercial and cooperative banks.

Consequent to the AIRCRC Report the dominance of Cooperatives was substituted by the multi-agency approach. This period witnessed nationalization of banks to prevent the concentration of resources in certain sectors and channelize credit to the sectors that were historically starved for credit. This period is referred to as the "social and development phase of banking". During this period, the policy stance adopted by the government included measures like the directed credit programme, Lead Bank scheme, and the establishment of institutions like the Regional Rural Banks (RRB) and the National Bank for Rural and Agricultural Development (NABARD).

The recommendations of the AIRCRC (1969) led to the setting up of Agricultural Credit Corporations and Small Farmers' Development Agencies

(SFDAs) to channelize credit to small and marginal farmers and to the landless labourers.

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The Cooperatives tried to break away from the accusations of elite capture and regional concentration by initiating certain policy measures like those recommended by the **Bawa Committee (1971)** such as the establishment of Large Area Multi-purpose Cooperative Societies (LAMPs)[13] in tribal areas to provide banking facilities to the tribal population as well as to assist them to market their products. In 1975 an RBI guideline mandated directing 40% of the Cooperative credit to the small and marginal farmers for being eligible for refinance**. The National Commission on Agriculture (1976)** recommended setting up of Farmers' Service Societies (FSS) at the grass-root level to cater to the credit needs of small farmers as well as to equip them with technical assistance and other financial services. **The Integrated Rural Development Programme (IRDP)** was launched in 1977 to alleviate poverty through the provision of credit to the rural poor. **The Committee to Review the Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) (1981)** too emphasized on the need to further develop the FSS and the LAMPS and to make the Cooperative institutions a single point of contact for different rural borrowers like farmers, artisans and labourers. It made provisions for the membership of the weaker and backward sections of the population. It also led to the creation of the National Bank for Agricultural and Rural Development (NABARD).

There were attempts to bring about structural changes and reorganization of the credit cooperatives with the **Hazari Committee (1975)** recommending the integration of short term and long term credit structures to enhance profitability and the **Hate Working Group (1981)** suggesting that the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) of the Cooperative Banks should be brought at par with the Commercial Banks. However, none of these recommendations were acted upon. Similarly, the **Multi-State Cooperative Societies Act, 1984** that came into existence after repealing the

[13] LAMPS are also known as Large Area Adivasi Multi Purpose Societies

former Act of 1942 aimed at bringing uniformity in the administration and management of multi-state Cooperatives.

The eighties was an era characterized by the rise of neo-liberalism world-wide with Deng Xiaoping, Margaret Thatcher and Ronald Reagan coming to power. It was in this backdrop that the **Agriculture Credit Review Committee (1989)** was constituted that encouraged the mutual thrift and credit societies and suggested measures to make them self reliant and sustainable. It also recommended that the cooperative sector should play a pivotal role in financing agricultural and village development.

Thus, this period (1969-1990s) saw concerted efforts at improving the state of the Cooperative Credit institutions, extension of credit facilities to the weaker sections and the backward regions but despite the reforms, the Cooperatives could not effectively accommodate the needs of the rural poor. Studies reveal that the Cooperatives were deeply entrenched in corruption and nepotism and subject to elite capture with strong resistance from incumbent controlling interests to any attempt to dislodge their monopolistic position and their vested political concerns. The Cooperatives in turn also failed to instill faith and confidence in the rural poor. The financial condition of the Cooperatives also showed signs of weakness as the accumulated losses and growing overdues attained unsustainable levels and prompted the Government to launch a scheme of loan waivers and write-offs in 1989 to benefit the farmers. (Vaidyanathan, 2013)

1.2.3 THE PERIOD: 1991-2014

The nineties coincided with a paradigmatic shift in favor of neo-liberal policies that discouraged the State's interventionist role on the grounds of it being inimical to the growth and restrictive of the functional autonomy of the Cooperatives. Clearly, the focus of all the policy initiatives during this period was to move away from directed credit and differential interest rates which involved State financing through subsidies. The measures suggested by the Committees constituted during this period centered around democratic management through elections, reduced role of the government, professionalization of staff and prudent use of resources.[14] There was also an attempt to homogenize the financial structures by imposing similar legislation and regulatory frameworks across institutions irrespective of their specific objectives of establishment. (discussed in Chapter 2) The paradigmatic shift also saw a change in the role attributed to the Cooperatives. From being mooted as vehicles to achieve socio-economic development, these institutions were now viewed as commercial enterprises that were to operate on sound business lines and deliver on the parameters of efficiency and productivity. This significantly altered the character and operations of the Cooperatives as will be discussed later. The systematic neglect of the rural credit structure led to a further deterioration of these institutions and resulted in a decline in their share in rural credit.

The reforms set in motion a process of dilution of the earlier regulatory framework in the form of Cooperative laws that severely curtailed the powers of the Registrar and the Government. It also restricted any financial assistance in the form of State equity. **The Choudhary Brahm Prakash Committee (1991)** was one of the first Committees that was constituted in the liberalized regime. It endorsed a unified Model Cooperative Law to be adopted across States to ensure uniform legislation. It also emphasized revamping the regulatory framework and making the Cooperative Banks accountable under the Banking Regulation Act, 1949. The Model Cooperative Law advocated by this Committee was recommended by the successive Committees.

The economic reforms laid a great emphasis on deregulation of institutions. One example of these reforms was witnessed when the Andhra Pradesh Government passed the **Mutually Aided Cooperative Societies Act (1995)** to promote the growth of SHGs into cooperatives along the guidelines of the Brahm Prakash Committee Report. The Cooperatives formed under this parallel law were constituted and aided by the members and enjoyed complete autonomy from their respective State Governments and the Registrars and were accountable only to their members. At the same time these Cooperatives are not eligible to receive any financial assistance from the State in any form. A similar legislation was then passed by other states like Bihar, Jharkhand,

[14] GOI. (2004).*Taskforce on Revival of Cooperative Credit Institutions*

Madhya Pradesh, Chhattisgarh, Orissa, Uttarakhand, Karnataka and Jammu and Kashmir.

The neo-liberal policy shift also saw implementation of so-called "international best practices" in the form of prudential norms and provisioning to the Commercial Banks which was then subsequently extended to the rural Cooperative Banks in 1996-97 in a phased manner. While the Public sector Banks received capital infusion for making this transition, no such provisions were extended to the Cooperatives. Thus, these norms that were aimed at strengthening the capital base of these banks only ended up weakening these institutions. Faced with the pressure to comply with these norms and regulations, the Cooperatives resorted to rationalise their funds into investments in Government securities and fixed deposits instead of their regular banking operations. Their nature of lending was also influenced by these norms as it became less responsive to the needs of the vulnerable sections and was driven by the pursuit of profits. The immediate impact of these reforms was seen in the debilitating financial state of these institutions which prompted the Government to commission various Working Groups and Committees to revive the Cooperatives.

The Kapoor Committee (1999) and the **Vikhe Patil Committee (2001)** were constituted to look into this issue. Both the Committees made important recommendations on issues like recovery management, expansion of the resource base, regulation and supervision, cost management, professionalization and business diversification. The Kapoor Committee suggested a revitalization plan for the Cooperatives, adoption of the Model Cooperative Law and also setting up of a Rehabilitation and Development Fund at NABARD and Assistance Fund at the state level. It sought to tackle the problem of dual control by making the provisions of the Banking Regulation Act, 1949 fully applicable to the credit cooperatives and in turn advocated centralization of credit provision. It also recommended the expansion of the activities of the cooperative credit institutions to include the provision of housing and consumer loans and distribution of insurance products. The Kapoor Committee's recommendations had serious implications for the functioning of the Cooperatives. Not only did it approve the deviation of the Cooperatives from their objectives in strengthening the rural economy but legitimatized the transition. Instead of recommending the use of surplus generated by the Cooperatives for rural development projects, it prescribed the siphoning away of this surplus to garner quick profits. It also recommended discontinuing and curtailing several functions of the PACs like the PDS as it considered them to be non-remunerative. This too would severely impair the functioning of the PACs as the lifeline of the rural population.

The **Vikhe Patil Committee (2001)** was constituted to examine the feasibility of the revitalization procedure recommended by the Capoor Committee and to devise a mechanism for funding and cost-sharing. However, the recommendations of both these Committees failed to be implemented due to disagreement in sharing the costs of the revitalization package between the Union and State Governments. Hence the atrophying of the rural credit cooperative structure continued.

In 2002, the Government announced a **National Policy on Cooperatives** that envisioned the promotion and development of cooperatives as independent and democratic organisations to promote socio-economic growth and to restore the cooperative principles. It aimed at reducing regional disparities while placing greater emphasis on human resource development through education and training. The Taskforce that was constituted to formulate this policy sought to replace all existing Parallel Laws with a single Cooperative Law. In a similar vein, **the Multi-State Cooperative Societies (MSCS) Act, 2002** that replaced the pre-existing Multi-State Cooperative Law, 1984 was an attempt to converge to the new Model Act**.**

The slowdown in credit flow to agriculture partially because of the implementation of the stringent prudential norms perpetuated the agrarian crisis that revived the need to recapitalise the Cooperatives and use these institutions as conduits for channelizing credit to this sector**. The Vyas Committee** that was constituted during this period (2001 and 2004) identified the major impediments to the flow of credit to agriculture and other disadvantaged segments of the society. It reiterated the need for revitalising the Primary Agricultural Credit Societies and recommended structural changes like de-layering of the cooperative credit structure and integration of the long and short term credit structures. It was in this backdrop that the Government decided to launch the Doubling of Agricultural Credit Program (DACP) in

2004 to augment the credit flow to agriculture. During the same year, it also appointed the **Taskforce on the Revival of Rural Cooperative Credit Institutions (Vaidyanathan Committee)** to implement a revitalisation plan for the cooperatives. The same Committee also devised a revival package for the long-term cooperative structure in 2008-09.

The recommendation of the Kapoor Committee in favor of the Cooperatives diversifying their lending portfolios beyond rural credit was just a prelude to the larger policy change that awaited the Cooperatives. As the sequence of events unfolded, it became evident that the reforms that began as prescribing uniform legislation would slowly impinge upon the nature and direction of lending of the Cooperatives. The liberalised regulatory framework and the competitive environment lured these banks to undertake business activities that militate against the very ethos and fundamentals of the Cooperatives.

In 2005-06, the Cooperatives were allowed to enter into insurance business on a referral basis and also to deploy their surplus funds in areas beyond the Cooperative ambit like non-SLR securities.[15] The most shocking part of these developments was that they emerged in the aftermath of the scams in the Urban Cooperative Banks like the Madhavpura Mercantile Cooperative Bank. Following that many other cases resurfaced where prudential and regulatory norms were openly violated and where the banking entities were found redirecting funds to sensitive areas like the stock markets. Thus, instead of restoring the confidence of the public by tightening supervisory and regulatory norms, the rural cooperatives were granted leeway to employ their funds in speculative activities. It was through these channels that the cooperative banks that were once largely insulated from global shocks got embroiled in the global financial crisis of 2007-08.[16] While this transition was more radical for the Urban Cooperative Banks who are now permitted to enter into business transactions like foreign exchange and money markets, this tendency warrants immediate attention and strengthening of the internal control system as it induces financial fragility and puts to risk the limited endowments of the most

[15] RBI. (2006).*Report on Trend and Progress of Banking in India, 2005-06*

[16] The other channel through which the global financial crisis got transmitted to the Cooperative Banks was their dependence on NABARD for refinance which in turn was dependent on market borrowings for its funds.

vulnerable section of the society. The changes in the regulatory framework are discussed in detail in the next chapter.

The global financial crisis coupled with the regulatory requirements induced risk averseness in the Cooperatives and further constrained funds to agriculture and allied sectors as the banks inherently found their traditional banking activities riskier and unprofitable and instead diverted funds to investments. The global downturn also coincided with severe droughts and other natural calamities that affected various parts of the country. This led the government to launch various relief measures in the form of the Agricultural Debt Waiver and Debt Relief Scheme, interest subvention scheme along with the financial recapitalization of the Cooperatives to benefit the rural population and to propel the rural economy.

It was in the backdrop of the global crisis that the RBI and the Government constituted the **Committee on Financial Sector Assessment (2009)** under the Chairmanship of Dr. Rakesh Mohan to assess the financial health and stability of the credit institutions in the country. A major recommendation of this Committee was that it mandated licensing for the rural cooperative banks by March 2012 to continue their operations.

The Cooperatives may have weathered the financial turmoil by the active role of the State, however, the neo-liberal assault on these institutions continued.

In 2013, the **Expert Committee to examine Three Tier Short Term Cooperative Credit Structure (ST CCS) (2013)** was set up under the Chairmanship of P. Bakshi to evaluate the performance of the Cooperatives as purveyors of agricultural credit. The Committee took note of the failure of the rural credit cooperatives in fulfilling their prime objective of providing credit to this sector and hence recommended that the STCCS should provide atleast 15% of the agricultural credit requirements in their operational area, and to subsequently increase the figure to 30%. It also recommended that atleast 70% of the total advances of the DCCBs should be directed towards agriculture. If these banks failed to meet these targets, they would lose their status as rural credit cooperatives and be treated as Urban Cooperative Banks. The other important recommendation of this Committee that could affect rural credit delivery and the federal structure of the Cooperatives was the conversion of the PACs into bank correspondents. Consequent to which, there was an attempt to convert all the PACs to Banking Correspondents of their affiliated StCBs/DCCBs. (NABARD Circular dated July 22nd, 2013).This process entailed that the PACs cease to accept deposits from the public and in turn transfer all their funds and resources to the upper tiers. However, this directive that was an attack on the existing rural cooperative structure was widely opposed and subsequently withdrawn as it would adversely affect the credit flow to the local population.[17]

In sum, in the wake of the neo-liberal reforms, this period saw unprecedented attacks on the character and autonomy of the Cooperatives. About a dozen Committees were constituted to assess the performance of these institutions and to revive their health, however, these Committees differed only in their nomenclature. The common element running through all these Committees was to serve the neo-liberal agenda by diluting the regulatory framework, prescribing homogeneous legislation and supervisory norms, ascribing a minimalist role to the State and centralization of banking operations. The underlying objective of all these Committees was only to improve the efficiency and profitability of the Cooperatives and they remained silent over the issue of rural credit and development. The outcome of this was that the commercial interests soon overshadowed the goals of socio-economic development and the Cooperatives slowly drifted away from their stated objectives. The changing perception towards the Cooperatives was a reflection of the changing policy environment and the State's notion of development. As a result of which, this period saw the share of Cooperatives declining in institutional credit and a re-emergence of the informal sector. It also saw the rise and proliferation of microfinance institutions in the country. (discussed in Chapter 5)

1.3 REVIEW OF LITERATURE

The Credit Cooperatives being among the oldest existing credit institutions have been the subject of a vast literature. This section attempts to review some of the recent debates and issues of the Cooperatives.

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[17] NAFSCOB.(2014).*Annual Report,2013-14*

Puhazhendhi and Jayaraman (1999), Patil (2005), Mohan (2006) and Shah, Rao and Shankar (2007) study the performance of the rural credit institutions in the country. Their papers document the evolution of the rural credit structure as well as the changing pattern of rural credit. Their study traces the historical context of the emergence of the Cooperatives, the shift to multi-agency approach with the Commercial Banks and the Regional Rural Banks and the growth of microfinance with the initiation of the neo-liberal reforms.

Mandal (1970)'s study is based on the success of the agricultural Cooperatives in Japan. He recounts that the success of the cooperatives in the country should be attributed to the pivotal role played by the Government and using these institutions to enforce the National Agricultural Policy. He also adds that the Japanese model of success can be replicated in developing countries through institutional reforms and training.

Dadhich (1977) drew attention to the fact that the Cooperative credit institutions had failed in their objective to bring about social-economic transformation as their benefits failed to reach out to the weakest social groups primarily the SC and the STs .His study is based on macro-level data of 12 states for the year 1974-75.

Chavan's (2007) paper explores the failure of the formal institutions of credit in bringing the Dalit households into its purview. The credit situation has worsened for these groups after the neo-liberal reforms and these households have been forced to depend on the exploitative moneylenders for their credit needs. Her claim is substantiated by the data on Small Borrowers' Loans that reveals a decline in the flow of credit to these social groups as well as the failure of the Commercial Banks to meet their Priority Sector Lending obligation to advance 10% of the total credit to the weaker sections.

Chavan (2015) examined the flow of cooperative credit in Maharashtra between 1960 and 2000 in various dimensions like regions, social groups, crops etc. Her study revealed that despite the growth of the Cooperative societies in the state, there existed wide and growing disparities in terms of regional distribution of cooperative credit as well as crops. It also showed that the Cooperatives had failed to meet the objective of reaching out to either tenant farmers or to the other weaker sections of the rural population.

Biswas (1993) in his paper compares Regional Rural Banks (RRBs) and the District Central Cooperative Banks on the parameters of organization and efficiency. The results displayed that the RRBs fared better than the DCCBs in terms of social responsibility but there was no discernible difference in terms of their economic performance.

Pandey (1994) notes the role played by the Cooperative Banks in the sixties in bridging the gap between the land reforms and the Green Revolution. The Primary Agricultural Cooperative Societies were instrumental in purveying credit to the small and medium farmers who had benefitted from the land-reforms to prevent them from slipping back into the clutches of the moneylenders and the exploitative system of the interlocked credit, labor and land markets. It also provided cheap credit and marketing facilities to the farmers to help them benefit from the Green Revolution.

Iyer (2005) draws attention to the regulatory framework of the Cooperative banks. He attributes the various failures in regulation to dual regulation, political interference and mis-management. He recommends bringing the Cooperative banks under a single regulatory body as well as introducing transparency in the information of the banks with efficient monitoring by the Central Bank to ensure the efficient use of resources.

Shivamaggi (1996) traced the problem of the Cooperative movement in India to the interventionist role of the Government that prevented the cooperatives to evolve naturally. It lists the various problems of these institutions as the lack of leadership, poor management due to political control of the Cooperatives, uneconomic size and inability to exploit economies of scale. In order to restructure the Cooperatives, it recommended the integration of the short and medium term credit structure with the long-term credit structure. It also suggested having larger primary societies at the tehsil level instead of small unviable units at the village level.

Das et.al (2006) examine the prospects and the challenges faced by the cooperative sector in the era of marketisation. The paper points to various problems of the Cooperatives like poor infrastructure and management, excessive dependence on government and lack of professionalism.

Vaidyanathan (2013) traces the evolution of the Cooperatives, the problems stifling these institutions and suggests reforms for their growth

Dubhashi (2001) makes an assessment of the various shortcomings of the credit cooperatives and evaluates the recommendations of the Capoor Committee (1999).

Sriram (2006) examines the issues involved in the implementation of the recommendations of the Vaidyanathan Committee. Some of the concerns that he raises are the top-down approach employed in the revitalization plan, the enormity and feasibility of the task and the lacunae of the Report in terms of defining viability norms etc.

Sarma and Kumar (2008) critiqued the recommendations and the financial revitalization package introduced by the Vaidyanathan Committee. It raised questions on the feasibility of the implementation of the CRAR norms, relation between financial performance and state equity and between the federal structure and the economic costs of operation.

Satyasai and Badataya (2000) attribute the inherent weakness of the Cooperative institutions to its structural infirmities. They note that the three-tier federal structure as well as the existence of separate structures for disbursing short and medium and long term credit results in cost escalation for the poor borrowers as every subsequent tier adds a margin to account for the cost of funds whose ultimate burden falls on the borrower. Thus, they suggested de-layering of the three-tier structure of the rural credit structure.

Their paper makes an assessment of the financial position of the cooperative structure since independence to the mid-nineties.

Harper, Berkhoff and Ramakrishna (2005) examine the feasibility of a SHG-linkage with the Cooperatives. Their paper asserts that while such an initiative would be mutually beneficial, the participation of the cooperatives had been considerably limited. The paper analyzes the spread and extent of the SHG-cooperative linkage, the financial performance of the cooperatives and the impact of such a linkage.

CHAPTER-II

STRUCTURE OF THE RURAL COOPERATIVE CREDIT INSTITUTIONS

2.1 COOPERATIVE CREDIT STRUCTURE IN INDIA

The Cooperative Credit structure in the country comprises of two segments- the rural credit structure and the urban cooperative banks. The Urban Cooperative Banks (UCBs) or the Primary Cooperative Banks operate in the urban and semi-urban areas and serve the lower and middle income groups. It caters to the needs of small borrowers like small entrepreneurs, retail lenders etc in urban and semi-urban areas.

The rural Cooperative credit structure has a more extensive and varied framework as compared to the Urban Cooperative Banks. The rural credit structure can be further classified in terms of the duration of loans provided, primarily the short and medium term and the long term credit structure.[18] There exists a three-tier structure to advance short and medium term credit with the primary agriculture credit societies at the base , the central co-operative banks at the district level and the state co-operative banks at the apex level. The upper tiers were set up to provide refinance facilities and supervise the actions of the lower tiers.

The long-term cooperative structure consists of State Cooperative Agriculture and Rural Development Banks (SCARDBs) and Primary Cooperative Agriculture and Rural Development Banks (PCARDBs) and provides loans for undertaking projects with long-term investments like land development. The short term credit cooperatives account for a dominant share with over 90% of the total assets of the rural credit cooperative sector.[19]

- The Primary Agricultural Credit Societies (PACs) that operate at the grass-root level are an association of borrowers and non-borrowers usually residing in the same village. They obtain funds from share

[18] The Short Term credit is advanced for a period not exceeding a year and the medium term loans are advanced for a period ranging from fifteen months to five years .The long term credit is provided for a duration of more than 5 years.

[19] RBI. (2013).*Report on Trend and Progress of Banking in India, 2012-13*

capital from the State and its members, deposits from its members and loans from the central cooperative banks. The major objectives of the primary agricultural credit societies are to supply agricultural credit to meet the short and medium term credit requirements for agricultural production, distribution of essential consumer commodities and provision of storage and marketing facilities.

- The Central Cooperative Banks (DCCBs) operate at the district level and its members include both primary societies and individuals. They raise funds either from deposits from members, share capital from the State and its members, loans and overdrafts from the State Cooperative Banks.
- The State Cooperative Banks (StCBs) play a supervisory role in the functioning of the federal structure of the cooperatives. They receive funds from the deposits and share capital of its members. They also receive funds through refinance facilities from Commercial Banks, NABARD and RBI.

There are 19 states that have a three-tier rural Cooperative credit structure comprising of the StCBs, DCCBs and the PACs while 12 states (including the north-eastern states) have a two-tier structure comprising the StCBs and the PACs. The north-eastern states (except Tripura and Assam) do not have a separate long term-credit structure. The long term structure of the cooperatives varies across states and may be unitary, federal or mixed. [20]

2.1.1 ROLE OF NABARD

The recommendations of the Committee to Review Arrangements for Institutional Credit for Agricultural and Rural Development (CRAFICARD) led to the establishment of the National Bank for Agricultural and Rural Development in 1982 as an overarching regulatory authority for the Regional Rural Banks and the rural cooperative credit structure. It took over the functions and responsibilities that were performed by the Agricultural Credit

[20] RBI. (2013).*Report on Trend and Progress of Banking in India, 2012-13*

Department, Rural Planning and Credit Cell and Agricultural Refinance and Development Corporation of the RBI.

The NABARD performs three crucial functions for the Rural Short Term Cooperative Credit Societies (RSTCCS). Not only does it facilitate developmental activities, credit provision and refinance facilities but also plays a supervisory role on behalf of the RBI (discussed in Section 2.2).

- The NABARD provides credit as well as refinance facilities to the rural cooperative credit structure for meeting credit requirements for seasonal agricultural operations, marketing, procurement and distribution of farm inputs.
- The NABARD conducts inspections of the StCBs, DCCBs and SCARDBs under the provisions of the Banking Regulation Act, 1949. The NABARD adopted a system of off-site surveillance in 1998-99 to ensure continuous monitoring and to supplement the on-site monitoring of the rural Cooperative Banks. It further constituted the Board of Supervision in 1999 to guide and direct the StCBs, DCCBs and the RRBs on matters related to effective monitoring and supervision. It advocated the introduction of a Common Accounting System for the rural cooperative structure to ensure greater transparency in financial statements.
- The function of NABARD as a development bank includes provision of credit for investment and production activities, provision of refinance facilities, human resource development through education and training, rehabilitation of unviable units, and monitoring and coordinating development programs between various entities like the RBI, Central and the State Government. The NABARD initiated several Development Action Plans for improving the viability of the Cooperative Banks. It set up the Cooperative Development Fund in 1992-93 to provide financial assistance to Cooperative Banks which seeks to mobilize resources for the Cooperatives, provide assistance for infrastructural development and human resource development.

2.2 REGULATION OF THE RURAL COOPERATIVE STRUCTURE

The regulation of the Cooperatives has been the subject of a lot of debate and criticism. It is often argued that the Cooperative Banks are subject to weaker norms and guidelines in terms of regulation and supervision, internal governance and information and disclosure. (Hajra, 2002).It was argued that not only were these institutions subject to lower Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) norms but even the capital adequacy norms (CRAR) were not binding on these institutions. The minimum capital requirement for these banks was also fixed at Rs 1Lakh. The Cooperative Banks are also subject to supervision and regulation by multiple authorities that results in "considerable overlaps and voids" as well as delays the implementation of necessary disciplinary action. The neo-liberal reforms of the nineties began with extending uniform legislation and imposing a similar regulatory framework on the Cooperatives as the Commercial Banks and it was justified on grounds that capital adequacy and effective regulation were important for survival in the global environment.

The truth however remains that Cooperatives unlike other financial institutions are localized institutions operating on the principles of mutual help with simple banking products and low volume of business and account for a very small share of the total banking assets. These institutions rely on resources generated by their own members or from refinance and largely remain shielded from the market, speculative activities or risky ventures. Similarly, the rationale behind fixing the minimum capital requirement at Rs 1lakh was to promote the growth and spread of Cooperatives and to encourage people with limited resources to set up their own cooperatives. Thus, subjecting them to similar regulation as the Commercial Banks could stifle their unique nature and functioning. The next section deals with the regulatory framework of the rural cooperative credit institutions.

2.2.1 REGULATORY FRAMEWORK

Regulation of any financial intermediary is an important task as these institutions are responsible for mobilizing resources from those with surplus funds to channel them to those that are in deficit by converting small, liquid investments into large illiquid assets by mitigating capital and income risks. (Chandrasekhar, 2005). The depositors of these funds are not in a position to monitor the use of their funds. At the same time with financial development and innovations, most of the financial instruments lack transparency. Thus, the growing financial integration could trigger a contagion from fragility originating in any sector and jeopardize the entire financial system. In the case of Cooperative Banks, regulation assumes greater importance as these mobilize resources from the weakest sections of the society and hence warrant extra caution to safeguard the meager resources of these sections from embezzlement, misappropriation or misuse. The following section discusses the evolution of the regulatory framework of the rural cooperative credit structure[21] and some of the issues related to their regulation.

2.2.2 EVOLUTION OF THE REGULATORY FRAMEWORK

The regulatory framework of the Credit Cooperatives remained extremely primitive and rudimentary in the early stages of the development of the Cooperative movement which was compatible with the simple banking practices of the credit cooperatives. The constitutional reforms of 1919 brought the subject of "Cooperation" under the legislation of the State Government. Prior to 1966, the Cooperatives were governed primarily by their respective Registrars and their State Cooperative Acts. The State government controlled the Cooperatives through the Cooperative Acts and was instrumental in providing financial aid in the form of grants, subsidies, loans and other exemptions. The State government was also responsible for the registration, liquidation and management of the societies. But as the Cooperative movement gathered momentum, it was felt that these institutions required greater surveillance and supervision which brought the Cooperative

[21] The regulatory and supervisory framework differs for the Urban and rural Cooperative Banks. But this section deals only with the rural credit cooperatives since the study is based primarily on these institutions.

Banks under the purview of the Reserve Bank of India (RBI) through the Banking Regulation Act, 1949 on 1st March 1966. This gave rise to the problem of duality in regulation of Cooperative Banks.[22] (discussed in Section 2.3) The functions of the RBI prior to assuming its regulatory role involved provisioning of agricultural credit, refinancing and strengthening the Cooperatives.

With the implementation of the Banking Regulation Act, the StCBs and the DCCBs also came under the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). The individual depositors of the DCCBs and the StCBs are covered by the DICGC upto a limit of Rs 1 lakh. However, these benefits do not extend to the individual depositors of the PACs or the institutional depositors who maintain their funds with the upper tiers, thereby exposing them to the risk of erosion of their funds. The failure of the DICGC to cover these depositors is also another reason why despite their rural presence, the Cooperatives have failed to instill confidence in public and mobilize resources.

The establishment of National Bank for Agricultural and Rural Development (NABARD) in 1982 vested the supervision and regulation of the rural Cooperative Banks with it instead of the RBI. The NABARD conducts statutory inspections of the StCBs and DCCBs once every two years while the internal branch inspections and audits of these banks were conducted by their own staff or the Cooperation Department of the State Governments.[23]

With the introduction of the neo-liberal reforms, the process of diluting regulatory frameworks and legislation began under the pretext of upgrading supervisory arrangements. The underlying presumption behind these reforms was that the markets could deliver better results in terms of ensuring credit discipline and allocation of resources and hence favored deregulation and dismantling of the older regulatory regime. Thus, began the relentless process

[22] The PACs are still left out of the ambit of the Banking Regulation Act, 1949 and hence do not qualify as "Cooperative Banks".
[23] RBI. (2000). *Report of the Task Force to Study the Cooperative Credit System and Suggest Measures for its Strengthening*

of prescribing homogeneous supervisory and regulatory frameworks to institutions in an attempt to provide a "level playing field" to them regardless of their specific objectives, size, ownership and targeted clientele.

Based on the guidelines formulated by the Basle Committee on Banking Supervision, prudential norms in the form of capital adequacy, income recognition and provisioning were introduced first to the Commercial Banks and then to the Cooperative Banks. Notwithstanding the unique character of the Cooperative Banks, the so called international best practices in the form of prudential norms like income recognition and asset classification were extended to the DCCBs and the StCBs in 1996-97 and tightened further in 2000.[24] The provisioning norms too were implemented for the short term credit structure in a phased manner by 1999-2000. Similarly, in 2009-10 these prudential norms were introduced for the PACs as well. Detailed guidelines were issued to the Registrars of the Cooperatives in this regard as well as for the calculation of the ratio of capital to risk weighted assets (CRAR).[25] The problem with implementing these norms formulated by the G-10 countries (that failed miserably during the global financial crisis) is that these norms are not reflective of the situations in developing countries and are unsuitable for addressing the challenges and problems faced in rural credit delivery and in ensuring equitable growth. These norms that sought to strengthen the Cooperative Banks have paradoxically only weakened their capital base and have also altered their character and their lending behaviour. The credit delivery to the weak and the marginalized sections and sectors like agriculture have suffered due to the implementation of these stringent norms as they induce risk averseness in banks and compel them to undertake projects based on their commercial viability over the goals of development . (discussed in Chapter 4 and Chapter 5).

In 1998, the Expert Committee to Review the Supervisory Role of NABARD headed by U.K Sarma recommended that banking supervision should be based on parameters like financial soundness, efficiency and management. It

[24] While the Commercial Banks received capital infusion prior to the implementation of the prudential norms, the recapitalization process eluded the Cooperative Banks despite of their low resource base which subsequently weakened these institutions.
[25] RBI. (2010).*Report on Trend and Progress of Banking in India , 2009-2010*.

suggested adopting the CAMELS [26] (Capital Adequacy, Asset quality, Management, Earning Capacity, Liquidity and Systems and Control) model for judging the performance of the rural Cooperative credit institutions and the CAMELSC (Capital Adequacy, Asset Quality, Management, Earning Capacity, Liquidity, Systems and Controls and Compliance) model for their periodic inspections.

The reforms set into motion, a dangerous tendency of dismantling the earlier regulatory framework and replacing it with a more deregulated and liberalized regime. In order to provide more freedom to the Cooperative Banks, the NABARD dispensed with the Credit Authorisation Scheme (CAS) that was operational since 1974 and replaced it with the Credit Monitoring Arrangement (CMA) from 2000-01. While under the earlier framework, the StCBs and the DCCBs were obligated to obtain prior approval of the RBI for loan approval, the CMA exempted the Banks from this exercise and granted them autonomy in loan sanction so long as they conformed to the norms and regulations prescribed by the RBI and NABARD.

The StCBs and the DCCBs accessed the inter-bank market for meeting temporary liquidity mismatches but in order to curb their reliance on the call money market, the RBI recommended that daily borrowings from these markets should not exceed 2% of their aggregate deposits in the previous financial year with effect from April 2002.

However, gradually the norms that restricted the rural Cooperative Banks from undertaking business other than their mandated objectives began to be relaxed as the StCBs/ DCCBs could undertake business activities like insurance on a referral basis and invest their surplus funds in non-SLR securities without prior permission from RBI.[27] Thus, the firewall that had earlier restricted the Cooperatives from venturing into other risky areas began to be withdrawn. The outcome of these reforms was a subversion of the goals of rural development and financial inclusion due to a contraction of credit to these

[26] Alternately, CAMELS also stands for Capital Adequacy, Asset Quality, Management, Earning Capacity, Liquidity and Sensitivity to Market Risk.
[27] RBI. (2006).*Report on Trend and Progress of Banking in India , 2005-06*. (pp-235-237)

areas and exposing them to sensitive sectors like insurance and stock markets. This was in sharp contradiction to the objectives and character of the Cooperatives and also entailed serious implications for the depositors due to the inherent risks involved.

Another attempt to reform financial regulation came with the adoption of a 90-day norm of loan impairment (instead of the 180-day norm) by the DCCBs and the StCBs in March 2006.[28] The Banks were advised to charge monthly interest rates from April 2004 to facilitate this transition.

Over the last decade, especially after the recommendations of the Vaidyanathan Committee, the neo-liberal reforms have struck at the very roots of these institutions by not only enforcing stricter norms and regulations for the Cooperatives but also by bringing them at par with the Commercial Banks disregarding the fundamental difference in the objectives and operations underlying these institutions. Some of these are listed below:

- The CRAR norms were not applicable to the rural Cooperative credit institutions till 2007 as it was believed that the generation of every loan would contribute to empowerment of the rural poor, growth and rural development. However, with the change in policy stance it was claimed that a low capital base made it infeasible to operate in the new globalised environment. Thus, to ensure financial stability and to strengthen capital base, the Cooperative Banks were to maintain a minimum CRAR of 7% aided by external support by March 2015 to be raised eventually to 9% and 12% in a phased manner. The eligibility to seek refinance was also linked to the compliance with CRAR norms. The Banks were permitted to issue Long Term (Subordinated) Deposits (LTD) and Innovative Perpetual Debt Instruments (IPDI) to facilitate this process. (Joshi, 2014a) However the application of the CRAR norms to the rural Cooperative credit institutions would pre-empt a portion of the already scarce resources to maintain regulatory capital that would not earn any return. To compound the problem further, while the international norms prescribe maintenance of 8%

[28] However the 180 day norm continues for gold loans and loans upto Rs 1 lakh.

CRAR, in India the Commercial Banks follow the norm of 9% CRAR. Subjecting the Cooperatives to similar CRAR norms of 9% and eventually raising it to 12% is going to prove extremely detrimental to the process of credit creation, capital formation and rural development. Also, under the Basel norms about 50% of bank's capital should be maintained as core capital (equity and disclosed reserves) but a study by Sarma and Kumar (2008) reveals that other than in Madhya Pradesh, the Cooperatives in all the other states fell short of this target and would require borrowing to meet these obligations adding to their financial burden and further worsening the situation by raising the quantum of borrowings.[29]

- Earlier, the Banking Regulation Act, 1949 required the Cooperative Banks to maintain a part of their Net Deposits and Time Liabilities (NDTL) as SLR and CRR to meet liquidity requirements. The SLR/CRR levels remained considerably low and unchanged for many decades to increase the quantum of resources for credit creation and financing capital formation. In 1966, the Cooperative Banks maintained CRR to the tune of 3% of NDTL and 25% as SLR. (Joshi, 2014a) However with the Banking Laws (Amendment) Act, 2012 amendments were made to Sections 18 and 24 that empowered the RBI to prescribe SLR and CRR levels for the Cooperative Banks. Consequent to this, from 12th July 2014 the SLR and CRR levels of the Cooperative Banks were brought at par with the Commercial Banks. The CRR rates were raised from 3 % to 4% of NDTL while the SLR rates were brought down from 25% to 22.5% (with effect from 1st April 2015) without payment of interest on these balances.[30] Another circular by the RBI (5th June 2014) de-recognized listing of deposits of the DCCBs with the StCBs as SLR deposits. These Banks were instead asked to maintain their SLR assets in Government securities like the Commercial Banks to secure the deposits of these banks. The rationale provided for this policy directive was that the quantum of funds

[29] Tier-I capital= Equity and Reserves, Tier-II capital= Borrowings

[30] NAFSCOB.(2015). *Annual Report ,2014-15*

borrowed by the DCCBs from the StCBs in the form of refinance exceeded their deposits with the latter as SLR deposits. Thus, in the event of loan delinquency or insolvency, it would erode even the SLR funds of the DCCBs. Hence, the RBI made this recommendation to safeguard the deposits of the Cooperatives and in the larger interests of the banks. However, this will not only undermine the resource base of the StCBs by the withdrawal of funds of the DCCBs (which would eventually adversely affect credit flow to the lower tiers) but the problem would be exacerbated further since the CRR on deposits earn no returns and would move in tandem with that of the Commercial Banks. These funds that were earlier employed by the Cooperatives to support rural development would now be diverted to investments in Government securities and would force the Cooperative Banks to venture into unfamiliar terrain by exposing them to the volatility of the market which in turn would affect their profitability and financial health. (Mitra, 2014)

From October 2014, the regulatory functions of both the urban and rural cooperative banks have been brought under the purview of a single department of the RBI. The supervisory functions of the Urban Cooperative Banks are undertaken by the Department of Cooperative Bank Supervision (DCBS) while the same is conducted by NABARD for the StCBs and DCCBs. (Gandhi, 2016)

Besides this, all the Cooperative societies (other than Credit Cooperative Societies) are prohibited from using terms like “bank”, “banker”, “banking” etc to their registered names under Section 7 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies) to prevent misuse and the laundering of public funds.[31] Also since the PACs are not regulated by the Banking Regulation Act and the DICGC, they are prohibited from accepting deposits from non-members.

However, in recent times there has been a growing tendency to violate these regulatory norms as by March 31, 2015, there were 2589 cases of frauds and

[31] GOI. (2004). *Taskforce on Revival of Cooperative Credit Institutions*

scams of the StCBs/DCCBs that were reported and amounted to Rs 877.7 Crores. (Gandhi, 2016)

The other issues pertaining to regulation are listed below:

INVESTMENT IN GOVERNMENT SECURITIES

The Government prescribed strict guidelines to the Cooperative Banks in 1992 regarding transactions in securities with brokers, Subsidiary General Ledger internal control systems, audits etc. The Cooperative Banks were earlier prohibited from placing their funds with Public Sector Units (Corporations/Companies), Urban Cooperative Banks or NBFCs. However, they were permitted to invest 10% of their surplus funds in non-SLR investments. The Cooperative Banks were required to formulate an investment policy and all transactions in Government securities were to be recorded in the Subsidiary General Ledger[32] accounts. The Banks could intermediate only through brokers registered with BSE, NSE or OTCEI and their role was restricted only to introducing the two transacting parties. There were also ceilings imposed on the transactions per broker. The Banks were also to monitor their transactions in government securities through effective internal control.(Kamesam, 2002) However the RBI Circular of 5th June 2014 made a complete turnaround by mandating the rural cooperatives to invest in government securities instead of maintaining their funds with the DCCBs as SLR requirements.

LICENSING

Earlier, the StCBs and the PACS were required to seek permission from the RBI before opening a new branch or relocating. However, the DCCBs were exempted from this practice. This led to the proliferation of DCCBs, most of which had fragile foundations. To curb this indiscriminate growth, the Committee on Financial Sector Assessment (2009) headed by Rakesh Mohan made an important recommendation regarding the licensing of the Cooperative

[32] The Subsidiary General Ledger is an account maintained by the RBI to hold the Government securities of the Banks (as part of the SLR requirements) in an electronic book-entry format. The purpose of this account is for holding and settling trade of Government securities.

Banks. It made licensing mandatory for the operation of the Cooperative Banks. In March 2009, only 14 of the then 31 StCBs and 75 of the 371 DCCBs were licensed, following which the licensing criteria was relaxed. The norms for the licensing of the Cooperative Banks were that the banks were to maintain a minimum CRAR ratio of 4% and comply with the stipulated CRR and SLR ratios for over a year. Consequent to this, by 31st December 2013, all the 32 StCBs[33] and 348 of the 371 DCCBs were licensed. (Joshi, 2014b)

AUDITS

All the Credit Cooperative units are subject to periodic inspection by NABARD and are required to submit a record of their financial performance. However, compliance with these requirements remains poor. In 1996, after the financial sector reforms, the RBI had advised the Registrars of the Cooperative Banks to adhere to prudential norms in preparing financial statements. The StCBs and the DCCBs are also required to disclose certain critical information in their audit reports like returns on assets, movements in NPAs etc as part of their adherence to transparency and disclosure norms which would be facilitated by adopting the Common Accounting System. The task of conducting audits that was earlier the responsibility of the State officials has now been assigned to professional Chartered Accountants by the Vaidyanathan Committee.

EXPOSURE TO SENSITIVE SECTORS

Since the primary objective of the rural credit cooperatives is to promote rural development and agricultural credit, the RBI prohibits the entry of the rural Cooperative Banks into sensitive sectors like real estate. But for those credit facilities already extended towards these sectors it mandated adequate provisioning and forbade renewing such facilities.[34] Further the RBI mandated all dealings and transactions of the Cooperative Banks above Rs 1 crores with primary dealers and Non Banking Financial Companies (NBFCs)

[33] The Jharkhand State Cooperative Bank came into existence on 1st September 2012 and was listed as a State Cooperative Bank in 2013.
[34] RBI. (2009). *Report on Trend and Progress of Banking in India, 2008-09*

or regulated markets (like Government securities) to be routed through electronic payment mechanism from 1st April 2008. [35]

CREDIT INFORMATION COMPANIES (REGULATION) ACT (2005)

Under the Act, all credit institutions are mandated to be a part of a Credit Information Company (CIC) to ensure the efficient collection and dissemination of reliable information to the public to facilitate decision making. (Joshi, 2014b)

2.3 DUALITY OF CONTROL

The regulation of the Cooperatives was found to be suffering primarily due to duality of control, ambiguity in powers and areas of jurisdiction and failure in compliance to regulatory norms. (Vaidyanathan Committee, 2004). As discussed in the previous section, the Cooperative Credit institutions were governed only by the State government and the Registrars of their respective States till 1966. But after the credit cooperatives were brought under the purview of the Banking Regulation Act, 1949, it gave rise to the problem of duality in regulation.

This duality arises from the inherent character of these institutions. "Cooperation" is a subject governed by the State Governments and their respective State Acts which varies across States while the function of banking is governed by the Central government under the Banking Regulation Act, 1949.[36]

The State governments are responsible for matters related to registration, membership, financial assistance, loans, conducting elections and audit and other business operations. The other functions related to banking like fixing of interest rates, branch licensing, area of operations etc are governed by the Banking Regulation Act, 1949. This turf-war over the area of jurisdiction has resulted in considerable lacunas and overlaps in the regulatory framework.

[35] RBI.*Report on Trends and Progress in Banking in India, 2007-08*

[36] The Cooperative Banks were earlier regulated and supervised solely by the Registrar of the Cooperative Banks and their respective Cooperative Societies Acts. The duality was attributed after the application of the Banking Regulation Act, 1949.

The supervisory jurisdiction of the rural cooperatives lies with the NABARD and its regulation with the RBI. Although these institutions are subject to periodic inspection by NABARD, the compliance with the supervisory findings remains poor. This coupled with the reluctance of the State Governments to comply with the norms and directives of the RBI has further aggravated the problem of effective regulation and supervision.

It is often critiqued that the duality in nature of the regulatory framework is the reason for many malpractices, frauds and scams. However, many note that it is not the duality of control wherein the source of trouble lies but in the "absence of a clear demarcation of responsibilities of the State governments and the Reserve Bank of India."[37] Many believe that all the banking-related functions should be brought under the purview of the Banking Regulation Act, 1949. It was also felt that the Banking Regulation Act should be accorded primacy and over-riding powers over any State Acts and laws. This would clearly define the domain of activities under each authority and help overcome the problem of duality. Others are of the view that there should either be a single regulator or an apex supervisory body comprising of officials from the RBI, the State Government and banking professionals to oversee the regulation of the Cooperatives.

On repeated interventions by the RBI to resolve the issue of duality, "The Banking Regulation (Amendment) and Miscellaneous Provisions Bill, 2003" had been tabled before the Parliament. The Joint Parliamentary Committee that was set up to recommend changes in the regulatory framework suggested a segregation of banking related operations from administrative powers by amending various State Government Acts. But despite RBI's recommendations this issue remains unresolved.

However, there is no easy solution to the problem of dual regulation. According primacy to the Banking Regulation Act would cause a centralization of banking operations and would result in credit migration from the rural areas to the urban agglomerates, delays and significant costs in credit dispensation. It would also affect the autonomy and functioning of the Cooperative Banks. Similarly, if absolute autonomy and authority was

[37] RBI. (1999). *Report of the High Power Committee on Urban Cooperative Banks*

accorded to the State government and/or the Registrars, the Cooperatives would run the risk of being controlled and governed by the powerful rural elites and local politicians. The State government has received criticism for misusing the Cooperative laws to supersede boards of management to appoint rural elites and the influential who are responsible for misappropriating and siphoning of public funds for their vested interests. The elections to the Cooperatives are also not conducted at periodic intervals in sharp contrast to the fundamental democratic ethos of the Cooperative movement.

The Vaidyanathan Committee had tried to address this problem partially by prohibiting the State Governments from intervening in matters pertaining to banking and finance by entering into MOUs with the State Governments. However, it is more important for the RBI, the State Government and the members of these institutions to work in tandem to support and promote the growth of the rural cooperative credit institutions as it is only the close coordination of these three entities than can ensure effective supervision and the smooth functioning of the Cooperatives.

CHAPTER-III

TASKFORCE ON REVIVAL OF COOPERATIVE CREDIT INSTITUTIONS (2004)

In the previous chapters, it has been discussed that the Cooperatives that were once central to the development process began losing their significance in the planning process as the country ushered in the neo-liberal regime. The neo-liberal reforms that began with extending similar regulatory and supervisory norms like the prudential norms without any capital infusion resulted in severely deteriorating their financial base. The "reforms" also mandated the retreat of the State as its presence was felt to hamper the growth of the Cooperatives. This systemic neglect of the Cooperatives led to a worsening of their financial position. The poor recovery rates, growing overdues, depleting resource base and the Cooperatives' falling share in rural credit led to the constitution of many Committees to restore their health.

Many Committees and Working Groups that preceded the Vaidyanathan Committee reviewed the performance of the Cooperative institutions but while the recommendations of some failed to be implemented due to bureaucratic inaction, the others made only a few structural changes without addressing the inherent weakness, issues of autonomy and restoration of health of the institutions. It was due to the failure of these Committees in restoring the ailing condition of the Cooperative Banks that led to appointment of a new Committee that could provide a fresh perspective to the issues of the Cooperative Banks as well as suggest a plan to reform the existing structure.

The Taskforce was constituted by the Government in 2004 and headed by Prof. A.Vaidyanathan to revitalize the Cooperative credit institutions. It was felt that despite being pivotal in purveying credit to the rural areas and to the weaker sections of the society, the financial health of these institutions was deteriorating steadily. Thus an urgent need was felt to commission a Taskforce that could chart out a roadmap to restore the health of these institutions. The Taskforce taking cognizance of the fact that mere financial injection would be inadequate in addressing the deep-rooted problems of the Cooperatives, it went a step ahead by recommending a comprehensive package of legal and institutional reforms to restore the "Cooperative-character" of these institutions.

The Committee recognized that there was an urgent need to revive the Cooperatives as they formed an unmatched and unparalleled network to disburse rural credit. It also acknowledged that the other institutional sources of credit had diversified their lending portfolios to accommodate the better off segments of the population and lacked the willingness to disburse credit to the rural population. Thus, it was imperative to resurrect the Cooperatives in the best interests of the weak and marginalized sections that depended on these institutions for their sustenance.

This chapter discusses some of the salient features and recommendations of the Committee Report and the progress in their implementation. However, it is important to mention here that the Vaidyanathan Committee too was anchored firmly in the larger neo-liberal policy shift as it drew attention away from the more fundamental goals of rural credit delivery and inclusive growth and focused only on reviving the efficiency and profitability of these institutions. This is reflected in its policy recommendations that are discussed in the course of this chapter.

3.1 TERMS OF REFERENCE

The Taskforce drafted a plan for the revitalization of the Cooperative Credit institutions based on the recommendations of the previous Committee Reports.[38] The terms of reference of the Vaidyanathan Committee were:[39]

- To devise a plan for the revival of the rural credit cooperatives,
- To amend certain laws and recommend changes to the existing regulatory framework.

[38] The Vaidyanathan Committee made recommendations drawing heavily from the findings of i) the Task Force to study the functioning of Cooperative Credit System and Suggest Measures for its Strengthening (Kapoor Committee , 1999) ii) Expert Committee on Rural Credit (Vyas Committee, 2001) and iii) Joint Committee on Revitalization Support to Cooperative Credit Structure (Vikhe Patil Committee, 2001).
[39] GOI.(2004). *Taskforce on Revival of Cooperative Credit Institutions*

- To assess the recapitalization costs and make recommendations in terms of eligibility, the mode of assistance, pattern of cost sharing, time frame etc of the revitalization scheme.
- To suggest other measures for improving the viability and profitability of these institutions.

3.1.1 FINANCIAL RECAPITALISATION

The taskforce suggested a “financial re-engineering” process which meant revitalizing and restructuring all the tiers of the rural Cooperative Banks. It also suggested infusing capital into these institutions not just to wipe out accumulated losses but also to enable them to maintain a CRAR of 7%, eventually raising it to 9% in three years and 12% in two years. The revival package also covered costs of upgrading the human resource base, introducing technological changes and the costs of implementation.

The criteria for eligibility for the recapitalization were based on financial viability parameters that could be easily identified and empirically verified.

TABLE 3.1 ELIGIBILITY CRITERIA FOR THE RECAPITALISATION PACKAGE

INSTITUTIONS	CRITERIA
PACS	Gross Interest Margin>= 50% of Gross Operating Expenses and Recovery >=50 of Demand
DCCBs	Positive Net Worth and those with negative net worth with deposit erosion of less than 25%
StCBs	Positive Net Worth and those with negative net worth with deposit erosion of less than 25%

SOURCE: Taskforce on the Revival of Cooperative Credit Institutions (Vaidyanathan Committee, 2004)

TABLE 3.2 ESTIMATED COSTS AND THE PATTERN OF COST-SHARING

(in Rs Crores)

ELEMENTS	RESPONSIBILITY OF		
	GOI	STATE GOVT.	CCS UNITS
Accumulated Losses Due To:			
• All Credit Business Of PACS +Agricultural Credit Business of DCCBs and StCBs	3922		
• Non- Agricultural Business of StCBs/DCCBs	841	93	401
• Non-Credit Business Of PACs (PDS etc)		1425	
• Unpaid Invoked Guarantees		1164	
• Other Receivables from State Governments		72	
Return on Government Equity			1243
Minimum CRAR of 7%			**
Human Resource Development + Special Audits	154		
Computerization including Software	516		
Implementation Costs	360		
TOTAL	5,793	3402	1644
Share of Liability	53%	31%	16%
Means of Financing	Grant by GOI	Soft Loan by GOI to State Government (if required)	Soft Loan by GOI to CCS Units (if required)
TOTAL	10,839		
Added Contingencies	4,000		
GRAND TOTAL	14,839		

NOTE: ** Amount to be estimated only after recapitalization

SOURCE: Taskforce on Revival of Cooperative Credit Institutions (Vaidyanathan Committee, 2004)

The recapitalization plan sought to provide financial assistance of Rs 14,839 crores to the short-term rural credit structure. The taskforce mandated that the cost of the financial stimulus of these institutions must be borne by the owners primarily its members and the State governments. But since the Central Government had played an integral role in the promotion and development of the Cooperatives since their inception, it felt its presence and contribution inevitable to the recapitalization exercise. The revival package envisaged the provision of aid to wipe out accumulated losses, cover unpaid State guarantees, provide technical assistance and raising capital to achieve 7% of CRAR.

The cost sharing of the recapitalization process was based on the origin of loss. It was decided that the Union Government would bear the entire losses arising out of agriculture and credit businesses while the State Government would bear the losses occurring on account of non-business credit like the PDS as these businesses were largely driven by them. Thus the Government of India, State Government and the Credit institutions would have their stakes in the ratio 68:28:4.[40]

3.1.2 INSTITUTIONAL AND LEGISLATIVE REFORMS

The Committee recognized that mere financial injection wouldn't be sufficient to restore the health of the Cooperatives and highlighted the need to restructure the supervisory and the regulatory framework. The Committee was of the opinion that the only way to ensure a revival of the Cooperatives was to curtail State support to these institutions and to make them member-driven institutions. Some of the important recommendations of the Committee are listed below:

- The Committee attributed the infirmities and the weaknesses of the Cooperatives to the excessive involvement of the Government in the affairs of these institutions. True to its neo-liberal agenda, the Committee prescribed a minimalist role for the Government in the functioning of the cooperatives and to enable them to develop into

[40] RBI. (2006).*Report on Trend and Progress of Banking in India, 2005-06*

democratic, self reliant and autonomous institutions. The Committee believed that the State's role was intrusive and inimical to the growth of the Cooperatives and hence recommended the retirement of State equity of the Cooperatives through the provision of soft loans. It also curtailed all forms of State support to these institutions. However, it failed to take note that as the Cooperatives serve the weak and marginalized section, they cannot adequately raise resources to sustain their banking operations. The infusion of share capital by the Government was an important source of strengthening the capital base to help them in their banking operations as well as to avail refinance that was crucially linked to the share capital of the Cooperatives.

- The Committee endorsed the "Model Cooperative Law" along the lines of the Brahm Prakash Committee (1991) to ensure uniform legislation across states. For the states that had two pre-existing laws (like the parallel Mutually Aided Societies Act coexisting with the older Cooperative Societies Acts), it recommended convergence to the model cooperative law. Thus, the Committee advocated homogeneous legislation for the Cooperatives irrespective of their historic evolution and the regional specificities associated with rural credit.
- The Committee also recommended amending State Cooperative Laws to ensure RBI's direct intervention in regulatory affairs rather than acting through the Registrar. It also prohibited the State Government in intervening in matters related to banking and finance. This would not only result in centralization of banking operations that could lead to credit migration from rural to urban areas but also affect the autonomy of these institutions
- The Committee granted full autonomy to the PACs to decide the institutions to associate, federate, borrow from and deposit funds in. At present the PACs depend on the affiliated DCCBs for seeking refinance from NABARD. But, although the Committee grants them the freedom to seek refinance facilities, however, in practice, its

failure to bring about subsequent amendments in the NABARD Act, Banking Regulation Act etc. renders all these provisions ineffective.[41]

- The financial reforms of the nineties had prescribed prudential norms for the Commercial Banks which subsequently got extended to the Cooperative Banks. The Committee went a step further and not only introduced stricter prudential norms and procedures for all the tiers but also brought it on par with the Commercial Banks completely disregarding the difference in the objectives and the nature of lending in these institutions. In order to ensure compliance with the prudential norms, it recommended linking the premium rates of the DICGC and the terms of refinance to the financial health of the Cooperatives and the adherence to these norms. The Committee also recommended extending capital adequacy norms to all the tiers of the rural cooperative credit structure. The credit cooperatives were required to increase their capital to maintain CRAR norms of 7% which would be increased to 12% in a phased manner. The result of implementing these norms would not only pre-empt the existing scarce resources from the process of credit creation but also compel the Cooperatives to forego their objectives of growth and development for projects that are deemed to be relatively safer and profitable.
- The Cooperatives have for long restricted membership. The voting rights too were restricted only to the borrowers and not the depositors of the funds who were either denied membership status or remained only nominal members without voting rights. It was felt that such a practice was inconsistent with the democratic ethos and principles characterizing the Cooperatives as the entities whose funds were being intermediated did not have any power in the process of decision-making. Thus the Committee made recommendations to bestow equal voting rights on all members (depositors as well as users of financial services) of the Cooperatives. It also advocated conducting of elections at regular intervals of time.

[41]At present, NABARD can provide refinance facilities only to Banks and not the PACs as these institutions are not covered under the Banking Regulation Act and hence do not qualify as banking entities.

- All the cooperative societies other than Cooperative Banks were prohibited from accepting deposits from public as well as the use of "bank, banker and banking" in their registered names.

3.1.3. PROFESSIONALISATION

The Committee was of the opinion that the interference of the State Governments and the Registrars of the Cooperatives was the primary cause of the poor management and governance of these institutions. Their interference in matters like audits, elections, staffing patterns and financial matters often subverted the democratic ethos of these institutions. The Boards of Management of the Cooperatives were often controlled by the ruling elites and local politicians who misused their position to influence election results and to exact benefits and concessions received by these institutions. It was argued that since the managers of the Cooperatives were drawn from a common staff pool and their remuneration was unrelated to the financial performance of these institutions, there was a lack of accountability on their part. The problems of overstaffing, poorly trained staff personnel and weak internal control also contributed to the poor management of the credit cooperatives.

Thus, the Vaidyanathan Committee emphasized on the need to develop the human resource base to ensure the prudent use of resources and to improve their efficiency. It recommended improving the quality of the personnel employed through training and skill development. The training programs were to encompass both an upgradation of skills as well as aptitude development. It also advocated standardization in curricula and training programs under the aegis of the NABARD.

It sought to redress the problem of delays in audits and elections and also the problem of politicization of the Cooperatives by the ruling elite through reconstitution of the Boards of Management. It abolished the cadre system of employees and recommended that the Boards must comprise of elected members who are professionals instead of State nominees. The CEOs and the staff of the Credit Cooperatives too should be elected and should be in accordance with the eligibility criteria laid down by NABARD. The audit of the Cooperative structure too would be conducted by professional Chartered

Accountants instead of State officials. It also limited the powers of the State Government to supersede the boards of the banks and vested it in the hands of the RBI. The consequence of these reforms was that it significantly curbed the powers of both the Registrars and the State Government and increased the concentration of powers with the RBI which would adversely affect the functional autonomy of the Cooperatives.

3.1.4. TECHNOLOGICAL REFORMS

It is widely accepted that the induction of modern technology in the form of information technology and communication networking has drastically altered the banking landscape as it opens a vista of avenues by introducing innovative products and services to customers. Technological advancement not only enables free flow of information and decision making but also reduces operational costs and improves the efficiency of banks. It was felt that the Cooperative Banks lagged far behind in technology as compared to the other institutions of credit. Thus, the Committee recommended technical reforms for the Cooperatives in the form of computerization and technical upgradation. It advocated the adoption of Common Accounting System (CAS) and Management Information System (MIS) practices to improve the efficiency of the Cooperative Credit Institutions. The DCCBs and the StCBs were also advised operationalization of the Core Banking Solutions (CBS) and provision of Real Time Gross Settlements, NEFT, ATM and POS based devices to its members.

3.2 IMPLEMENTATION OF THE RECOMMENDATION

The revival package for the short-term Cooperatives was announced in January 2006. The States received a notice period till 31st March 2008 for accepting the recapitalization plan and its associated conditionalities after which the offer for participation would stand closed. The process of implementation entailed the Central and State Governments entering into a Memoranda of Understanding with NABARD. On the recommendation of the Vaidyanathan Committee Report, a revised package of Rs.13,596 Crore was sanctioned after consultation with the State Governments.

The Department for Cooperative Revival and Reforms was constituted within the NABARD and entrusted with the responsibility for the implementation of the revitalization process. The NABARD would provide technical assistance and manpower for conceptualization and execution of the plan. The scheme is monitored by the National Level Implementing Monitoring Committee and other Committees at the State and district levels.

By March 31, 2012 the Government had disbursed Rs 9850 Crores for the recapitalization plan, of which the Central Government contributed Rs 9000 Crores while the rest was contributed by the State governments. During the same period 25 States had signed the MOU and 21 States had amended their respective Cooperative Acts. The revival plan incorporated 54,715 PACs and 13 DCCBs across 17 States that accounted for 96% of all the rural Cooperatives. In terms of technical reforms, the NABARD had finalized the core software and disseminated it to 20 States and tried it in 10 States. [42] The training modules for the Cooperative staff and functionaries were designed and a team of 254 trainers was constituted to train and conduct orientation programmes at the lower nodes. [43] By 31st January 2014, the CBS implementation was completed in 28 of the 32 StCBs and 294 of the 371 DCCBs. (Joshi, 2014b) By February 2016, all 32 StCBs and 347 DCCBs were technically equipped to offer RTGS ,NEFT and Direct Benefit Transfer scheme to its members. (Gandhi, 2016)

3.3 CRITIQUE

In sum, the Committee made a few recommendations like the financial recapitalization, upgradation of technology and human resource development that would indeed benefit the Cooperatives in the future. However, it failed to address the more fundamental problems that plagued the Cooperatives. It failed to recognize the special character and the objectives of the Cooperatives and the need to preserve it for ensuring access of credit to the weak and the

[42]The twenty States include Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Gujarat, Jammu and Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Mizoram, Nagaland, Odisha, Rajasthan, Sikkim, Tripura, Uttar Pradesh and West Bengal. The ten States where the software has been tried are Assam, Arunachal Pradesh, Chhattisgarh, Gujarat, Jharkhand, Maharashtra, Madhya Pradesh, Odisha, Uttar Pradesh and West Bengal, and is in progress in Karnataka, Rajasthan and Tripura.

[43] RBI. (2012).*Report on Trend and Progress of Banking in India, 2011-12*

marginalized sections and sectors like agriculture. Instead of drawing attention to matters like strengthening these institutions through State support, it recommended a minimalist role for the Government. By recommending the retirement of State equity, not only did it undermine the resource base of the Cooperatives but also withdrew their existing support system which could severely impair their functioning in future. The Cooperatives are already faced with a precarious resource base due to the localized area of operations, nature of their lending, and the clientele they serve. Thus, subjecting them to similar prudential norms and regulations as the Commercial Banks would further worsen their situation. Similarly, in an attempt to curb the powers of the State Government and the Registrars of the Cooperatives, the Committee compromised on the functional autonomy of these institutions by centralizing these powers with the RBI.

Thus, the short-sighted perspective of the Committee reflected in its approach that focused only on improving the performance of the Cooperatives in terms of the neo-liberal financial indicators like profitability, efficiency and productivity which was evident from its recommendations that were limited to upgrading technology or human resources. Contrary to its claim, it also failed to make any recommendation on rural credit delivery or financial inclusion of the weak and the marginalized sections.

The Committee, in trying to recast the Cooperatives as profitable and viable entities that are "autonomous, self-reliant and member-driven institutions" has only weakened their role as specialized agents for socio-economic transformation. These institutions that are constituted for realizing the objectives of growth and rural development serve the purpose which the profit-driven institutions fail to attain and hence require Government support rather than a "one-time recapitalization" to continue their operations. The failure in providing the requisite support could lead to a subsequent collapse of the credit cooperatives.

CHAPTER-IV

FINANCIAL PERFORMANCE OF THE RURAL COOPERATIVE CREDIT INSTITUTIONS

As discussed earlier, the implementation of homogeneous regulatory and supervisory practices has fundamentally altered the character of the Cooperatives. These institutions are vested with the dual responsibility of achieving the goals of socio-economic equity and commercial viability and efficiency in a competitive environment. Notwithstanding their special character, these institutions today are faced with the difficult choice of either conforming to the parameters of performance under the neo-liberal regime or meeting the specific objectives that they had been set with the minimal support from the State. The study attempts to address this issue in Chapter 4 and Chapter 5.

The major objective of constituting the Taskforce headed by Prof A. Vaidyanathan was to restore the health of the rural cooperative credit institutions through financial recapitalization and to enhance their financial performance by improving their viability, profitability and efficiency. This Chapter aims to analyze the financial performance of the rural credit cooperative structure after the recapitalization process introduced by the Vaidyanathan Committee. Although the Committee was constituted in 2004, it submitted its report a year later while the Government announced the revitalization package in 2006. However, its implementation has been staggered across states.

The performance of these institutions is gauged in terms of seven parameters like resource base, profitability, efficiency, productivity, asset quality, recovery rates and capital adequacy. However, it would be unfair to judge the contribution of these institutions based solely on these parameters as these institutions are not driven by the motive of profits or commercial viability but were constituted with the specific objective of rural and community development by bringing those segments of the society back into the folds of institutional credit that were deemed “un-bankable” and unprofitable for the Commercial banking sector. However, since the study aims at evaluating the performance of the rural credit cooperative structure after the reforms introduced by the Vaidyanathan Committee, it becomes important to analyze the financial performance of these institutions through the parameters identified by the Committee itself.

Thus, this chapter focuses on analyzing the financial performance of the rural cooperative structure while the next chapter evaluates their performance in terms of attainment of the socio-economic development goals.

The period of analysis under consideration is from 1993-94 to 2011-12.[44] For comparison the period has been divided into two sub-periods based on the submission of the Vaidyanathan Committee Report in 2004. This is done to ensure uniformity in comparison as the implementation of the Committee recommendations varied across states as well as the promised grant assistance was released in stages subject to compliance with the conditionalities imposed by the Vaidyanathan Committee.

Hence, the sub periods range from

i) the period prior to the Vaidyanathan Committee Report (1993-94 to 2003-04) and

ii) the period post the Vaidyanathan Committee Report (2004-05 to 2011-12).

The chapter is subdivided into three sections. The first section evaluates the performance of the Primary Agricultural Cooperative societies (PACs), the second section deals with the District Central Cooperative Banks (DCCBs) while the last section discusses the performance of the State Cooperative Banks (StCBs)

[44] The period of analysis is restricted to the year 2012 as the data on the rural cooperative credit structure is available with a year lag. Also since 2014, the RBI has merged the publication of the Financial Stability Report with the Report on Trend and Progress of Banking In India, hence , comparable data for most of the parameters remains un-available.

4.1 PERFORMANCE OF THE PRIMARY AGRICULTURAL COOPERATIVE SOCIETIES

The Primary Agricultural Cooperative societies form the base of the three tier structure of the rural cooperative credit structure. It is this tier that operates at the grass-root level and interacts directly with the rural clientele like farmers and artisans. The PACs form a vast and an unmatched network of societies penetrating even the remote and inaccessible corners of the country. Today, the PACs have proliferated in number and account for 93,042 societies and 130,120 members spread across the country.[45] Both the DCCBs and the StCBs are dependent on the PACs for their business as well as the stability of the rural credit cooperative structure. Hence the health of the Primary Agricultural Cooperative Societies is a crucial determinant of the sustainability and the viability of the rural cooperative credit structure.

4.1.1 COMPOSITION OF THE RESOURCE BASE

The resources of the PACs comprise owned funds (paid up capital and Government's share capital), deposits and borrowings. The PACs have a weak resource base that needs to be supplemented through borrowings. The borrowings constitute a major share of the resources of these institutions. The PACs rely heavily on the borrowings from upper tiers as well as refinance facilities from other institutions for their banking operations.

The resource base of the PACs has grown from Rs 13,913 Crore in 1993-94 to Rs 155,084 Crore in 2011-12. The resource base of the PACs has registered a phenomenal growth in the recent years especially after 2004-05. However, it is interesting to note that most of the increase in resources has come as a result of an increase in the borrowings. On an average, borrowings form the dominant share in the resource base (57%) with the deposits and owned funds accounting for 28% and 15% respectively. After the revitalization plan the share of deposits in the resource base has increased but the reliance on borrowings continues.

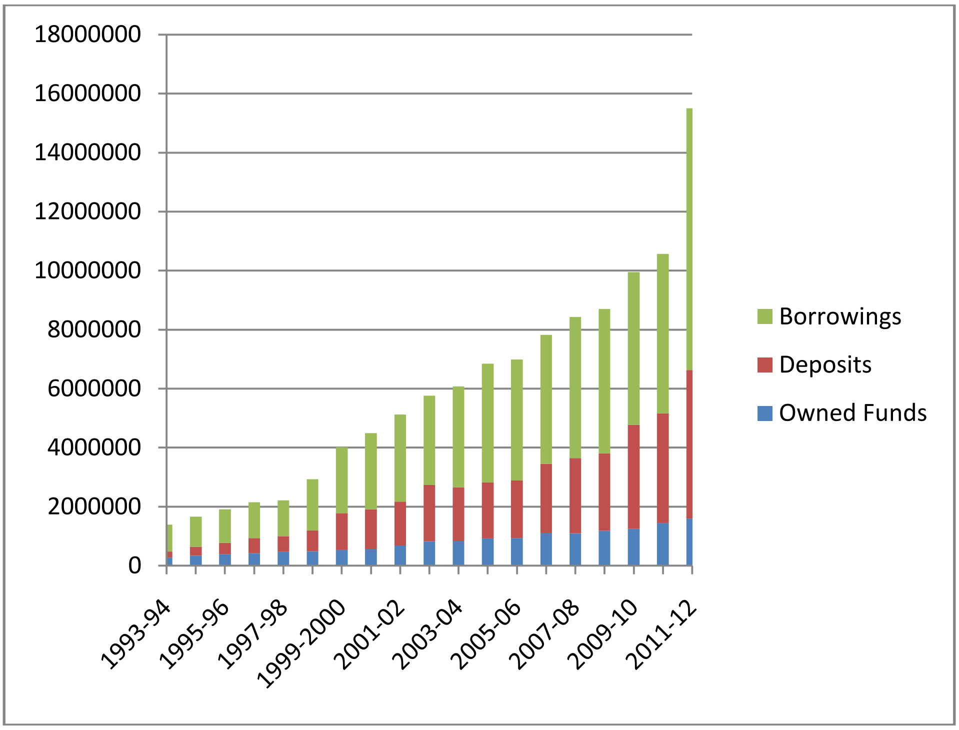
The figures are indicative of the fact that these institutions are still perceived as centres to meet credit needs without simultaneously inculcating the habit of

[45]NAFSCOB. (2014).*Basic Data on Performance of State Cooperative Banks, 2013-14*

saving and thrift which is reflected in the low share of deposits. It also reflects the inability of these institutions to raise resources and their dependence on the upper tiers and NABARD for funds.

CHART 4.1 COMPOSITION OF THE RESOURCE BASE OF THE PACs

(In Rs lakhs)



SOURCE: Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

The Government's role in encouraging these institutions through financial support is visible in its contribution to the share capital of these institutions. Although the share of the government's contribution to the PACs has increased in absolute terms, its share in the total resource base has declined consistently over time. This is because of the recommendations of the Vaidyanathan Committee which mandated the retirement of government's equity in a phased manner.

4.1.2 VIABILITY OF PACs

Financial Viability[46] is an important parameter for judging the performance of the Cooperative Banks. The viability of banks is directly related to its cost margins. The transaction costs and the risk (through costs of provisioning) account for a major share of the costs of the PACs. The financial health of the PACs has been of primary concern as their viability and vulnerabilities affect the functioning of the upper tiers and threatens to jeopardize the entire rural Cooperative credit structure.

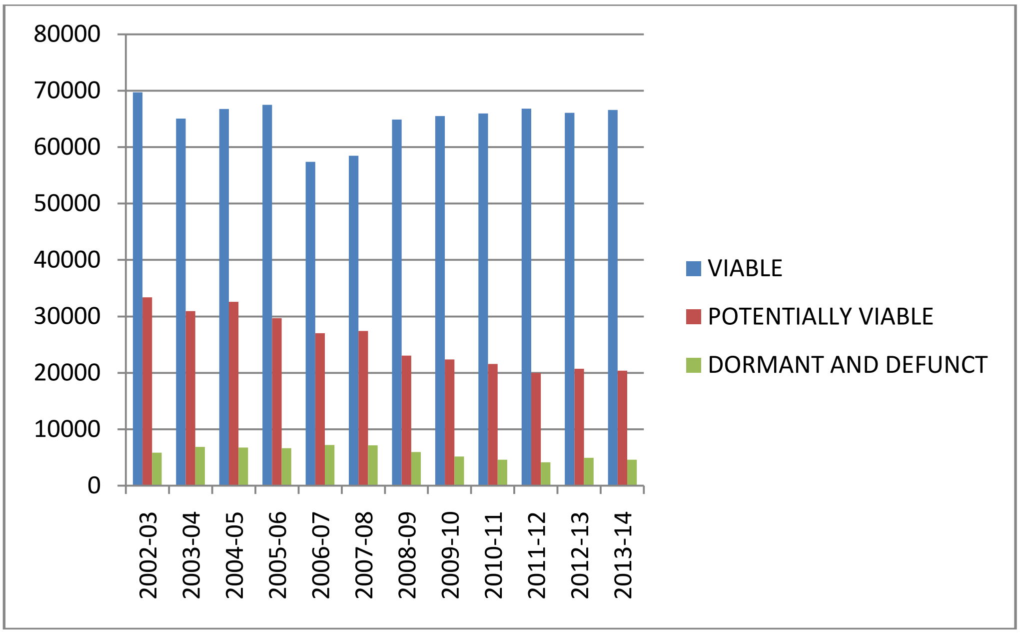
In 2002-03, about 62% and 29% of the PACs were reported to be viable and potentially viable while the dormant and defunct PACs constituted only 5% of the total. In contrast in 2013-14, the viable and potentially viable PACs accounted for 72% and 22% of the total PACs while the dormant and defunct PACs stood at 5%. The figures suggest that it is the revival of the potentially viable PACs that accounts for the rise in the proportion of viable PACs. (Chart 4.2 (a) and (b))

Another point to be noted is that the number of Cooperative societies has not remained stationary. The societies have grown in number from 91,592 in 1993-94 rising to 112,309 in 2002-03 and then declining to 93,042 in 2013-14. The decline in the number of PACs is the result of closure or liquidation of the unviable units as a consequence of the implementation of the recommendations of the Vaidyanathan Committee Report.

[46] Financial Viability is defined in terms of the ability of a PAC to generate a surplus over and above its incurred costs (including provisioning for losses). Thus, potentially viable PACs are those that are at break-even point, while unviable PACs are those that fail to cover these costs.

CHART 4.2 (a) CLASSIFICATION OF PACs ACCORDING TO THEIR FINANCIAL VIABILITY

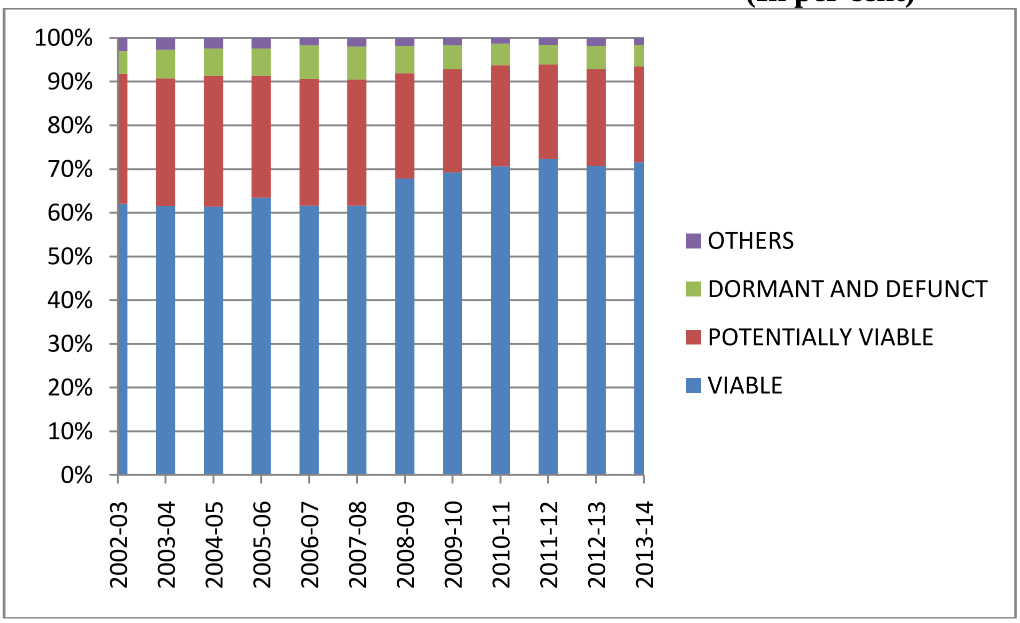
(in numbers)



SOURCE: Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

CHART 4.2 (b) CLASSIFICATION OF PACs IN TERMS OF THEIR FINANCIAL VIABILITY

(In per cent)



SOURCE: Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

In terms of regional distribution, in 2002-03, the Central region accounted for the highest proportion of viable PACs (75%) while the north-eastern region accounted for the lowest (47%). In 2013-14, although the region-wise performance did not change in relative terms but there was a marked improvement in the regions respectively with a rise in the proportion of viable PACs.

TABLE 4.1 REGION-WISE DATA ON THE VIABILITY OF THE PACs FOR THE YEAR 2013-14

(in numbers)

REGION	TOTAL PACs	VIABLE PACs (OF COL.2)	POTENTIALLY VIABLE PACs (OF COL.2)	DORMANT AND DEFUNCT PACs (OF COL.2)
1	2	3	4	5
Central	13386 (14.39)	10778 (80.52)	1989 (14.86)	549 (4.10)
Eastern	18566 (19.95)	13977 (75.29)	2997 (16.14)	995 (5.36)
North-Eastern	3491 (3.75)	1839 (52.68)	491 (14.06)	1053 (30.16)
Northern	12899 (13.86)	9384 (72.75)	2760 (21.40)	578 (4.48)
Southern	15040 (16.17)	10679 (71.00)	3290 (21.88)	690 (4.59)
Western	29660 (31.88)	19920 (67.16)	8840 (29.80)	727 (2.45)
INDIA TOTAL	93042 (100)	66577 (71.56)	20367 (21.89)	4592 (4.94)

SOURCE: Performance of Primary Agricultural Credit Societies, NAFSCOB (2013-14)

NOTE: The figures in the bracket represent the percentage to total

Central Zone consists of Delhi, Madhya Pradesh and Uttar Pradesh

Eastern Zone consists of Bihar, Orissa and West Bengal

North-Eastern Zone consists of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura

Northern Zone consists of Chandigarh, Haryana, Himachal Pradesh, Jammu and Kashmir, Punjab, Rajasthan, Chhattisgarh and Uttarakhand

Southern Zone consists of Andaman and Nicobar, Andhra Pradesh, Karnataka, Kerala, Pondicherry and Tamil Nadu

Western Zone consists of Goa, Gujarat and Maharashtra

An interesting trend that emerges is that although the north-eastern region fares poorly in terms of viability, some of the north-eastern States like Arunachal Pradesh, Assam, Manipur and Tripura outperform the others in terms of viability. The other States that have a high proportion of viable PACs are Haryana, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Rajasthan, Uttar Pradesh and West Bengal. Himachal Pradesh (22.43%), Mizoram (12.12%), Nagaland (27%), Tamil Nadu (31%), and Jharkhand. (28.85%) are some of the states that fare poorly on the viability parameter and fall considerably below the national average of 62%. Nagaland (60%) and Jammu and Kashmir (30%) account for the largest proportion of dormant and defunct PACs.

4.1.3 SOCIETIES IN PROFIT AND LOSS

Due to non-availability of data, profitability indicators cannot be calculated for this tier. However, Table 4.2 shows the number of societies in profit and loss. It also shows the quantum of profit and loss. The data reveals that the societies in profit have on an average been balanced by the societies in loss. However, the PACs have for long registered negative profits or losses. The trend remains unchanged even during the period characterized by the recapitalization plan. However, the year 2013-14 marks a turnaround recording a profit of Rs 1934 Crores.

During 2002-03 and 2004-05, the profit-making PACs exceeded the loss making units, thereafter for five consecutive years the loss making PACs out-numbered the profit making units.

This trend was reversed in 2010-11 with the profit making PACs dominating the loss making PACs and finally the PACs registered positive net profits in 2013-14. While many believe that the losses of the PACs were attributed to issues pertaining to governance, the possibility that centralization resulted in shifting of funds of the PACs to levels where profits could be shored up cannot be ruled out.

TABLE 4.2 PACs IN PROFIT AND LOSS

(in Rs Crores)

YEAR	NO. OF PROFIT MAKING SOCIETIES	AMOUNT IN PROFIT	NO .OF LOSS-MAKING SOCIETIES	AMOUNT IN LOSS	NET PROFIT/LOSS*
2002-03	83349	404.43	53626	1861.84	-1457.4
2003-04	75680	598.47	73781	2266.72	-1668.25
2004-05	79717	728.41	54158	3536.57	-2808.16
2005-06	44321	719.36	53026	1920.48	-1201.12
2006-07	33983	748.94	48078	2401.70	-1652.76
2007-08	38307	750.78	48520	2027.90	-1277.11
2008-09	37291	842.60	45869	1915.19	-1072.59
2009-10	40936	1226.62	41679	2365.57	-1138.96
2010-11	44554	1841.21	38065	2032.79	-191.578
2011-12	45433	1405.01	36375	3426.85	-2021.84
2012-13	42586	2083.78	37955	4214.14	-2130.36
2013-14	43327	11052.53	37662	9118.30	1934.23

NOTE: *- The net profit/loss column represents current profit or loss and not accumulated profit/loss.

SOURCE: Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

4.1.4 PRODUCTIVITY

Productivity refers to maximizing the output with the given set of inputs. In the available literature on banking, output is measured by the total volume of business (the sum of the value of deposits and the loans) and the working capital[47]. In this study productivity is measured by the total volume of business per employee and the working funds per employee. As discussed earlier, the Vaidyanathan Committee report made recommendations on increasing the staff productivity of the Cooperative Credit institutions through training and professionalization of the Boards of Management.

Table 4.3 clearly illustrates that there has been a consistent rise in productivity as measured by both the indicators of productivity during the period 2004-05 to 2011-12.

The volume of business increased from Rs 13.5 lakhs in 1994-95 to Rs 67.80 lakhs in 2011-12. During the period 1994-95, the volume of business per employee hovered around Rs 30 lakh but it almost doubled from that level in the next period. Similarly the working funds per employee also rose from Rs 16.14 lakhs in 1994-95 to Rs 76.91 lakhs in 2011-12. The productivity of the PACs was affected by the global meltdown in 2007-08 and declined marginally in 2010-11due to a rise in the number of employees.

A glance at Chart 4.3 shows a turnaround in productivity from the year 2004-05 onwards, with significant increases over the subsequent period. Thus, the above findings establish that the productivity of the PACs has increased after the implementation of the Vaidyanathan Committee recommendations.

[47] The working capital (working funds) is defined as the total of balance sheet items like deposits, borrowings, share capital and the reserves after making deductions for contra items and accumulated losses.

TABLE 4.3 PRODUCTIVITY INDICATORS OF THE PACs

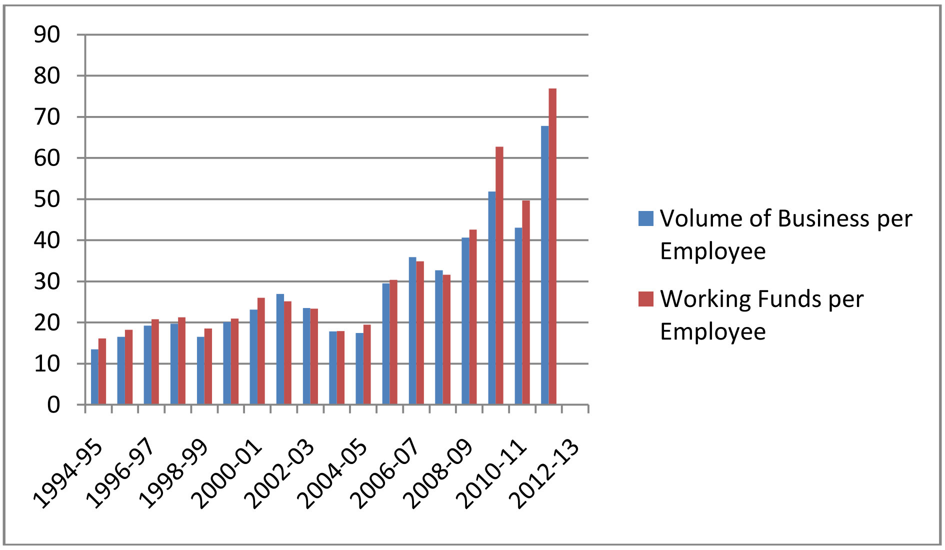
(In Rs lakhs)

YEAR	VOLUME OF BUSINESS PER EMPLOYEE	WORKING FUNDS PER EMPLOYEE
1994-95	13.50	16.14
1995-96	16.49	18.24
1996-97	19.25	20.76
1997-98	19.66	21.24
1998-99	16.53	18.52
1999-00	20.12	20.95
2000-01	23.14	25.97
2001-02	26.94	25.13
2002-03	23.53	23.38
2003-04	17.86	17.87
2004-05	17.46	19.43
2005-06	29.53	30.37
2006-07	35.85	34.92
2007-08	32.68	31.60
2008-09	40.64	42.57
2009-10	51.86	62.73
2010-11	43.03	49.64
2011-12	67.80	76.91

SOURCE: Estimated from Performance of the Primary Agricultural Credit Cooperatives, NAFSCOB (Various Issues)

CHART 4.3 PRODUCTIVITY INDICATORS OF THE PACs

(in Rs Lakhs)



SOURCE: Estimated from Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

4.1.5 ASSET QUALITY

Although, the PACS outperform the Scheduled Commercial Banks and the Regional Rural Banks in their coverage and geographical spread, these institutions draw a lot of criticism due to their poor financial position. The poor health of the PACs is attributed largely to their poor recovery rates which is reflected in the rising overdues. The low recovery rates give rise to a vicious cycle. The low recovery rates erode the resource base and dissuade depositors from maintaining their funds with the PACs. The lack of funds prevents potential credit worthy borrowers from entering the ambit of the formal banking sector. This hampers the process of credit creation and in turn causes the resource base to shrink further. It also restricts the ability of the PACs to access refinance from the higher tiers.

The percentage of overdues to demand and percentage of overdues to total outstanding loans is used as an indicator of the NPAs for this tier.

The total overdues of the Primary Agricultural Cooperative Societies have increased over six times from Rs 4183 crores in 1993-94 to Rs 29653 crores in 2013-14. (Table 4.4) However, the overdues do not show a secular rise. During the period 1993-94 and 2011-12, the overdues show a marked increase in 1996-97, 1999-2000, 2002-03, 2007-08 and 2008-09. While the last two years are the ones affected by the global financial crisis, the other periods are marked by natural calamities like severe droughts (2002-03) that affected the country which resulted in mounting overdues.

The ratio of overdues to the total outstanding loans and overdues as percentage of demand declined marginally from the year 1996-97 and has continued to decline till 2002-03. This was the result of the "One-Time Settlement Scheme" [48] of the NPAs introduced by the NABARD in 1998 and was operational till 2004

[48] The One Time Settlement Scheme (OTS) was an initiative by the NABARD along the lines of the RBI to bring the small and marginal farmers back into the banking folds. These farmers had become ineligible to seek fresh loans from financial institutions due to their earlier defaults. Thus this scheme aimed at settling their previous accounts and made them eligible to seek credit.

TABLE 4.4: OVERDUES OF THE PACs

(In Rs Lakhs)

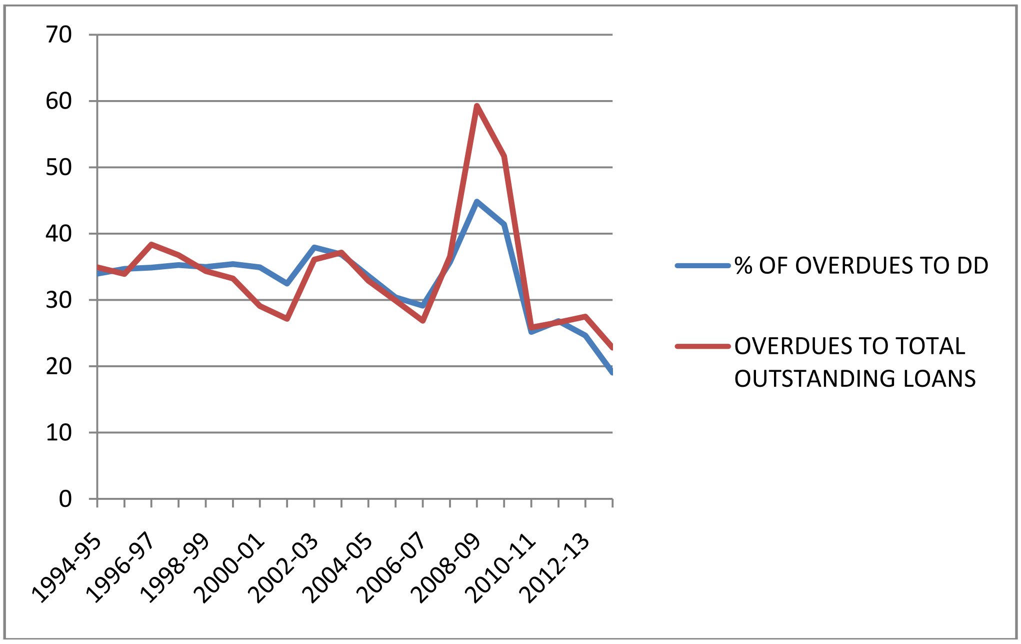
YEAR	TOTAL OVERDUES	OVERDUES TO DD (%)	OVERDUES TO TOTAL OUTSTANDING LOANS (%)
1993-94	418333		39.71
1994-95	423988	33.94	34.92
1995-96	490582	34.69	33.92
1996-97	613640	34.85	38.33
1997-98	629385	35.27	36.76
1998-99	731721	34.95	34.35
1999-00	948442	35.39	33.22
2000-01	1003788	34.90	29.08
2001-02	1106727	32.48	27.14
2002-03	1528937	37.90	36.05
2003-04	1629517	36.84	37.14
2004-05	1605223	33.59	32.90
2005-06	1547623	30.36	29.89
2006-07	1575291	29.11	26.87
2007-08	2400348	35.67	36.55
2008-09	3793654	44.82	59.23
2009-10	3952401	41.39	51.68
2010-11	2269759	25.15	25.86
2011-12	2430359	26.78	26.64
2012-13	3830559	24.65	27.48
2013-14	2965368	19.03	22.80

SOURCE: Estimated from Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

The overdues rose again in 2002-03 and 2003-04, (the years that India faced one of the worst droughts since independence) before registering a decline. The overdues and the ratios peaked again in the years coinciding with the global meltdown of 2007-08 after which it declined again in 2010-11. (Chart 4.4)

CHART 4.4 OVERDUES OF THE PACSs

(In per cent)



SOURCE: Estimated from Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

The dramatic decline in the overdues after 2009-10 was attributed to the financial recapitalization introduced by the Taskforce as well as the Agriculture Debt Waiver and Debt Relief Scheme (2008) of the Government that helped cleanse the balance-sheets of the PACs.

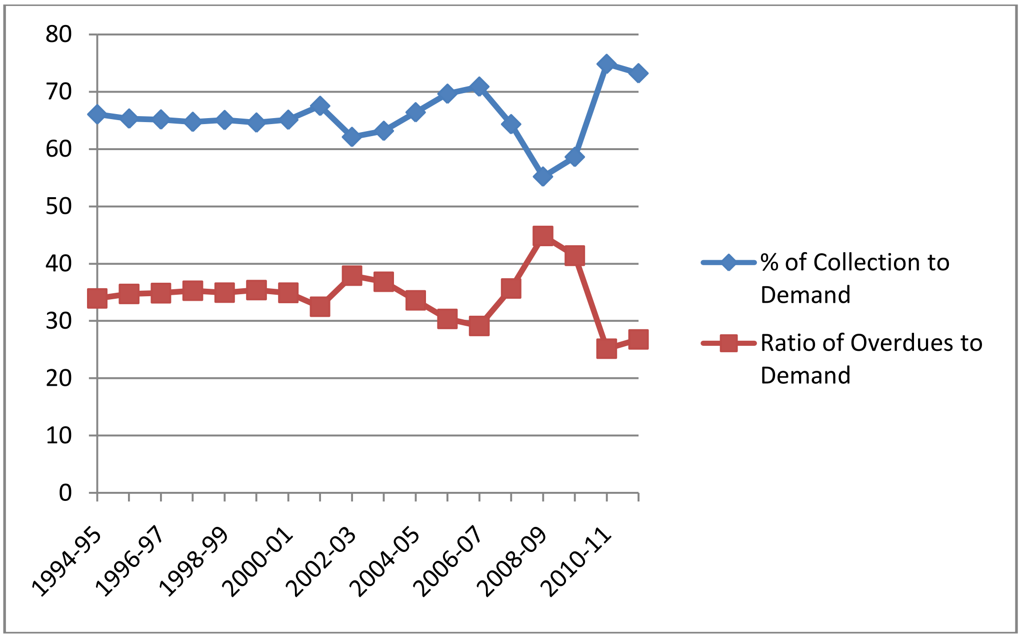
4.1.6 RECOVERY RATES

The recovery rates have implications for the overdues, working capital and the resource base. The recovery rates for this tier in the study are measured as a percentage of collection to demand. The recovery rates for the PACs have remained close to 65% for the period from 1993-94 to 2003-04. The recovery rates improved in the year 2005-06 (70%) and remained at that level for the successive year before slumping to 64% in the year 2007-08 which coincides with the Global Financial Crisis. The recovery rates dipped further to 55% in 2008-09, improved slightly to 58.62% in the subsequent year before rising to 75% in 2010-11 and 74% in 2011-12.

The recovery rates and the overdues represent different sides of the same coin and the financial recapitalization and the loan waiver scheme has helped improve the financial position of the PACs, as is evident from a decline in the overdues and an improvement in the recovery rates. The improvement in recovery rates also points at a disquieting tendency as the PACs have resorted to a shift in the composition of their loan portfolios to improve their financial position. The PACs have moved away from their traditional role of disbursing agricultural credit in favor of non-agricultural loans as the former are deemed to be riskier, antithetical to profits and burdens their balance-sheets with overdues. (discussed in Chapter 5)

CHART 4.5: RECOVERY RATES OF THE PACs

(in per cent)



SOURCE: Estimated from Performance of Primary Agricultural Credit Societies, NAFSCOB (Various Issues)

4.2 DISTRICT CENTRAL COOPERATIVE BANKS

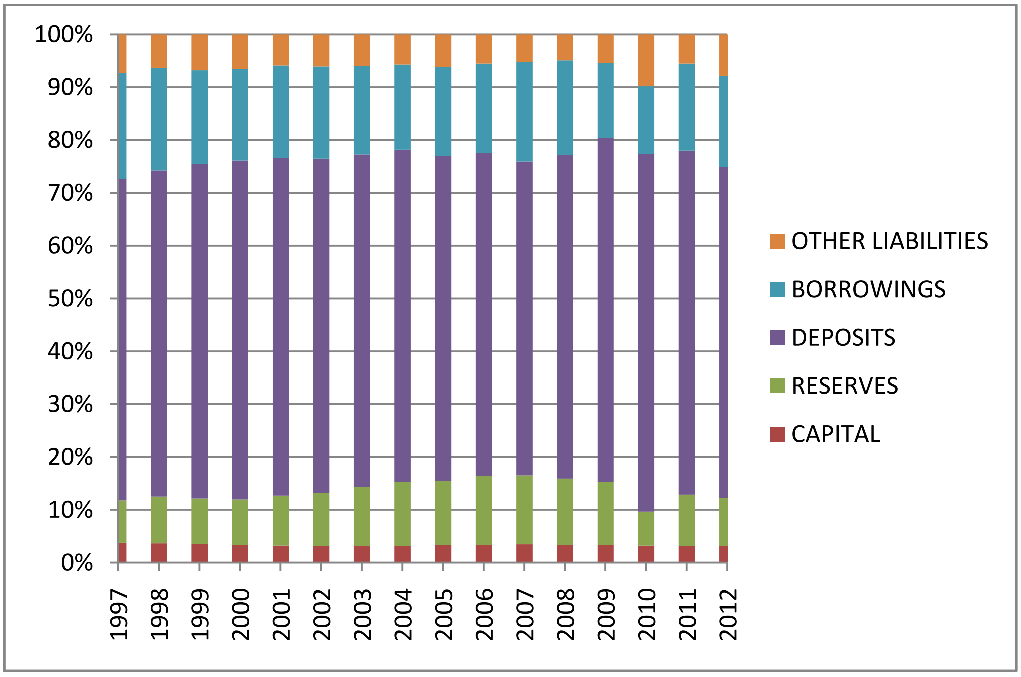
The District Central Cooperative Banks form the intermediate tier in the rural Cooperative Credit structure. In the federal, rural cooperative structure, this tier serves as the inter-linkage between the PACs and the StCBs. Today there are 372 DCCBs with 13811 branches operational in the country.[49] This section examines the performance of the DCCBs.

4.2.1 BALANCESHEET INDICATORS

An analysis of the balance sheet of the DCCBs is crucial in understanding the financial performance of these institutions. On the liabilities side, the deposits form the dominant share accounting for 60 percent of the total liabilities. The borrowings form the second most important component of the liabilities (17%).The other components of the DCCBs are reserves (10%), capital (3%) and other liabilities (6%).

CHART 4.6: COMPOSITION OF LIABILITIES OF THE DCCBs

(in per cent)



SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

[49] NAFSCOB.(2014).*Basic Data on Performance of District Central Cooperative Banks, 2013-14*

TABLE 4.5: LIABILITIES OF THE DCCBs

(In Rs.Crores)

YEAR	CAPITAL	RESERVES	DEPOSITS	BORRO WINGS	OTHERS	TOTAL LIABILI TIES
1997	1895	4007	30512	10053	3641	50589
1998	2153	5291	36777	11574	3766	59561
1999	2511	6197	45536	12773	4860	71877
2000	2826	7290	54248	14658	5554	84576
2001	3128	9105	61813	16937	5704	96687
2002	3424	10717	68181	18820	6523	107665
2003	3569	12829	72344	19243	6848	114833
2004	3897	15234	79153	20256	7145	125685
2005	4342	16155	82129	22575	8174	133377
2006	4748	18702	87532	24217	7891	143090
2007	5458	20722	94529	29912	8273	158894
2008	5939	22467	109597	32130	8749	178881
2009	6578	23227	127623	27663	10593	195684
2010	7309	14400	152900	28735	22200	225400
2011	8000	25100	168000	42500	14300	257800
2012	9000	26900	184200	50800	22900	293700

SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

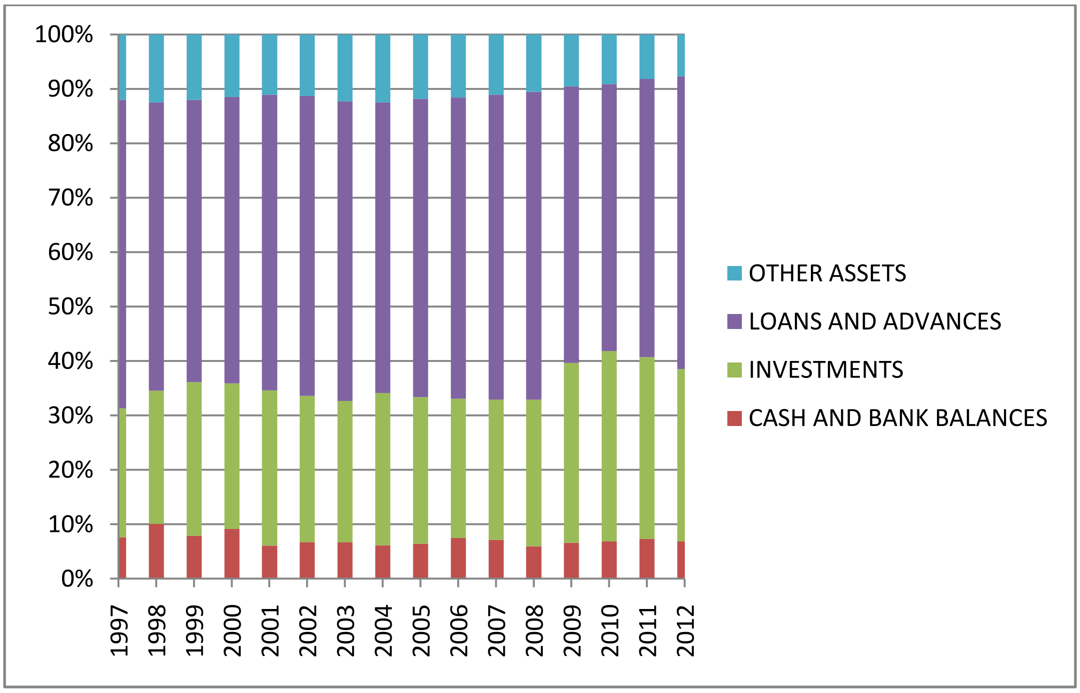
- The DCCBs receive deposits from affiliated Cooperatives, individuals, local bodies and other sources. Between 2001 and 2014, the deposits of individuals accounted for almost 60% of the total deposits, the deposits by the affiliated Cooperatives stood at 33% while the rest were contributed by local bodies and other sources. After 2009-10, the share of deposits of individuals in the total deposits has risen with a corresponding decline in the share of the cooperatives. This could be a positive outcome of the Vaidyanathan Committee that extended voting rights to the depositors that was encouraging them to maintain their funds with the credit cooperatives.
- Borrowings from the StCBs and the NABARD account for almost 95% of the total borrowings of the DCCBs. The share of borrowings declined from 19.87 % in 1997 to a low of 16.92 % in 2006. The borrowings of the DCCBs rose to 18.83% in 2007 during the global financial crisis. With the capital infusion introduced by the Taskforce the reliance of the DCCBs on borrowings reduced to 12.75 % in 2010. However its share has risen again in the recent years.
- The reserves of the DCCBs comprise of statutory reserves (13%), contributions from Agriculture Credit Stabilization Fund (7%) and other funds (80%). The weak capital base of the cooperatives is because most of these institutions prevent the accumulation of retained earnings to evade income tax as retained earnings of the cooperatives are treated as funds out of the purview of members and account for taxable income.[50]
- The share capital of the DCCBs was contributed primarily by the affiliated Cooperatives, the Government and individuals. The Cooperatives accounted for 83.25% of the total share capital in 2002-03 and after plummeting to 65% in 2009-10, that figure made a steady recovery in the aftermath of the Global financial crisis to 82% in 2013-14. Corresponding to this, the Government's share rose from 15% in 2002-03 to 31% in 2009-10. The share capital contributed by

[50] GOI.(2009*).High Powered Committee on Cooperatives*

individuals forms a miniscule share of the total capital with their share rising from 1.8% in 2002-03 to 4.1% in 2013-14. The lack of share capital not only constrains the growth of cooperatives but also the lack of stake of members in the cooperatives results in lack of responsibility and accountability on part of the members resulting in poor management and governance.

CHART 4.7 COMPOSITION OF ASSETS OF THE DCCBs

(in per cent)



SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

On the asset side, the loans and advances account for over half the assets while the share of investments contribute to around a third of the assets. The asset composition of the DCCBs has changed from 2009 onwards with a decline in the share of loans advanced and a rise in investments. (Chart 4.7) This trend depicts the risk averse behavior of the Cooperative banks in the backdrop of the Global Financial crisis of 2007-08. It could also be seen as a response to changes in the regulatory requirements that made financial intermediation "riskier and unprofitable" inducing the DCCBs to divert funds to investments.

TABLE 4.6:ASSETS OF THE DCCBs

(In Rs Crores)

YEAR	CASH AND BANK BALANCES	INVESTMENTS	LOANS AND ADVANCES	OTHER ASSETS	TOTAL ASSETS
1997	3829	12012	28684	6065	50589
1998	5987	14584	31550	7440	59561
1999	5678	20285	37272	8642	71877
2000	7731	22594	44538	9713	84576
2001	5853	27616	52512	10706	96687
2002	7206	28958	59316	12185	107665
2003	7704	29813	63198	14118	114833
2004	7689	35180	67152	15664	125685
2005	8567	35937	73125	15748	133377
2006	10695	36628	79202	16565	143090
2007	11274	41006	89038	17576	158894
2008	10609	48228	101221	18823	178881
2009	12917	64709	99429	18629	195684
2010	15400	78900	110600	20600	225400
2011	18800	86100	131800	21100	257800
2012	20000	93200	157900	22600	293700

SOURCE: Report on Trend and Progress of Banking in India, RBI (Various Issues)

The investments of DCCBs comprise primarily of fixed deposits and government securities and the period characterized with the reforms saw a shift of funds of DCCBs to investing in fixed deposits. The situation is likely to worsen in the future with a RBI circular (5^{th} June 2014) mandating the DCCBs and the StCBs to invest in Government securities. This obligation for the DCCBs to invest in government securities will reduce the resources available for disbursal of credit.

The DCCBs advance short and medium term loans for both agricultural and non-agricultural activities. However, the composition of loans advanced by the DCCBs has changed over time with a view to diversify their loan portfolio. (discussed in detail in Chapter 5)

4.2.2 PROFITABILITY

Profitability of the District Central Cooperative Banks is measured by four indicators namely operating profits, net profits, operating profits as a proportion of total assets and net profits as a proportion of total assets. The profitability indicators are represented in Chart 4.8 (a) and (b)

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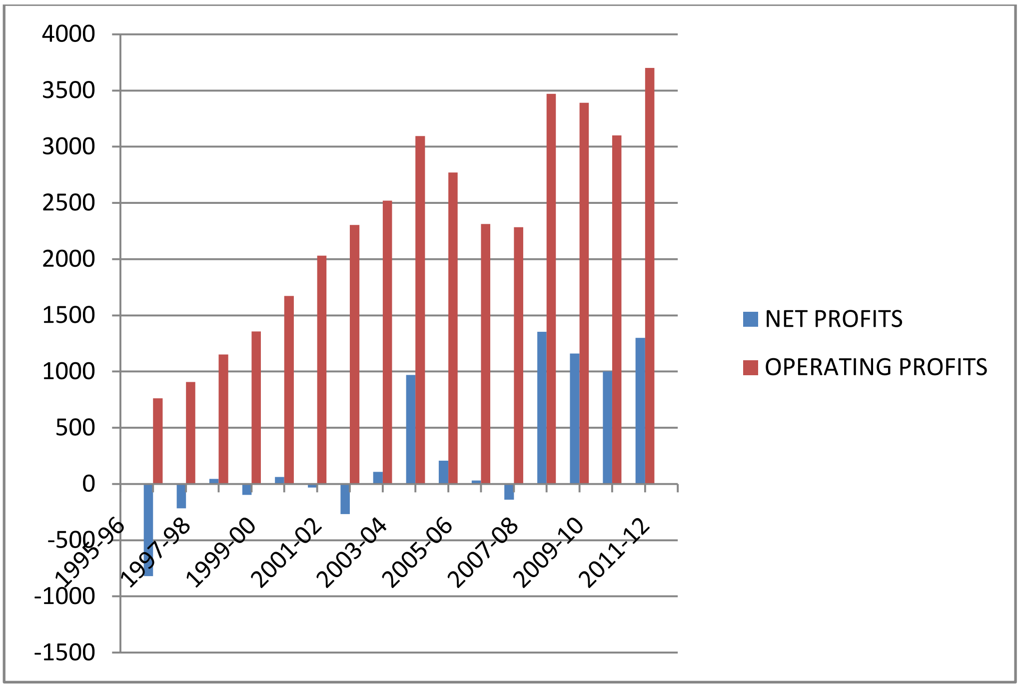
CHART 4.8 (a): PROFITABILITY INDICATORS OF THE DCCBs

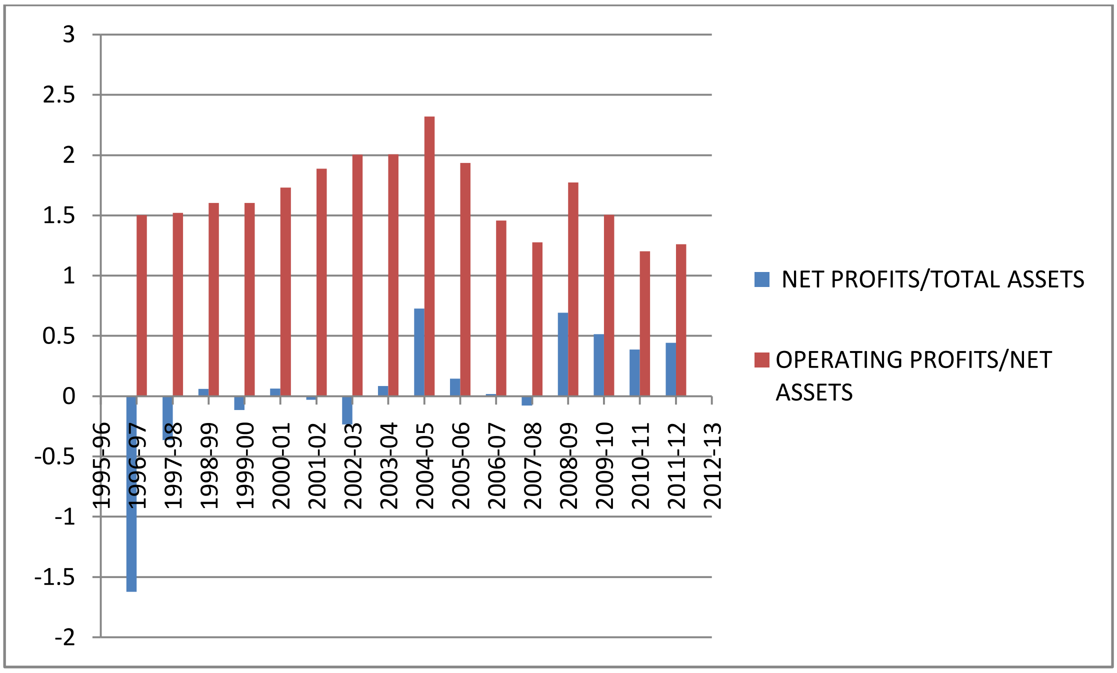
(in Rs Crores)



SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

CHART 4.8 (b) PROFITABILITY INDICATORS OF THE DCCBs

(in per cent)



SOURCE: Estimated from data by Report on Trends and Progress of Banking in India, RBI (Various Issues)

TABLE 4.7 (a): WORKING RESULTS OF THE DCCBs FROM 1996 TO 2004

(Rs in Crores)

	INCOME			**EXPENDITURE**				**PROFITS**	
Year	**Interest**	**Other**	**Total Income**	**Total Expenditure**	**Interest Expended**	**Provisions & Contingency**	**Operating Expenses**	**Operating**	**Net**
1996-97	5555	278	5833	6654	3958	1582	1115	760	-821
%	10.98	0.55	11.53	13.15	7.82	3.13	2.2	1.5	-1.62
1997-98	6327	355	6682	6899	4477	1123	1289	917	-207
%	10.62	0.6	11.22	11.58	7.52	1.89	2.16	1.54	-0.35
1998-99	7469	485	7954	7910	5232	1109	1570	1153	44
%	10.39	0.67	11.07	11	7.28	1.54	2.18	1.6	0.06
1999-00	8718	469	9187	9283	6149	1453	1681	1357	-96
%	10.31	0.55	10.86	10.98	7.27	1.72	1.99	1.6	-0.11
2000-01	9829	565	10394	10332	6950	1611	1770	1672	62
%	10.17	0.58	10.75	10.69	7.19	1.67	1.83	1.73	0.06
2001-02	10911	635	11546	11579	7693	2065	1821	2031	-34
%	10.13	0.59	10.72	10.75	7.15	1.92	1.69	1.89	-0.03
2002-03	11291	795	12086	12354	7812	2571	1971	2303	-268
%	9.83	0.69	10.52	10.76	6.8	2.24	1.72	2.01	-0.23
2003-04	11023	888	11911	11804	7318	2414	2071	2522	108
%	8.77	0.71	9.48	9.39	5.82	1.92	1.65	2.01	0.09

NOTE: The figures in percentage represent percentage to total assets.

SOURCE: Report on Trend and Progress of Banking in India, RBI (Various Issues)

TABLE 4.7 (b): WORKING RESULTS OF THE DCCBs FROM 2004-2012

(Rs in Crores)

	INCOME			EXPENDITURE				PROFITS	
Year	Interest Income	Other income	Total Income	Total	Interest	Provisions & Contingency	Operating Expenses	Operating	Net
2004-05	11420	1310	12730	11759	7405	2125	2230	3096	971
%	8.56	0.98	9.54	8.82	5.55	1.59	1.67	2.32	0.73
2005-06	10688	1000	11688	11481	6577	2563	2341	2769	207
%	7.47	0.70	8.17	8.02	4.60	1.79	1.64	1.94	0.15
2006-07	10597	1055	11652	11622	6668	2284	2670	2314	31
%	6.67	0.66	7.33	7.31	4.20	1.44	1.68	1.46	0.02
2007-08	11980	1155	13135	13274	7872	2423	2980	2284	-139
%	6.70	0.65	7.34	7.42	4.40	1.35	1.67	1.28	-0.08
2008-09	14817	1485	16302	14949	9413	2119	3417	3473	1353
%	7.57	0.76	8.33	7.64	4.81	1.08	1.75	1.77	0.69
2009-10	15936	1800	17736	16576	10300	2230	4000	3363	1136
%	7.07	0.80	7.87	7.35	4.57	0.99	1.77	1.49	0.50
2010-11	17900	1200	19100	18100	11300	2100	4700	3100	1000
%	6.94	0.47	7.41	7.02	4.38	0.81	1.82	1.20	0.39
2011-12	21600	1300	22900	21600	13600	2400	5600	3800	1400
%	7.35	0.44	7.80	7.35	4.63	0.82	1.91	1.29	0.48

NOTE: The figures in percent represent percentage to total assets.

SOURCE: Report on Trend and Progress of Banking in India, RBI (Various Issues)

In the period prior to the Vaidyanathan Committee, the balance sheets of the DCCBs recorded net losses for five of the eight years under consideration. The extent of losses fell from Rs 821 crores in 1996-97 to Rs 207 crores in the next year .The DCCBs recorded positive profits in 1998-99. This favorable outcome came as a result of a decline in the share of provisions and contingency in total expenses. The period was interspersed with alternating years of profit and loss. In 1999-2000, the DCCBs again registered losses due to rising costs attributable to the implementation of provisioning norms to the StCBs and the DCCBs. After a year of making profits, the DCCBs again slumped back into losses owing to rising costs of provisions and contingency.

In 2003-04 despite the rising operating costs, the DCCBs garnered net profits of Rs 108 Crores due to the interest income outpacing the expenses. The operating profits of DCCBs during this period grew from Rs 760 crores in 1996-97 to Rs 2522 crores in 2003-04 while as a proportion of the total assets its share grew from 1.5% to 2.01%. (Table 4.8)

A striking difference in the performance of the DCCBs between the two periods under comparison is that during the first period, profits were earned as a result of an increase in the share of interest income in the total assets, while during the next period profitability was achieved by economizing on the operating costs and the costs incurred on account of provisions and contingency as a proportion of the total assets.

There has been a remarkable turnaround in the profitability of the District Central Banks during the period 2004-12, which is reflected in all the profitability indicators. The year 2004 was marked by an economic boom which saw the net profits of the DCCBs surge to Rs 971 crores in 2004-05 from Rs 108 crores in the preceding year (increase by 800%). However, the growth slowed down in the subsequent year and the DCCBs registered losses in 2007-08. In 2008-09 the DCCBs turned around the corner and registered net profits of Rs 1353 crores and operating profits of Rs 3473 crores. The profits (net and operating) declined again before recovering in 2011-12 to Rs 1400 crores and Rs 3800 crores. The profits (net and operating) as a proportion of total assets too made a marginal recovery in 2011-12. (Table 4.8)

TABLE 4.8 PROFITABILITY INDICATORS OF THE DCCBs

(In Rs Crores)

YEAR	OPERATING PROFITS	NET PROFITS	OPERATING PROFITS/TOTAL ASSETS (%)	NET PROFITS/TOTAL ASSETS (%)
1996 - 97	760	-821	1.50	-1.62
1997-98	917	-207	1.54	-0.35
1998-99	1153	44	1.60	0.06
1999-00	1357	-96	1.60	-0.11
2000-01	1672	62	1.73	0.06
2001-02	2031	-34	1.89	-0.03
2002-03	2303	-268	2.01	-0.23
2003-04	2522	108	2.01	0.09
2004-05	3096	971	2.32	0.73
2005-06	2769	207	1.94	0.14
2006-07	2314	31	1.46	0.02
2007-08	2284	-139	1.28	-0.08
2008-09	3473	1353	1.77	0.69
2009-10	3363	1136	1.49	0.50
2010-11	3100	1000	1.20	0.39
2011-12	3800	1400	1.29	0.48

SOURCE: Estimated from data by Report on Trends and Progress of Banking in India, RBI (Various Issues)

The improvement of the indicators of profitability of the DCCBs came as a result of wiping off the losses of these institutions through financial recapitalization recommended by the Vaidyanathan Committee as well as through the Agriculture Debt Waiver and Debt Relief Scheme (2008)[51] of the government. And hence, the profitability figures are not strictly comparable to the previous figures. The loan waiver and the financial recapitalization cleared

[51] Under this scheme, the Government sought to waive off all the overdues of the small and marginal farmers (<2 ha) that remained unsettled on 31st December 2007 until February 29 2008. The other farmers were offered a “One Time settlement Scheme” for all similar eligible loans.

the NPAs of the DCCBs resulting in lowered costs incurred under the "provisions and contingency" head as a proportion of the total assets which boosted the profitability of this tier. The other factor that contributed to profitability was the improved spreads with the interest income outpacing the interest expended.

4.2.3 PRODUCTIVITY INDICATORS

The productivity indicators used for the DCCBs are the Volume of business per employee, working funds per employee and gross income per employee. The volume of business per employee has grown from Rs 33.73 lakhs in 1993-94 to Rs 374 lakhs in 2011-12 (CAGR 13.5%). The working funds per employee rose from Rs 27.62 lakhs in 1993-94 to Rs 299 lakhs in 2011-12. (CAGR 8.34%).Similarly the income per employee also grew from Rs 5.62 lakhs in 1996-97 to Rs 26.63 lakhs in 2011-12 (CAGR 10.2%). (Table 4.09)

The productivity indicators for the DCCBs have visibly improved after the implementation of the revitalization package by the Vaidyanathan Committee. However the growth in productivity was briefly interrupted in 2005-06 and 2006-07 during which all the productivity indicators of the DCCBs registered a drastic decline. This was because the number of employees of the DCCBs almost doubled from 109124 in the preceding year to 211,770 in 2005. The number of employees fell marginally to 183,536 in the following year and almost halved to 90035 in 2007-08. This downsizing of the workforce was the major driver of productivity growth in the DCCBs from the year 2007-08 onwards. This volatility in the productivity figures and the working staff of the DCCBs was a result of closure/amalgamation of the unviable PACs as recommended by the Vaidyanathan Committee. The number of PACs and lower tier societies declined from 108,779 to 106,384 and further to 93224 between 2004 and 2006-07.

TABLE 4.9 PRODUCTIVITY INDICATORS OF THE DCCBs

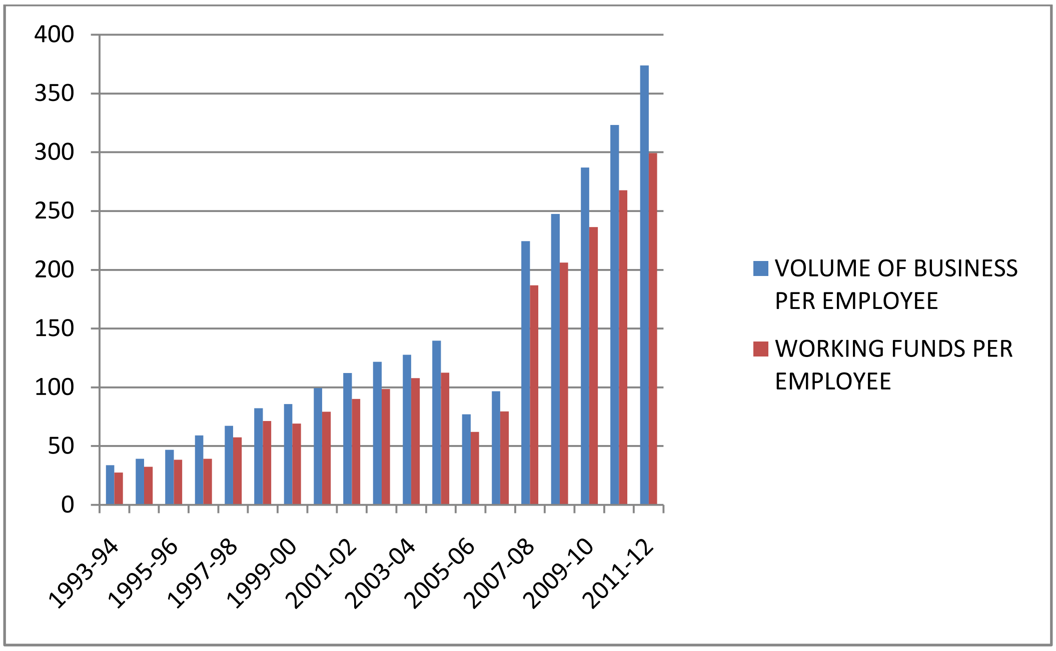
(In Rs lakhs)

YEAR	VOLUME OF BUSINESS PER EMPLOYEE	WORKING FUNDS PER EMPLOYEE	TOTAL INCOME PER EMPLOYEE
1993-94	33.73	27.62	
1994-95	39.17	32.34	
1995-96	46.92	38.45	
1996-97	59.01	39.15	5.62
1997-98	67.17	57.59	6.52
1998-99	82.13	71.22	7.74
1999-00	85.86	69.21	8.01
2000-01	99.44	79.23	9.20
2001-02	112.27	90.21	10.21
2002-03	121.66	98.45	10.91
2003-04	127.60	107.80	10.82
2004-05	139.81	112.38	11.66
2005-06	77.15	61.97	5.52
2006-07	96.73	79.59	6.35
2007-08	224.32	186.74	14.59
2008-09	247.51	206.18	18.26
2009-10	287.02	236.33	20.26
2010-11	323.11	267.76	21.72
2011-12	373.95	299.21	26.63

SOURCE: Computed from the various issues of Basic Data on Performance of District Central Cooperative Banks, NAFSCOB and Report on Trends and Progress in Banking in India, RBI.

CHART 4.9 PRODUCTIVITY INDICATORS OF THE DCCBs

(in Rs Lakhs)



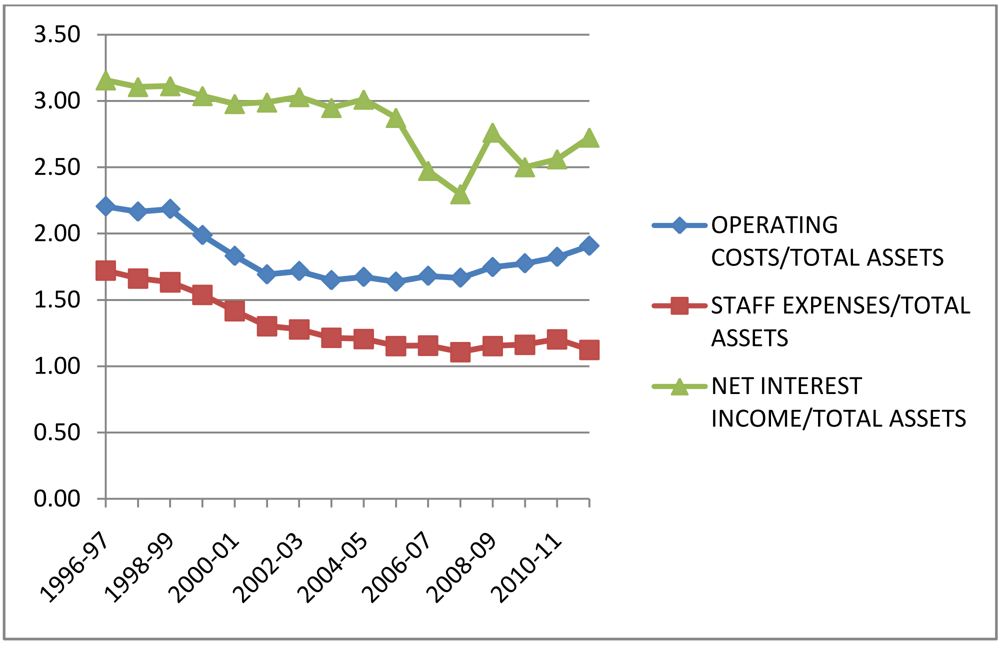
SOURCE: Estimated from Basic Data on Performance of District Central Cooperative Banks, NAFSCOB

4.2.4 EFFICIENCY INDICATORS

The terms of reference of the Vaidyanathan Committee clearly stated improving the efficiency of the rural credit cooperatives as one of its objective. “Efficiency” is a very loosely defined concept, however, in the study it has been used to represent allocative and technical efficiency in credit disbursal especially after the technical upgradation and human resource development initiatives taken by the Vaidyanathan Committee. While technical efficiency is measured through economizing on the costs of operations, allocative efficiency is gauged through the interest margins in financial intermediation. The efficiency indicators used to analyze the performance of the District Central Cooperative Banks are operating costs as percentage of total assets, staff expenditure (wages) as a percentage of total assets and the net interest income (spread) as a percentage of total assets. The trends in these efficiency indicators are presented in Table 4.10 and Chart 4.10.

CHART 4.10 EFFICIENCY INDICATORS FOR DCCBs

(in per cent)



SOURCE: Estimated from various issues of Basic Data on Performance of District Central Cooperative Banks, NAFSCOB and Report on Trends and Progress of Banking in India, RBI

The first indicator of efficiency is the operating costs as percentage of total assets. It declines consistently from its peak of 2.20 % in 1996-97 and plunges to a low of 1.64% in 2005-06. However, thereafter this ratio has increased over time. This rise in operating costs was attributed to the fixed costs involved in adopting modern techniques in banking operations like computerization and technical upgradation to achieve efficiency in the long run. The problem with this indicator is that operating costs includes both fixed and variable costs of operations, thus, in order to get a clear estimate of the variable costs of the cooperative banks we use staff expenses as proportion of total assets.

The second indicator of efficiency is the staff expenses as percentage of total assets. This ratio too declined steadily from a peak of 1.72 % in 1996-97 to a low of 1.11% in 2007-08. The staff expenses rose again marginally towards the end of the period. The decline of the staff expenses was on account of downsizing of the work force from 183536 in 2006-07 to 90035 in 2007-08.

The third indicator of efficiency is the net interest income as a percentage of total assets. It represents the cost of intermediation of funds for a banking entity. It is the difference between the interest incomes that a financial intermediary earns on its deposits and that it pays out to its lenders. A higher spread signifies higher profitability as it implies the tendency of a bank to mobilize low cost funds and its ability to advance loans at a higher interest rate over and above the costs it incurs on the funds. However, in terms of meeting the objective of social welfare, it is important to provide credit at a low cost and hence a lower spread is desirable. It also denotes low costs of intermediation and greater efficiency. The spread could also be lowered through the availability of low costs of funds but the Cooperatives could not achieve this as they had to offer higher interest rates to attract funds from competing financial institutions. The high cost of funds was also attributed to the large proportion of term loans in the total advances as well as the costs borne due to interest margins charged at every subsequent tier of the rural credit cooperative structure.

In this context, the spread as a proportion of total assets declined from its peak of 3.16% in 1996-97 to 2.98% in 2000-01. The spread as a ratio of the total assets hovered around that level till 2004-05. In 2003, an amendment was made to the NABARD Act to provide refinance facilities at lower interest rates on crop loans to the Cooperative institutions. A narrowing of spreads was observed for the DCCBs for the entire period 2004-12, which becomes more discernible from the year 2004-05 onwards. The spread declines to its lowest of 2.30 % in 2007-08. The decline in the interest rates could be attributed to the interest rate subvention scheme which has been operational since 2006-07. Under this scheme, an interest subvention of 2% was provided on short term credit of loans upto Rs 3 lakhs; this was reduced subsequently to 1.5%.[52] Although, the interest rate subvention scheme provides low costs funds to the StCBs through concessional refinance facilities, the DCCBs receive the funds at slightly higher costs (due to the costs and margins) with a cap on the interest that the latter may charge as the scheme aims at providing crop loans at 7% p.a. The net effect of which was the narrowing of the interest margins.

[52] RBI. (2011).*Report on Trend and Progress of Banking in India, 2010-11*

Thus, all the indicators of efficiency show appreciable signs of improvement after the reforms enacted by the Vaidyanathan Committee.

TABLE 4.10: EFFICIENCY INDICATORS OF THE DCCBS

(in per cent)

YEAR	OPERATING COSTS/TOTAL ASSETS	STAFF EXPENSES/TOTAL ASSETS	NET INTEREST INCOME/TOTAL ASSETS
1996-97	2.20	1.72	3.16
1997-98	2.16	1.66	3.11
1998-99	2.18	1.63	3.11
1999-00	1.99	1.54	3.04
2000-01	1.83	1.42	2.98
2001-02	1.69	1.30	2.99
2002-03	1.72	1.28	3.03
2003-04	1.65	1.21	2.95
2004-05	1.67	1.20	3.01
2005-06	1.64	1.15	2.87
2006-07	1.68	1.16	2.47
2007-08	1.67	1.11	2.30
2008-09	1.75	1.15	2.76
2009-10	1.77	1.16	2.50
2010-11	1.82	1.20	2.56
2011-12	1.91	1.12	2.72

SOURCE: Estimated from various issues of Basic Data on Performance of District Central Cooperative Banks, NAFSCOB and Report on Trend and Progress of Banking in India, RBI

4.2.5 ASSET QUALITY

The growth in the Non Performing Assets impedes the profitability of the DCCBs by raising the costs of provisioning but also constrains the resource base and the process of credit creation in turn hampering productive investments. The total Non-performing Assets of the DCCBs have increased from Rs 6,573 Crores in 1999 to Rs 18,100 Crores in 2013 (CAGR of 6.98%). The NPAs of the DCCBs rose at an accelerated pace during the period 1999-2004 with a CAGR of 16.15% while the rate of growth fell dramatically to 2.75% over the period 2004-13.

The NPAs of the DCCBs rose steadily after the droughts of 2002 with the percentage of NPAs to the total outstanding loans soaring to 24% in 2004. The asset-quality of the DCCBs has shown visible signs of improvement in the reform period[53] with this ratio showing a consistent decline over the period and falling to 9.9 % in 2013.

The NPAs show a dramatic decline after 2008 both in absolute terms as well as a proportion of total outstanding loans. This was the cumulative result of the financial recapitalization advocated by the Taskforce as well as the loan waiver scheme of the government.

However, this favorable development is accompanied with a worrying tendency. Although the asset quality of the DCCBs has improved, they have not been successful in curbing the growth of the doubtful and the bad assets as a proportion of the total assets which continue to rise over the period.

[53] The "reform period" here refers to the period after the implementation of the recommendations of the Vaidyanathan Committee Report (between 2004 and 2012)

TABLE 4.11: ASSET QUALITY OF THE DCCBs

(In Rs Crores)

Year	Sub-standard	Doubtful	Loss	Total NPAS	% Of NPAs to Total Loans Outstanding
1999	3360	2376	837	6573	17.8
2000	3723	2919	901	7543	17.15
2001	4994	3466	911	9371	17.9
2002	6325	4245	1268	11838	19.7
2003	7603	5060	1199	13862	22
2004	8428	6068	1648	16144	24
2005	6468	6053	1999	14520	19.9
2006	6905	6699	2109	15712	19.8
2007	6375	7648	2471	16495	18.5
2008	7880	8214	2660	18754	18.5
2009	8110	7202	2677	17989	17.9
2010	7229	6394	2611	16234	14.8
2011	5900	6200	2700	14800	11.2
2012	6300	7100	2700	16100	10.2
2013	7900	7600	2600	18100	9.9

SOURCE: Report on Trend and Progress of Banking In India, RBI, (Various Issues)

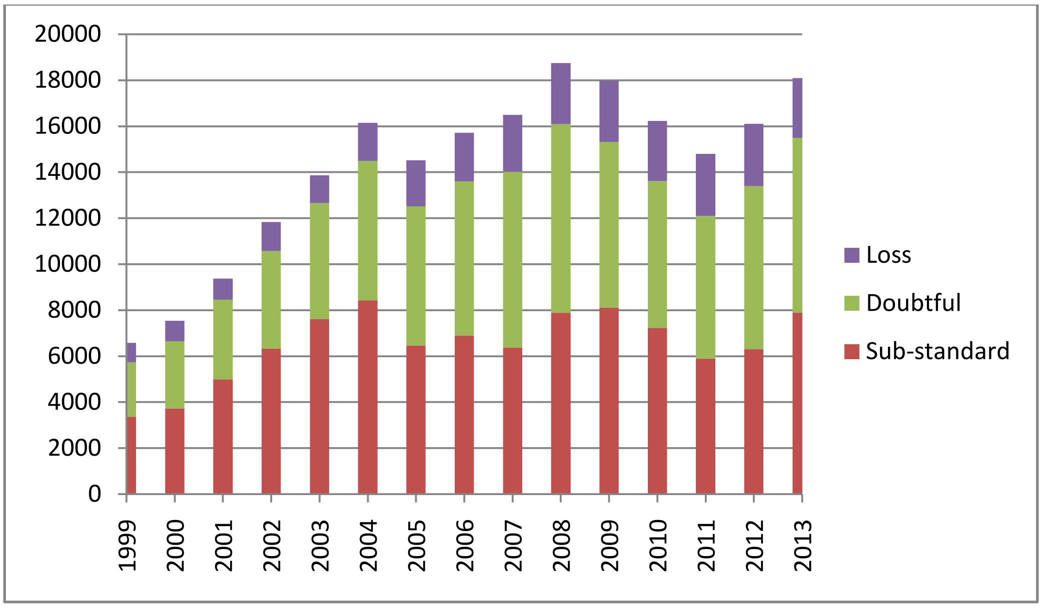
CHART 4.11 (a): ASSET QUALITY OF THE DCCBs

(in per cent)

SOURCE: Report on Trends and Progress of Banking in India, RBI, (Various Issues)

CHART 4.11 (b): ASSET QUALITY OF THE DCCBs

(Rs in Crores)



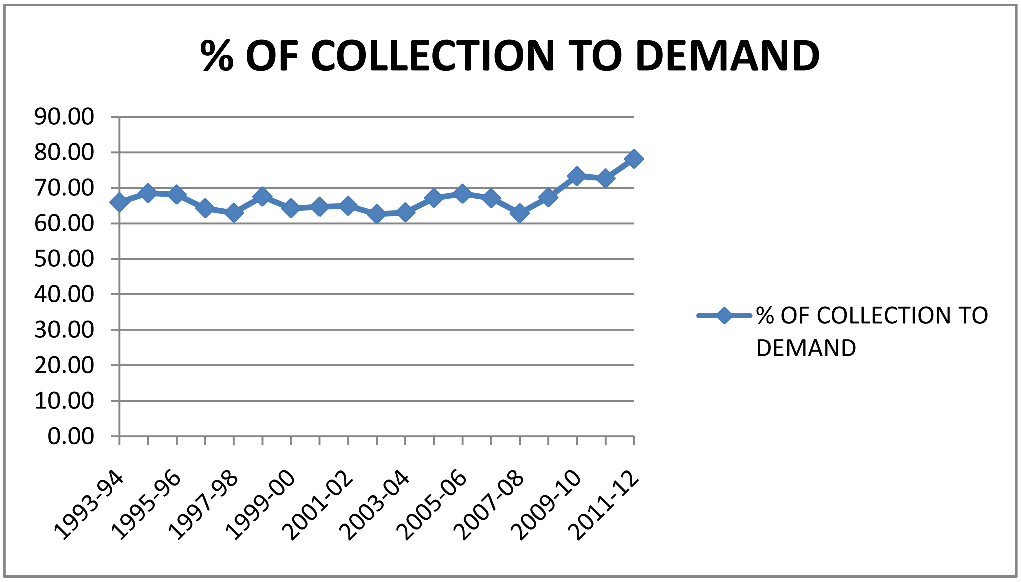
SOURCE: Report on Trends and Progress of Banking in India, RBI, (Various Issues)

4.2.6 RECOVERY RATES

In the study, the recovery rates of the DCCBs are estimated as a percentage of collection to demand. The recovery rates for this tier averaged around 65% for the period prior to the Committee report. The DCCBs registered an improvement in the recovery rates in 1998 owing to the "One Time Settlement Scheme" of the NABARD to clear the NPAs of these institutions which was subsequently extended till 2004. The recovery rates suffered again in 2002 due to natural calamities like the droughts that affected the country and resulted in loan delinquency. The recovery rates showed a discernible improvement after 2004-05. The year 2004 is also significant as the UPA Government launched an initiative to double agricultural credit. This package entailed debt restructuring and loan write-offs to benefit the farmers. This too led to an improvement in the recovery rates which continued to rise till the economy was affected by the global financial crisis of 2007-08 that resulted in mounting overdues for the DCCBs and retarded the recovery process.

CHART 4.12: RECOVERY RATES OF THE DCCBs

(In per cent)



SOURCE: Estimated from Basic Data on Performance of District Central Cooperative Banks, NAFSCOB

However, aided by the recapitalization process and the loan waiver scheme, the recovery rates picked up from a low of 63% in 2007-08 to 67% in 2008-09. Thereafter the recovery rates climbed up steadily to 78% in 2011-12.

4.2.7 CAPITAL ADEQUACY

The capital adequacy norms were imposed on the DCCBs and the StCBs in December 2007 as it was felt that these institutions were not adequately capitalized to sustain themselves in the global competitive environment. The recommendations of the Vaidyanathan Committee led to capital infusion in these banks to assist them to achieve CRAR of 7% by 2012 which was to be raised to 9% by 2015 and then subsequently to 12%.

The StCBs and the DCCBs were mandated to disclose their CRAR as "Notes to Accounts" in their balance-sheets from 31st March 2008.[54] The position of the DCCBs in terms of capital adequacy has strengthened over time. This is evident from the fact that while in 2011-12, 238 of the 370 DCCBs had attained CRAR levels of over 7%, by 2014-15 the number of DCCBs that had achieved this stipulated level grew to 301.

TABLE 4.12: CRAR POSITION OF THE DCCBs

(in numbers)

YEAR	< 4 %	4% to <7%	7% to <9%	9 % & above	Total DCCBs
2011-12	49	83	51	187	370
2012-13	45	47	70	208	370
2013-14	24	45	77	222	368
2014-15	43	27	93	208	371

SOURCE: NABARD AND RBI

However, these figures warrant more concern than appreciation as capital adequacy is achieved by the issue of Long Term (Subordinated) Deposits (LTDs) and Innovative Perpetual Debt Instruments. While the LTDs are eligible to be treated as lower Tier II capital, the amount raised through the issue of Innovative Instruments would qualify for Tier-I capital (subject to certain conditions)[55] for the calculation of CRAR levels for atleast ten years. However, these constitute borrowed funds which need to be repaid and hence would impose additional financial burden on the already precarious resource base of the DCCBs.

[54] RBI. (2008).*Report on Trend and Progress of Banking in India ,2007-08*

[55] Innovative Instruments must not exceed 15% of the Tier I capital. Innovative instruments in excess of this limit would be eligible to be treated as Tier II capital subject to the prescribed limits of Tier-II capital.

4.3 STATE COOPERATIVE BANKS

The State Cooperative Banks form the apex of the short-term rural Cooperative Credit structure. The performance of this tier has a great influence on the lower tiers that depend on it for refinance facilities and other financial assistance. This section analyzes the performance of the State Cooperative Banks.

4.3.1 BALANCESHEET INDICATORS

The total assets/liabilities of the State Cooperative Banks have grown from Rs 30,445 Crores in 1997 to Rs.148,300 Crores in 2012 (10.40% CAGR). Like the DCCBs, deposits form the major share of liabilities of the StCBs (61.5%) followed by borrowings (22.5%), reserves (9.76%) and capital (1.5%).

The StCBs receive deposits primarily from individuals, Cooperatives and other local bodies with the deposits from the affiliated cooperatives accounting for almost 75% of the total deposits. The resource base of the StCBs may deteriorate in future due to de-recognition of deposits of the DCCBs with StCBs as SLR deposits.

The StCBs rely on borrowings from NABARD and the RBI to provide financial assistance to the lower tiers. These Banks also receive large funds from the Government and other refinance agencies in the form of grants, subsidies and refinance. Between 2007 and 2010, the StCBs reduced their reliance on borrowings owing to the financial stimulus provided by the Vaidyanathan Committee. However this positive outcome was short-lived and the StCBs' borrowings began to rise again in 2011.

The reserves of the StCBs comprise of statutory reserves and contribution from other funds like the Agricultural Credit Stabilization Fund. The share of reserves in liabilities averaged 9.77% but between 2000 and 2007 the reserves of the StCBs rose to over 12%. However these reserves depleted over time as a result of the global events to a low of 6.3% of the liabilities in 2010 and then recovered to 8.8% in the following year.

TABLE 4.13: LIABILITIES OF THE StCBs

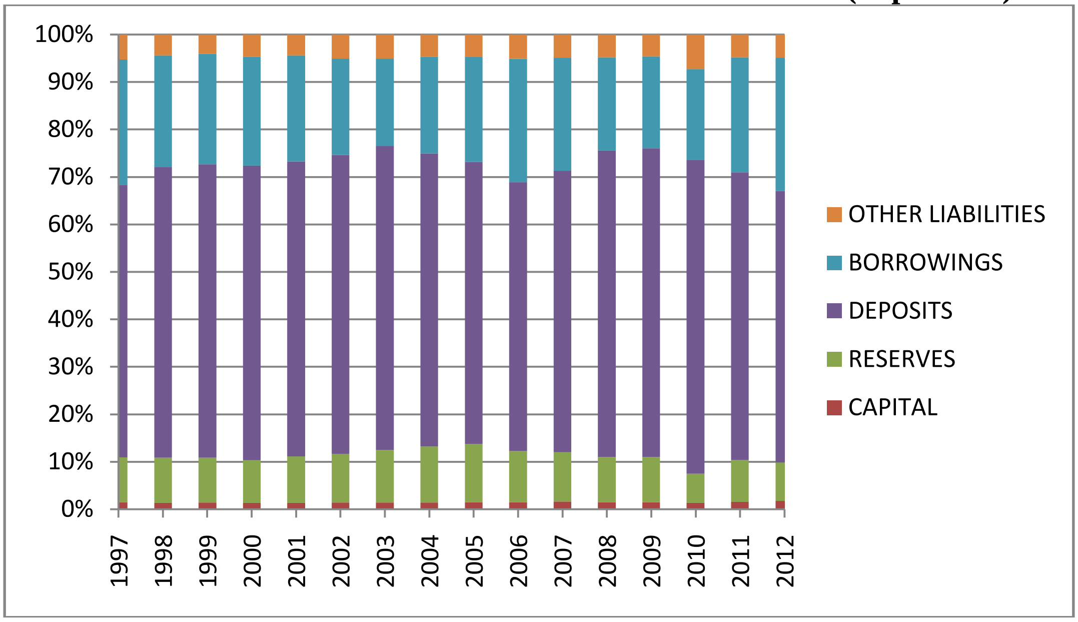
(In Rs Lakhs)

Year	Capital	Reserves	Deposits	Borrowings	Other Liabilities	Total Liabilities
1997	457	2871	17490	8033	1594	30445
1998	491	3440	22189	8525	1586	36230
1999	584	3951	25788	9739	1679	41741
2000	636	4275	29557	10859	2260	47587
2001	695	5,144	32,626	11,693	2318	52,476
2002	832	5,880	36,191	11,673	2902	57,478
2003	951	7,522	43,486	12,457	3,421	67,838
2004	1,012	8,488	44,335	14,602	3,388	71,825
2005	1,114	9431	45405	16989	3542	76481
2006	1246	9303	48560	22256	4392	85756
2007	1534	9905	56325	22577	4637	94977
2008	1569	10157	68659	20874	5062	106321
2009	1569	10325	70312	20913	4997	108116
2010	1631	7600	81200	23559	9000	120662
2011	2100	11800	80900	32400	6400	133600
2012	2600	12000	84900	41700	7200	148300

SOURCE: Report on Trend and Progress of Banking in India, RBI (Various Issues)

CHART 4.13: COMPOSITION OF LIABILITIES OF StCBs

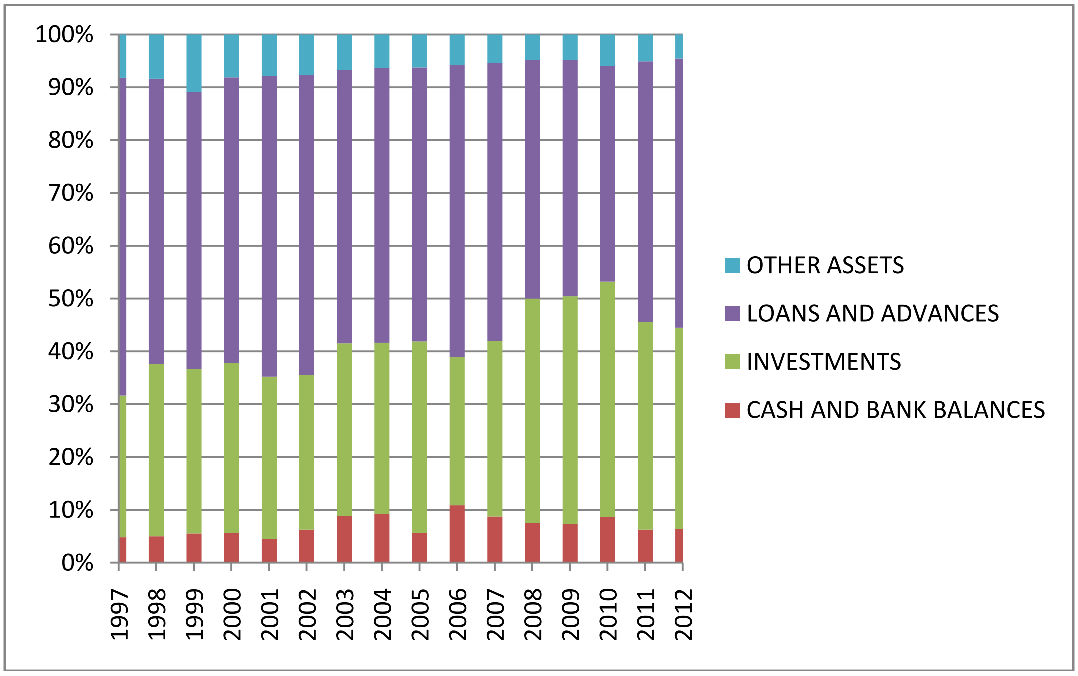
(in per cent)



SOURCE: Report on Trend and Progress of Banking in India, RBI (Various Issues)

CHART 4.14: COMPOSITION OF ASSETS OF THE STATE COOPERATIVE BANKS

(in per cent)



SOURCE: Report on Trend and Progress of Banking in India, RBI, (Various Issues)

Loans and advances account for over half the assets of the StCBs. Investments form the second important component and a third of the total assets of the StCBs. The composition of assets has changed over time. In 1998 the share of loans advanced by the StCBs declined from 60% to 54% and saw a corresponding rise in the share of investments. This large shift was a result of extending prudential norms to the StCBs that induced risk averseness in banks which found it safer to invest in government securities than continue with their banking operations.

The investments of the StCBs were primarily in government securities and fixed deposits. The banks resumed their lending activities in 2001 but a brief recovery was followed by a long spell of pessimism and the share of loans advanced by the StCBs decelerated to 51.89% in 2005. Between 2007 and 2010 the global turn of events influenced the banking practices of the StCBs.

The share of loans dipped further to 41% in 2010 with a simultaneous growth in investments to 45%. This demonstrates the risk averse attitude adopted by the StCBs in the light of the global meltdown and the implementation of the stringent prudential norms.[56] However, the banks made a quick recovery in 2011 with the share of loans advanced climbing to 51% in 2012. The composition of loans of the StCBs will be discussed in detail in the next chapter.

[56] Although the prudential norms were applicable to the StCBs and the DCCBs from the year 1996-97, the Vaidyanathan Committee brought them at par with the Commercial Banks.

TABLE 4.14: ASSETS OF THE StCBs

(In Rs Lakhs)

YEAR	CASH AND BANK BALANCES	INVESTMENTS	LOANS AND ADVANCES	OTHER ASSETS	TOTAL ASSETS
1997	1459	8176	18314	2496	30445
1998	1804	11805	19588	3033	36230
1999	2297	13011	21909	4523	41741
2000	2644	15362	25709	3872	47587
2001	2313	16156	29861	4146	52476
2002	3576	16825	32678	4399	57478
2003	5986	22187	35105	4560	67838
2004	6600	23303	37353	4569	71825
2005	4323	27694	39684	4781	76481
2006	9290	24140	47354	4971	85756
2007	8312	31541	50028	5095	94977
2008	7921	45230	48079	5092	106321
2009	7960	46567	48400	5188	108116
2010	10500	54334	49629	7333	120662
2011	8300	52500	66000	6800	133600
2012	9400	56600	75600	6700	148300

SOURCE: Report on Trend and Progress of Banking in India, RBI (Various Issues)

4.3.2 PROFITABILITY

Profitability of the StCBs has remained low for a long time and affects the viability of the rural cooperative credit structure. Like the DCCBs, the profitability of the State Cooperative Banks is also measured by indicators like net profits, operating profits, net profits as a proportion of total assets and operating profits as a proportion of total assets.

In order to analyze the performance of the StCBs it is important to examine the structure of their earnings and the expenses. (Table 4.15) During the period between 1996-97 and 2011-12, the total income increased from Rs 2969 Crores in 1996-97 to Rs 10200 crores in 2011-12. But as a proportion of total assets its share has declined from 9.75% to 7.63% during the same period. The total expenditure of the StCBs too has risen from Rs 2866 crores in 1996-97 to Rs 9700 crores in 2011-12. Its share as a proportion of total assets has also declined from 9.41% to 7.26% during the same period.

The net profits of the StCBs increased from Rs 103 crores in 1996-97 to Rs 500 crores in 2011-12 while the operating profits rose from Rs 437 crores to Rs 1000 crores.

During the period of analysis, the operating profits of the StCBs (sum of net profits and provisions and contingency) too increased from Rs 437 crores in 1996-97 to Rs 1577 crores in 2003-04. Thereafter, the operating profits declined continuously to a low of Rs.640 crores in 2009-10 but recovered at Rs 1000 in 2010-11 and remained at that level in the following year.
Between 1996 and 2004, the StCBs recorded losses in 1997-98 and 1998-99 to the tune of Rs.129 crores and Rs 108 Crores respectively after which they witnessed a turnaround and recorded profits that rose steadily to Rs 435 Crores in 2002-03. The losses in the year 1998-99 occurred due to the escalating costs of provisioning that were incurred due to the implementation of provisioning norms to the StCBs during that year. After 2002-03, the net profits declined to Rs 286 crores in 2004-05.

TABLE 4.15 (a): WORKING RESULTS OF THE StCBs FROM 1996-97 TO 2003-04

(Rs in Crores)

YEAR	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
INTEREST INCOME	2926	3534	4032	4678	5194	5508	5229	5314
%	9.61	9.75	9.66	9.83	9.9	9.58	9.05	7.83
OTHER INCOME	43	113	162	255	195	301	343	732
%	1.43	3.09	3.87	5.17	3.62	5.18	6.16	12.11
TOTAL INCOME	2969	3647	4194	4933	5389	5809	5572	6046
%	9.75	10.07	10.05	10.37	10.27	10.11	9.65	8.91
EXPENDITURE	2866	3776	4302	4794	5185	5632	5137	5673
%	9.41	10.42	10.31	10.07	9.88	9.8	8.89	8.36
WAGE BILL	180	210	238	286	280	304	284	317
%	6.28	5.56	5.53	5.97	5.4	5.4	5.53	5.59
INTEREST EXPENDED	2290	2805	3424	3765	4121	4192	3978	3998
%	7.52	7.74	8.2	7.91	7.85	7.29	6.89	5.89
PROVISIONS AND CONTINGENCIES	334	655	558	659	690	1024	700	1204
%	1.1	1.81	1.34	1.38	1.31	1.78	1.21	1.77
OPERATING EXPENSES	242	317	319	370	373	416	458	471
%	0.79	0.87	0.76	0.78	0.71	0.72	0.79	0.69
OPERATING PROFITS	437	526	451	798	894	1201	1135	1577
%	1.44	1.45	1.08	1.68	1.7	2.09	1.96	2.32
NET PROFITS	103	-129	-108	138	204	177	435	373
%	0.34	-0.36	-0.26	0.29	0.39	0.31	0.75	0.55

NOTE: The figures in percentage represent the parameters as a percentage of total assets

SOURCE: Report on Trends and Progress of Banking in India, RBI, Various Issues

TABLE 4.15 (b): WORKING RESULTS OF THE StCBs FROM THE PERIOD 2004-05 TO 2011-12

(Rs in Crores)

YEAR	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
INTEREST INCOME	5382	5320	4974	5980	7281	7800	8800	9700
%	7.49	6.96	5.80	6.30	6.85	7.21	7.29	7.26
OTHER INCOME	390	336	269	214	309	420	500	500
%	6.76	5.94	5.13	3.45	4.07	5.11	5.38	4.90
TOTAL INCOME	5772	5656	5243	6194	7590	8220	9300	10200
%	8.04	7.40	6.11	6.52	7.14	7.60	7.71	7.63
EXPENDITURE	5486	5278	4967	5973	7272	8000	9100	9700
%	7.64	6.90	5.79	6.29	6.84	7.40	7.54	7.26
INTEREST EXPENDED	3701	3658	3708	4586	5729	6600	7100	7900
%	5.15	4.78	4.32	4.83	5.39	6.10	5.88	5.91
PROVISIONS AND CONTINGENCIES	1259	1039	502	543	451	396	800	500
%	1.75	1.36	0.59	0.57	0.42	0.37	0.66	0.37
OPERATING EXPENSES	526	581	757	844	1092	1000	1200	1300
%	0.73	0.76	0.88	0.89	1.03	0.92	0.99	0.97
OPERATING PROFITS	1545	1417	777	764	768	640	1000	1000
%	2.15	1.85	0.91	0.80	0.72	0.59	0.83	0.75
NET PROFITS	286	378	275	221	318	240	200	500
%	0.40	0.49	0.32	0.23	0.30	0.22	0.17	0.37

NOTE: The figures in percentage represent the parameters as a percentage of total assets

SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

The profitability of the StCBs was adversely affected from the year 2005-06 and continued till 2009-10. Some of the factors that contributed to the poor performance of the StCBs during this period are:

a) The global financial crisis of 2007-08,
b) The rising operating costs incurred on account of fixed costs in adopting modern techniques to banking like computerization and technological upgradation to achieve efficiency in the long run. The operating costs were declining steadily in the period prior to the Vaidyanathan Committee. However, during the period 2004-12, the share of operating costs in the total expenditure has risen from 9.59% in 2004-05 to 15.24% in 2006-07 and remained at 13.40% in 2011-12.
c) The narrowing of spreads due to the interest rate subvention scheme introduced in 2006-07.

The StCBs made a recovery in 2011-12 with the net profits peaking at Rs 500 Crores and the operating profits at Rs 1000 crores. Some of the plausible factors that were responsible for this turnaround were

a) the income outpacing the expenditures primarily due to the rise in interest income
b) the financial recapitalization and the Agricultural Loan Waiver scheme
c) Lower costs of provisioning due to clearance of NPAs by the loan waiver scheme and recapitalization
d) Improved recovery rates on outstanding loans

Thus, during the period 2004-05 and the 2011-12, although the StCBs have recorded modest profits their performance has not been very impressive. This assessment is reinforced by the other indicators like the return on assets as well as the operating profits as a proportion of the total assets. (Table 4.16)

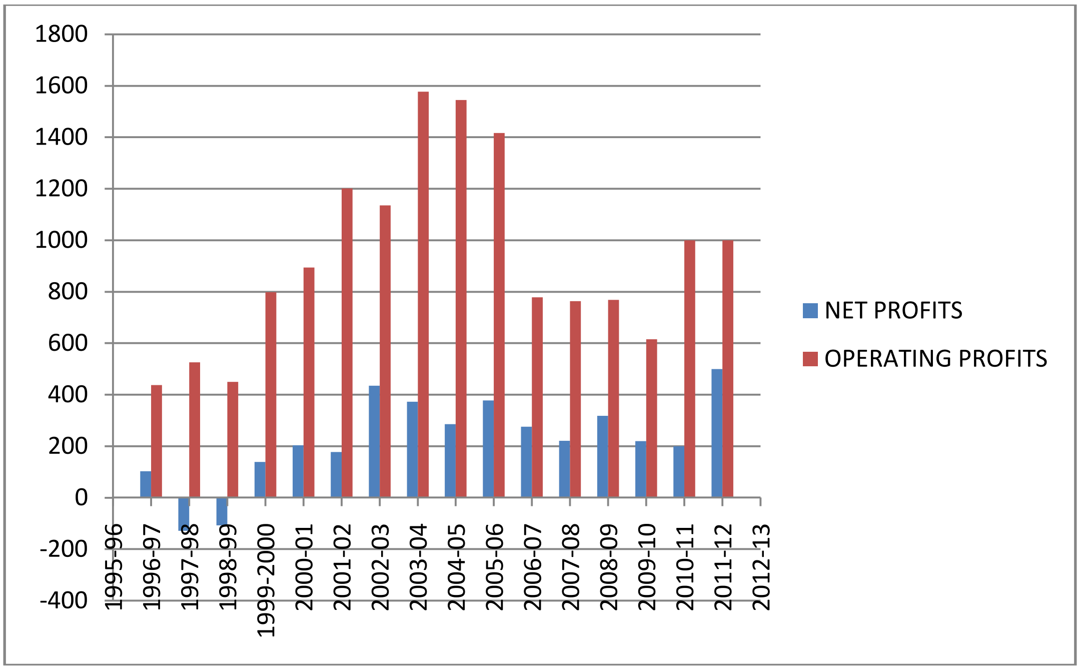
TABLE 4.16: PROFITABILITY INDICATORS OF THE StCBs
(in Rs Crores)

Year	OPERATING PROFITS	NET PROFITS	GROSS OPERATING PROFITS/TOTAL ASSETS (%)	RETURN ON ASSETS (%)
1996-97	437	103	1.44	0.34
1997-98	526	-129	1.45	-0.36
1998-99	451	-108	1.08	-0.26
1999-00	798	138	1.68	0.29
2000-01	894	204	1.70	0.39
2001-02	1201	177	2.09	0.31
2002-03	1135	435	1.96	0.75
2003-04	1577	373	2.32	0.55
2004-05	1545	286	2.15	0.40
2005-06	1417	378	1.85	0.49
2006-07	777	275	0.91	0.32
2007-08	764	221	0.80	0.23
2008-09	768	318	0.72	0.30
2009-10	640	240	0.59	0.22
2010-11	1000	200	0.83	0.17
2011-12	1000	500	0.75	0.37

SOURCE: Estimated from Report on Trends and Progress of Banking in India, RBI (Various Issues)

CHART 4.15 (a) PROFITABILITY INDICATORS OF THE StCBs

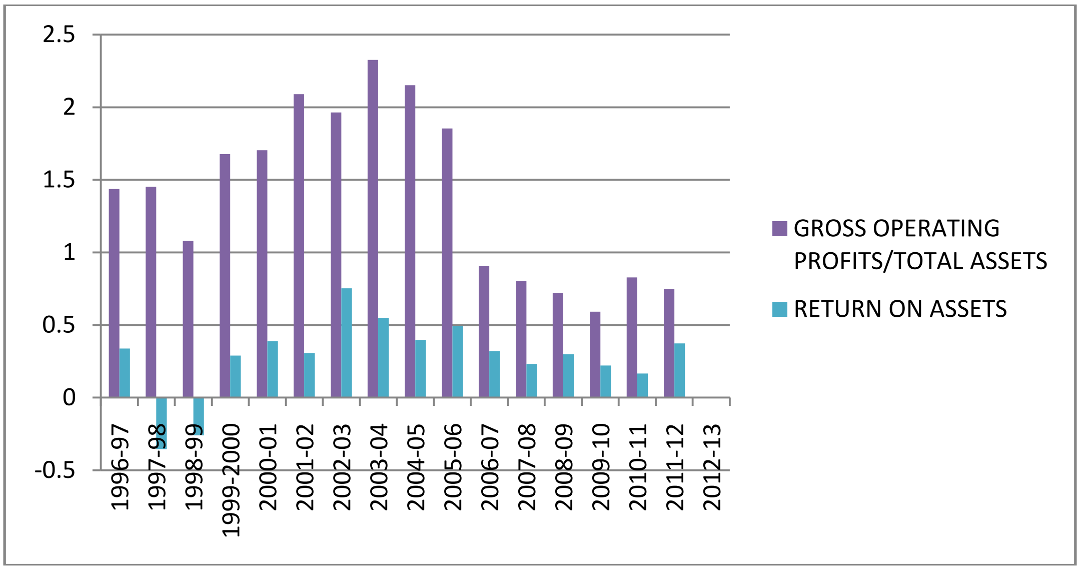
(in Rs. Crores)



SOURCE: Report on Trend and Progress of Banking in India. RBI (Various Issues)

CHART 4.15 (b) PROFITABILITY INDICATORS OF THE StCBs

(in per cent)



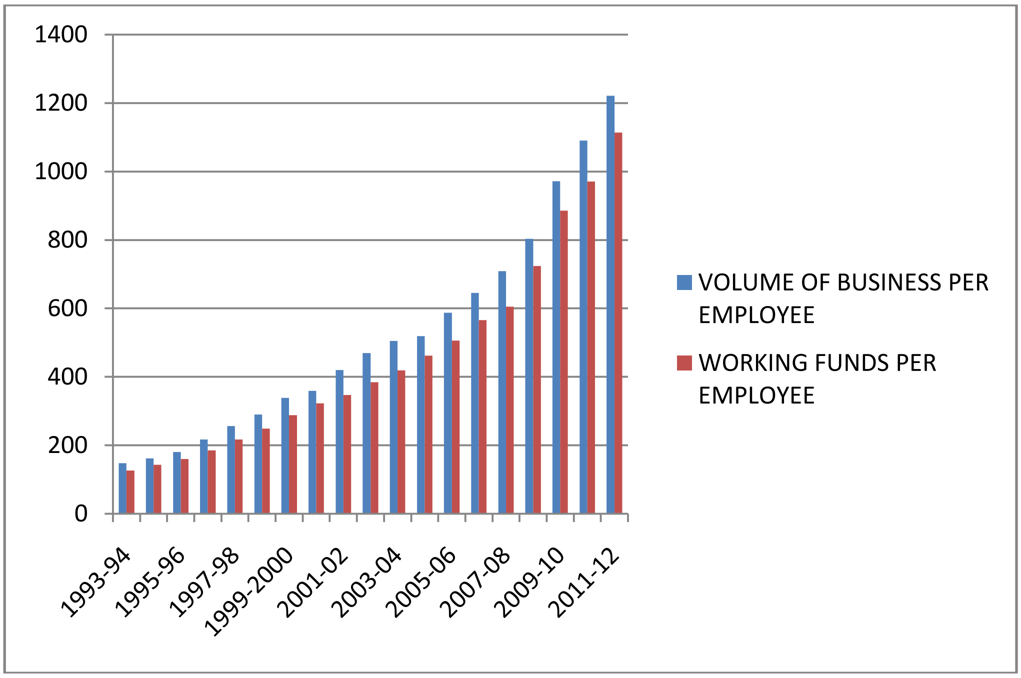
SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

4.3.3 PRODUCTIVITY

The productivity ratios for the State Cooperative Banks measured by the volume of business per employee[57], working funds per employee and total income per employee all show a consistent increase throughout the period from 1993-94 to 2011-12. However the increase in the post-reform period is more perceptible.

CHART 4.16 PRODUCTIVITY INDICATORS OF THE StCBs

(In Rs Lakhs)



SOURCE: Estimated from Basic Data on Performance of State Cooperative Banks, NAFSCOB (Various Issues)

The volume of business per employee increased from Rs 148 lakhs in 1993-94 to Rs 1,221 lakhs in 2011-12. The working funds per employee increased from Rs 126 lakhs in 1993-94 to Rs 1,114 lakhs in 2011-12. Similarly the gross income per employee rose from Rs 18.36 lakhs in 1996-97 to Rs 76.76 lakhs in 2011-12.

[57] The volume of business is calculated as the sum of the value of deposits and the total outstanding loans.

TABLE 4.17: PRODUCTIVITY INDICATORS OF THE StCBs

(Rs in lakhs)

YEAR	VOLUME OF BUSINESS PER EMPLOYEE	WORKING FUNDS PER EMPLOYEE	GROSS EARNINGS PER EMPLOYEE
1993-94	147.78	126.33	
1994-95	161.59	143.20	
1995-96	180.44	159.98	
1996-97	216.82	185.08	18.36
1997-98	255.92	217.21	22.59
1998-99	289.66	249.18	25.84
1999-00	338.95	287.92	30.60
2000-01	358.93	322.61	33.29
2001-02	420.07	346.56	35.51
2002-03	469.60	384.69	35.28
2003-04	504.69	419.29	38.87
2004-05	519.19	462.34	37.76
2005-06	587.66	505.65	38.37
2006-07	645.14	565.82	35.55
2007-08	709.35	604.77	41.69
2008-09	802.98	723.65	51.86
2009-10	971.93	885.69	59.65
2010-11	1090.16	970.74	69.09
2011-12	1221.29	1113.70	76.76

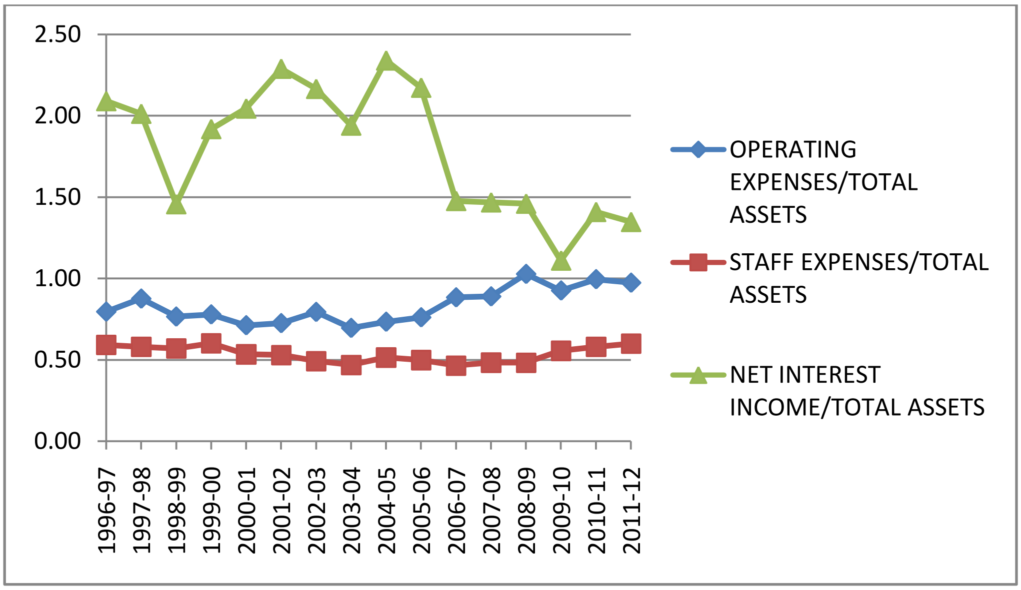
SOURCE: Estimated from Basic Data on Performance of State Cooperative Banks, NAFSCOB (Various Issues)

4.3.4 EFFICIENCY

The Vaidyanathan Committee laid great emphasis on improving the efficiency of the Cooperative Banks through training personnel and application of modern technology. The adoption of Common Accounting System and Management Information System was to further enhance the efficiency of these institutions. The adoption of modern technology was supplemented with training and orientation programmes to acquaint the employees with technology. The indicators of efficiency used are operating costs as proportion to assets, the ratio of staff expenditure to total assets and the spread (net interest income) as a proportion of total assets.

CHART 4.17: EFFICIENCY INDICATORS OF THE StCBs

(in per cent)



SOURCE: Estimated from various issues of Basic Data on Performance of State Cooperative Banks, NAFSCOB and Report on Trends and Progress in Banking in India, RBI

The first indicator measured by the operating costs as a percentage of total assets declines marginally during 2003-04 but then continues to rise and reaches a peak of 2008-09. This rise in operating costs could be attributed to the fixed costs incurred as a result of technical changes and modernization introduced by the Taskforce.

The second indicator used is the staff expenditure as a proportion of total assets. This indicator too shows visible improvement despite of an increase in the wage-bill. This improvement came as a result of staff restructuring and human resource development practices advocated by the Committee.

The third indicator is the net interest incomes (spread) as a percentage of the total assets of the StCBs which represents the costs of intermediation. The net interest incomes as a proportion of working funds has fluctuated widely during the period of analysis. However during the reform period[58] this ratio has seen a sharp decline as compared to the period prior to 2004-05. The narrowing of spreads after 2006-07 can be explained by the interest subvention scheme of the Government. The lower spread of the StCBs translates into lower costs of intermediation and reflects the enhanced efficiency of this tier.

The efficiency of the StCBs has thus shown an improvement which is broadly in consonance with the reforms introduced by the Vaidyanathan Committee.

[58] The "reform period" here refers to the period after the implementation of the recommendations of the Vaidyanathan Committee Report (between 2004 and 2012)

TABLE 4.18: EFFICIENCY INDICATORS OF THE StCBs

(In per cent)

YEAR	OPERATING EXPENSES/TOTAL ASSETS	STAFF EXPENSES/TOTAL ASSETS	NET INTEREST INCOME/TOTAL ASSETS
1996-97	0.79	0.59	2.09
1997-98	0.87	0.58	2.01
1998-99	0.76	0.57	1.46
1999-00	0.78	0.60	1.92
2000-01	0.71	0.53	2.04
2001-02	0.72	0.53	2.29
2002-03	0.79	0.49	2.17
2003-04	0.69	0.47	1.94
2004-05	0.73	0.51	2.34
2005-06	0.76	0.50	2.17
2006-07	0.88	0.46	1.48
2007-08	0.89	0.48	1.47
2008-09	1.03	0.48	1.46
2009-10	0.92	0.55	1.11
2010-11	0.99	0.58	1.41
2011-12	0.97	0.60	1.35

SOURCE: Estimated from Report on Trend and Progress of Banking in India, RBI, (Various Issues)

4.3.5 ASSET QUALITY

Before the application of asset classification norms the long term overdues (overdues more than three years) of the StCBs declined from 34% in 1995-96 to 24% in 1996-97.The provisioning norms for asset classification were introduced to the StCBs and DCCBs in 1996-97. The asset classification norms for the Cooperative Banks were tightened further in 2000.

Given the limited resources of the Cooperative Banks, the recovery rates and the asset quality have a strong bearing on the viability of these institutions. The financial soundness of the StCBs assumes greater importance as it has a bearing on the lower tiers that are dependent on it for assistance.

The performance of the StCBs has improved as the NPAs in absolute terms declined from its peak in 2006-07. However after 2008, a drastic decline in the NPAs of the StCBs was witnessed which like in the case of the DCCBs was brought about by the financial recapitalization as well as the loan waiver scheme of the government. Most of the decline in the NPAs has come as a result of a decline in the substandard and doubtful assets. But a worrying trend that has emerged is that while after recapitalization, the substandard and doubtful assets have declined as a proportion of the total NPAs, there is a rise in bad loans both in absolute terms as well as a proportion of the total NPAs.

TABLE 4.19: ASSET QUALITY OF THE StCBs

(in Rs Crores)

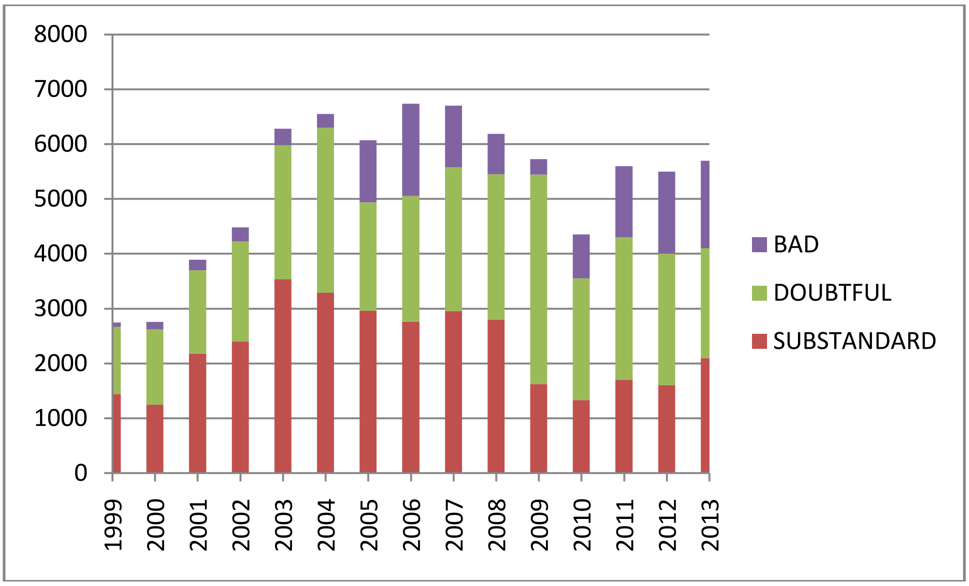
YEAR	SUBSTANDARD ASSETS	DOUBTFUL ASSETS	BAD ASSETS	TOTAL NPAs
1999	1445	1221	82	2748
2000	1248	1374	137	2758
2001	2178	1520	191	3889
2002	2403	1821	261	4485
2003	3535	2443	306	6284
2004	3288	3010	250	6548
2005	2962	1975	1136	6073
2006	2763	2292	1680	6735
2007	2957	2625	1122	6704
2008	2801	2653	737	6191
2009	1627	3822	276	5725
2010	1332	2219	802	4353
2011	1700	2600	1300	5600
2012	1600	2400	1500	5400
2013	2100	2000	1600	5600

SOURCE-Report on Trend and Progress of Banking in India, RBI (Various Issues)

The NPA ratio measured as a percentage of total outstanding loans and total assets too shows a marked improvement in the asset quality of the StCBs with both the ratios showing a sustained decline during the reform period. The NPAs as a proportion of total outstanding loans rose from 12.5% in 1999 to a peak of 17.9% in 2003 after which there was a sustained decline across the entire period to 7.14% in 2012. Corresponding to this, the percentage of NPAs to total assets also increased from 6.5% in 1999 to 9.26% in 2003 before steadily declining to 3.64% in 2012

CHART 4.18 (a) ASSET QUALITY OF THE StCBs

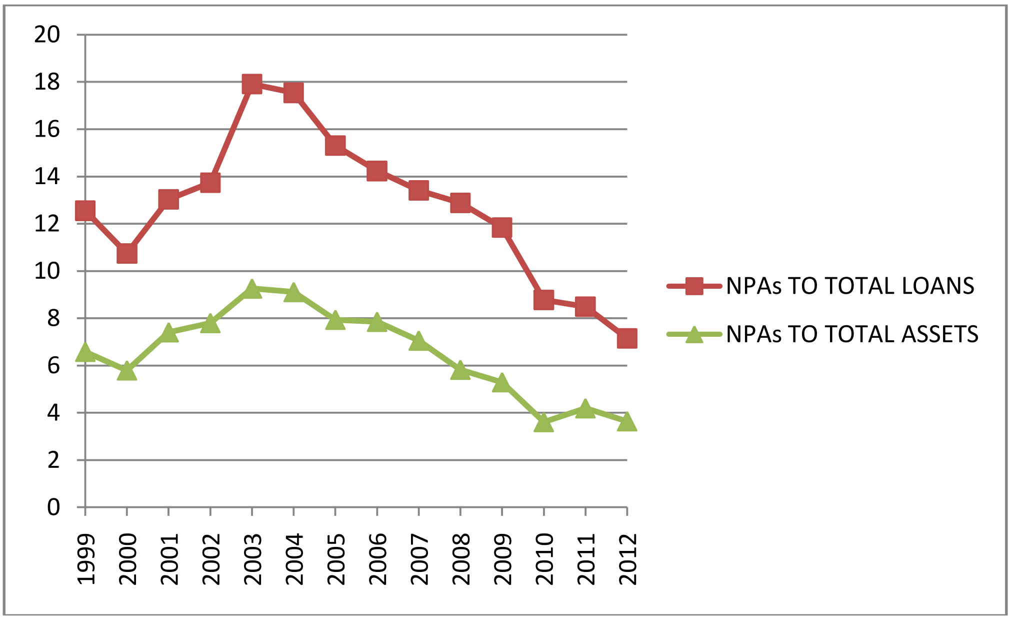
(In Rs Crores)



SOURCE: Report on Trends and Progress of Banking in India, RBI (Various Issues)

CHART 4.18 (b): ASSET QUALITY OF THE StCBs

(In per cent)



SOURCE: Estimated from data provided by Report on Trends and Progress of Banking in India, RBI (Various Issues)

This improvement was facilitated both by a decline in the NPAs as well as a growth in the business of the StCBs.

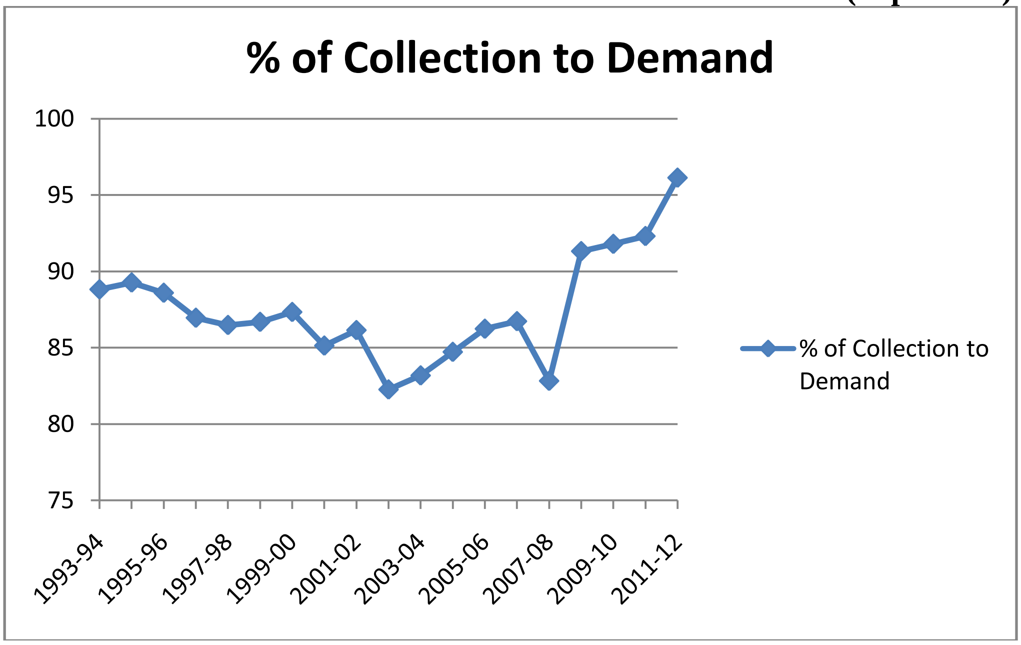
4.3.6 RECOVERY RATES

Like the DCCBs, the recovery rates for the StCBs too are estimated as percentage of collection to demand. However, the StCBs demonstrated better rates of recovery than the former as their recovery rates averaged 86% for the period prior to 2004-05. The high recovery rates were attributed to the presence of the StCBs as the apex body and their ability to mobilize resources. The StCBs were saddled with rising NPAs in the early nineties, thus the "One-Time Settlement Scheme" of the NABARD sought to improve the financial position of the rural credit cooperatives by clearing the overdues of the StCBs. There were periods when the recovery rates suffered due to growing overdues like in 2002-03 when the country faced severe droughts and in 2007-08 when the economy was affected by the global crisis. During these periods the recovery rates slipped to 82%.

After the financial recapitalization and the loan waiver scheme wiped out the overdues from the balance-sheets of the StCBs, the recovery rates shot upto 92 % in 2008-09 and further to 96% in 2011-12.

CHART 4.19: RECOVERY RATES OF THE StCBs

(in per cent)



SOURCE: Estimated from Basic Data on Performance of State Cooperative Banks, NAFSCOB (Various Issues)

4.3.7 CAPITAL ADEQUACY

Capital adequacy is an indicator of the resilience of banks against credit risks arising out of bad loans. The recapitalization package advocated by the Vaidyanathan Committee aimed to infuse capital into the Cooperative Banks to enable them to maintain capital adequacy norms (CRAR) at 7% which was to be raised subsequently. The refinance facilities of the StCBs and the DCCBs too were linked to the maintenance of a minimum CRAR of 4% in 2013-14.

The position of the State Cooperative Banks has improved in terms of attaining capital adequacy.

By 2011-12, 19 of the 31 StCBs had CRAR levels above 7%. This position improved in 2014-15 with 30 of the total StCBs registering CRAR levels above the stipulated level.

But we must not be led astray by these figures as capital adequacy is achieved through borrowed funds that need to be repaid and will pose a financial burden on the StCBs. This financial burden could render many StCBs unviable or unsustainable in the long run.

TABLE 4.20: CRAR POSITION OF StCBs

(in numbers)

YEAR	< 4%	4 %to <7%	7 % to <9%	9 % & above	Total StCBs
2011-12	5	7	4	15	31
2012-13	2	6	7	17	32
2013-14	0	6	7	19	32
2014-15	2	0	11	19	32

SOURCE: NABARD AND RBI

CHAPTER-V

SOCIO-ECONOMIC PERFORMANCE OF THE RURAL COOPERATIVE CREDIT INSTITUTIONS

As discussed in the previous chapter, the implementation of the recommendations of the Vaidyanathan Committee as well as the revitalization package has resulted in appreciable signs of improvement in most of the indicators of financial performance. However, institutions constituting the cooperative structure unlike other financial intermediaries have a special character to them. These institutions are not driven by profits but are premised on the more fundamental goals of achieving socio-economic growth and development. Cooperative institutions were established with the specific objectives of achieving rural development through development of agriculture, community development by financial inclusion of the weak and the marginalized sections and displacing the informal sources of credit like the exploitative and usurious moneylenders.

Thus, this chapter seeks to analyze the role of the cooperatives in fulfilling their primary objectives. It is divided into four sections. Section 5.1 examines the role of the cooperative institutions in financial inclusion and ensuring the ease of access of credit to the weak and marginalized sections of the society. Section 5.2 examines the role of the cooperatives in purveying credit to agriculture. Section 5.3 examines whether the cooperatives have been successful in displacing the informal sources of credit and the last section is a short commentary on the emergence of microfinance.

5.1 FINANCIAL INCLUSION OF THE WEAK AND MARGINALISED SECTIONS

The Cooperatives were established with the vision of upliftment and empowerment of the weakest and the most vulnerable. This section analyses the financial inclusion of the weak and marginalized sections by the cooperative institutions based both on social and economic factors. Thus in this section we evaluate the financial inclusion of:

- Socially disadvantaged groups like the SC/ST group, and
- The economically weaker section of the population based on occupation comprising small and marginal farmers, rural artisans and agricultural labourers

In India, caste remains deeply entrenched in the society and is used as a tool for the exclusion of the marginalized Scheduled Castes (SCs). Similarly the other social group that faces discrimination is the set of indigenous tribes categorized as the Scheduled Tribes (STs).

According to Census 2011, India's rural population comprises of 18.5 % SCs and 11.3% STs but despite progressive legislation and welfare and development programmes, these social groups face the greatest discrimination and deprivation. This discrimination reflects, inter alia, in their educational attainment, wages and access to credit that severely hampers their social, economic and political participation. This section seeks to examine whether the Cooperative Credit institutions have been successful in their objective of inclusive growth and facilitating access of credit to these sections of society. It also seeks to examine whether the Cooperatives have overcome their elite bias and have reached out to the marginalized sections of the society.

5.1.1 MEMBERSHIP

The number of members of the PACs has grown over time from 89 million in 1993-94 to 130 million in 2013-14. (Table 5.1) The membership of the PACs has seen an overwhelming increase after the period 2003-04 although the trend is marked by a lot of volatility. The volatility in the membership figures can be explained by the role of elections to the management of the cooperatives with a large number of members inducted into the Cooperatives to influence the election results and to gain political control.[59]

During 1978-79, the SCs and STs comprised 13.5% and 7.58 % of the total membership and 13.23% and 6.07% of the total borrowers. (Tendulkar, 1983) The representation of the SC/ST group in terms of membership remained close to 30% in the beginning of the nineties but by 2013-14 their membership had

[59] GOI.(2009).*High Powered Committee on Cooperatives*

declined to 21%. The proportion of SC/ST borrowers too declined to 19.39% in 2013-14.

The membership of the PACs also remains closely linked to weather fluctuations, natural shocks and global occurrences. This is evident from the drought years and the years of the global financial crisis (1999-2000, 2002, 2007-08 and 2012-13) during which the membership of the PACs saw a steep rise. These periods also coincided with greater participation in the membership of the SC/ST group as the droughts of 2002-03 saw the participation rate of this group rise to 37% from 23% in the preceding year. The membership of the SC/ST group hovered around this level till 2007-08 but subsequently declined only to rise again in 2011-12. The figures in terms of borrowers suggest dismal participation as the SC/ST group on an average constitutes less than 20% of the total borrowers. However their number rose during the periods marked by droughts or the global events primarily during 2000-01, 2002-03, 2004-05, 2007-08 and 2012-13.

The figures reaffirm that the local community often took recourse to the PACs in times of exogenous shocks and seasonal fluctuations to meet their shortfall in incomes and expenses.

A closer scrutiny of state-wise data reveals that some states/ Union territories like Dadra and Nagar Haveli, Manipur (55%), Meghalaya (100%), Mizoram (100%), Nagaland (50%), Orissa (76%), Uttar Pradesh (85%), Chhattisgarh (54%), Jharkhand (48%) and Uttarakhand (85%) display an overwhelming participation and reliance of the SC/ST community on the PACs. In terms of borrowers, too some states exhibit increased dependence of the SC/ST group on the PACs like Andhra Pradesh (55%), Haryana (52%), Himachal Pradesh (64%), Jammu and Kashmir (100%), Karnataka (48%), Tamil Nadu (59%), West Bengal (44%) and Uttarakhand (66%).

TABLE 5.1: COMPOSITION OF MEMBERSHIP/BORROWERS OF THE PACs

(In thousands)

Year	Total Members	SC/ST Members	% of SC/ST Members	Total Borrowers	SC/ST Borrowers	% of SC/ST Borrowers
1994-95	90621	23493	25.92	38047	6057	15.92
1995-96	90472	22765	25.16	47710	7589	15.91
1996-97	80258	23303	29.04	43496	7617	17.51
1997-98	80205	22753	28.37	43073	7459	17.32
1998-99	89568	22409	25.02	51643	8605	16.66
1999-00	108627	28768	26.48	42962	8024	18.68
2000-01	99918	22096	22.11	46533	9980	21.45
2001-02	102141	23796	23.30	55545	11466	20.64
2002-03	123552	45205	36.59	63880	19569	30.63
2003-04	135411	42503	31.39	51265	9930	19.37
2004-05	127406	42733	33.54	45070	10711	23.77
2005-06	125197	42243	33.74	46076	10307	22.37
2006-07	125792	40385	32.10	47910	9126	19.05
2007-08	131530	40924	31.11	51074	12764	24.99
2008-09	132350	38622	29.18	46219	8619	18.65
2009-10	126419	36597	28.95	59800	10226	17.10
2010-11	121225	25192	20.78	52388	9417	17.98
2011-12	113596	30399	26.76	44886	9175	20.44
2012-13	127468	29534	23.17	49533	11351	22.92
2013-14	130120	27557	21.18	48081	9324	19.39

SOURCE: Estimated from the various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

The borrower to member ratio is an important indicator of access to credit. The borrower-member ratio for the SC and the ST remained at 34.96% and 28.56 % respectively in 1978. (Tendulkar, 1978) The borrower-member ratio for the PACs on an average remained around 45% for the members as a whole but remains considerably low for the SC/ST group at around 30% during the period of analysis. This implies that although the SC/ST group was inducted as members to the PACs as a result of progressive legislation, in effect only 30% of its members could actually access credit from these institutions.

TABLE 5.2: BORROWER-MEMBER RATIO OF THE PACs

(In per cent)

YEAR	SC/ST	NON SC/ST	TOTAL
1994-95	25.78	47.66	41.98
1995-96	33.34	59.26	52.73
1996-97	32.69	63.00	54.20
1997-98	32.78	61.99	53.70
1998-99	38.40	64.08	57.66
1999-00	27.89	43.75	39.55
2000-01	45.17	46.97	46.57
2001-02	48.18	56.26	54.38
2002-03	43.29	56.56	51.70
2003-04	23.36	44.49	37.86
2004-05	25.06	40.58	35.38
2005-06	24.40	43.12	36.80
2006-07	22.60	45.41	38.09
2007-08	31.19	42.28	38.83
2008-09	22.32	40.12	34.92
2009-10	27.94	55.19	47.30
2010-11	37.38	44.75	43.22
2011-12	30.18	42.92	39.51
2012-13	38.44	38.99	38.86
2013-14	33.83	37.79	36.95

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

The ratio shows an improvement for a brief period between 1999 and 2004. This could be attributed to:

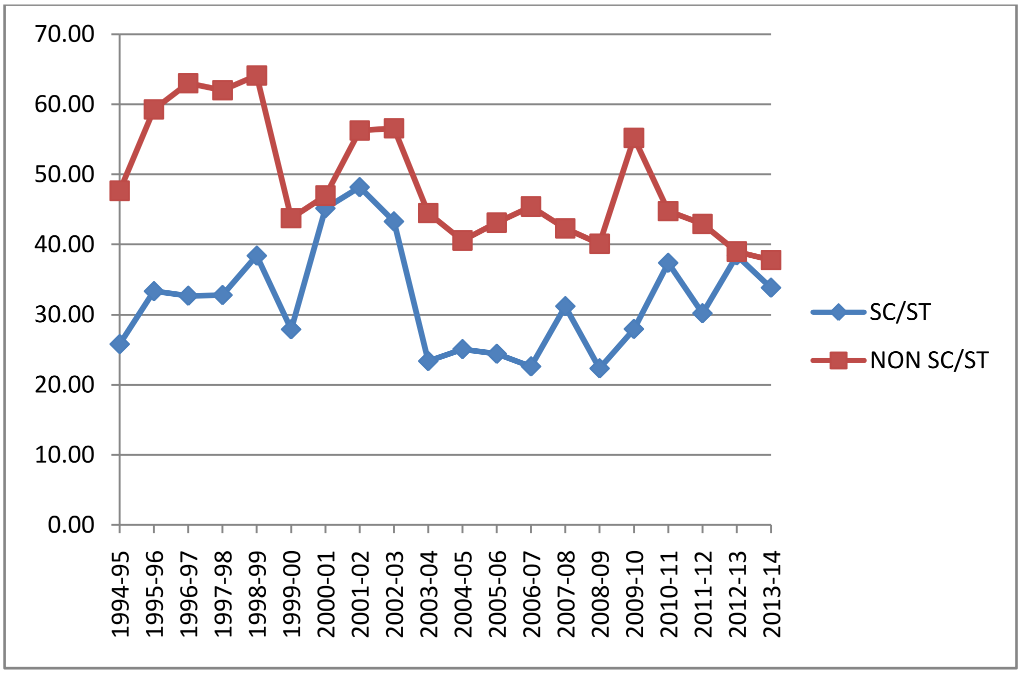
a) One Time Settlement Scheme (1998) that wiped out the existing overdues of the members, that made them eligible for seeking fresh loans,

b) Severe drought conditions of 2002 and 2004

c) The doubling of the Agricultural Credit Program (2004) that not only raised credit flow to agriculture but also entailed debt relief measures through financial assistance, debt waivers and “one time settlement” scheme.

CHART 5.1: BORROWER-MEMBER RATIO OF THE PACs

(in per cent)



SOURCE: Estimated from the various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

Chart 5.1 shows that there was a wide gap in terms of the borrower-member ratio between the non SC/ST group and the SC/ST group that reflects the discriminatory lending practices of the PACs. The low ratio implies that it was difficult for the SC/ST group to avail credit from the PACs as opposed to the non-SC/ST group despite being members.

This ratio has improved after 2008-09 but this too has been achieved through a decline in the proportion of SC/ST members. (Table 5.1) It could also be a result of the Agricultural loan waiver scheme (2008) and the financial recapitalization introduced by the Vaidyanathan Committee that cleared the past overdues of the small and marginal farmers and made them eligible for seeking fresh finance. State-wise data reveals that some states like Assam (46%), Bihar (41%), Madhya Pradesh (46%), Maharashtra (74%), Nagaland (50%) and Chhattisgarh (51%) had a higher borrower-member ratio than the national average.

Thus, the declining figures in terms of members, borrowers and the widening gap in the borrower-member ratio of the SC/ST group and the non-SC/ST group all seem to suggest that the PACs are not adequately representing these socially disadvantaged groups. Section 5.1.2 seeks to further examine whether these groups are discriminated against in the provision of credit.

Besides social factors, the weak economic position of some of the social groups due to their occupation acts as a deterrent to their access to credit through formal institutions. The rural community comprises largely of small and marginal farmers, agricultural labourers and small artisans. These social groups have very limited resources to make ends meet. Most financial institutions are reluctant to provide credit to this section of the society as they are perceived to be riskier, unviable and un-profitable in comparison to the larger borrowers. The Agricultural Census (2010-11) reveals that about 85% of the total landholdings in India were small and marginal (below 2 ha). The marginal farmers own 67% of the total land-holdings. Thus for realizing the goal of inclusive growth the PACs must ensure the entry and active participation of the people from this strata of the society.

TABLE 5.3: COMPOSITION OF MEMBERS OF PACs BASED ON OCCUPATION

(In Thousands)

Year	Total Membership	Small Farmers	% in Total	Rural Artisans	% in Total	Marginal Farmers and Others	% in Total
2002-03	123552	43457	35.2	7521	6.1	27369	22.2
2003-04	135411	50094	37.0	6384	4.7	36459	26.9
2004-05	127406	49431	38.8	7268	5.7	27974	22.0
2005-06	125197	44732	35.7	6497	5.2	31725	25.3
2006-07	125792	44136	35.1	4295	3.4	36776	29.2
2007-08	131530	48996	37.3	4713	3.6	36896	28.1
2008-09	132350	40673	30.7	6549	4.9	46701	35.3
2009-10	126419	39557	31.3	5307	4.2	44959	35.6
2010-11	121225	39070	32.2	5390	4.4	51573	42.5
2011-12	113596	33854	29.8	4827	4.2	44515	39.2
2012-13	127468	40402	31.7	6564	5.1	50968	40.0
2013-14	130120	40181	30.9	7148	5.5	55234	42.4

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

The small farmers constitute an important share in the total membership of the PACs and account for almost a third of the members. The rural artisans form a relatively small share of around 5% in terms of both members and borrowers of the PACs. Separate data for the marginal farmers is not available and is covered under the third category and hence any significant result could not be derived for this group. Thus, we limit our analysis to only two categories: small farmers and rural artisans.

The proportion of small farmers in the total members has declined after 2007-08 with a corresponding rise in the rural artisans. But in terms of borrowers, there has been a marked increase for both these groups. A positive development that has occurred after the global financial crisis of 2007-08 is the improved borrower-member ratio for both the small farmers and rural artisans. But while this has improved as a result of higher number of borrowers for the rural artisans, for the former it has come as a result of a decline in the members. Nevertheless, the improved borrower-member participation could also be attributed to the loan waiver scheme, interest subvention scheme as well as the financial infusion that has strengthened the financial position of the PACs prompting the members to rely on the PACs for their credit needs.

The Expert Committee to examine the Three Tier Short Term Cooperative Credit Structure (2013) observed that in 2011-12 the Cooperatives provided agricultural credit to 3.09 Crore farmers as opposed to 2.55 Crore farmers by Scheduled Commercial Banks and 82 lakhs by the RRBs. It also financed 67 lakh new farmers during the same period as compared to 21 lakh farmers by Commercial Banks and 9 lakh farmers by RRBs.

The figures reiterate the fact that the PACs are an important source of credit to the small and marginal farmers and rural artisans. Thus in order to take advantage of the growing network of these institutions and to realize the goal of financial inclusion, membership to the PACs and active participation of the members should be encouraged.

TABLE 5.4: COMPOSITION OF BORROWERS OF PACs BASED ON OCCUPATION

(In thousands)

Year	Total Borrowers	Small Farmers	% in Total	Rural Artisans	% in Total	Others	% in Total
2002-03	63880	17206	26.9	3039	4.8	23778	37.2
2003-04	51265	13504	26.3	2488	4.9	25343	49.4
2004-05	45070	12695	28.2	2113	4.7	19547	43.4
2005-06	46081	14651	31.8	1795	3.9	19324	41.9
2006-07	47910	15422	32.2	1922	4.0	21440	44.8
2007-08	79408	26081	32.8	2046	2.6	38517	48.5
2008-09	46219	14230	30.8	2271	4.9	21086	45.6
2009-10	59800	17171	28.7	2619	4.4	29784	49.8
2010-11	52388	15494	29.6	2879	5.5	24597	47.0
2011-12	44886	14728	32.8	2428	5.4	18554	41.3
2012-13	49533	16430	33.2	2657	5.4	19094	38.5
2013-14	48081	17188	35.7	2791	5.8	18778	39.1

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

Like the PACs, the membership to the DCCBs and the StCBs has also witnessed a phenomenal growth. The members of the DCCBs include individuals as well as institutions like the Primary Agricultural Cooperative Societies (PACs), Farmers' Service Societies (FSS) and Large-sized Adivasi Multipurpose Societies (LAMPS). The total membership of the DCCBs has grown from 13 lakhs in 1993-94 to 36 lakhs in 2013-14. The individual membership rose from 10.52 lakhs to 29.90 lakhs during the same period while the number of affiliated societies has grown from 2.76 lakhs in 1993-94 to 5.72 lakhs in 2013-14. Most of this increase was witnessed after 2006-07 which could be an outcome of the implementation of the recommendations of the Vaidyanathan Committee Report.

The membership of the StCBs too has grown from 1.87 lakhs in 1993-94 to 3.38 lakhs in 2013-14.The number of individual members has grown from around 1 lakh to 3.18 lakhs during the same period.

5.1.2 ACCESS OF CREDIT TO THE WEAK AND MARGINALIZED SECTIONS

As discussed earlier, the Cooperatives were for long controlled and dominated by the village gentry while the weaker and disadvantaged groups were often subject to humiliation and unfair treatment. As Shah, Rao and Shankar (2007) quote from the Royal Commission Report (1929) "outcaste men will not get a loan unless they promise to sell their labor to the caste man who is a member of the panchayat at a lower rate than what he can get in the market". This section examines how far the Cooperatives have progressed in terms of transcending the caste barrier and in overcoming their elite bias.

In the previous section, it was shown that the SC/ST group was discriminated against in terms of access to credit as a very small proportion of the SC/ST members could actually avail loans from the PACs. This section enquires further into the issue by examining the distribution of loans advanced by the PACs in terms of proportion and size of loans accruing to the SC/ST group.

Table 5.5 and Table 5.6 show that the distribution of loans remains extremely skewed towards the non SC/ST group. Although the SC/ST group comprised around 20% of the total borrowers, this group received only 10% of the total credit advanced while a significant share of the loans was cornered by the non-SC/ST group. The share of short-term credit advanced to the SC/ST group declined consistently from 12.52 % in 2002-03 to 8.55% in 2006-07, while for the medium term loans it almost halved from 15.62 % in 2002-03 to 7.66 % in 2005-06.

This tendency was arrested briefly by the introduction of various schemes like the interest subvention scheme (2006-07), Agricultural Debt Waiver and Debt Relief Scheme (2008) and the financial recapitalization of the PACs. However, this positive outcome was short-lived as the share of the SC/ST group in the total credit advanced again began to decline after 2009-10.

TABLE 5.5 SHORT-TERM LOANS ADVANCED BY THE PACs

(Rs in Lakhs)

Year	Credit Advanced to SC	% Share in Total Credit	Credit Advanced to ST	% Share in Total Credit	Credit to SC/ST	% Share in Total Credit	% Share of SC/ST in Total Borrowers	Others	Total Loans
2002-03	223616	8.22	116858	4.30	340474	12.52	30.6	2379530	2720004
2003-04	201352	6.87	125608	4.28	326960	11.15	19.4	2605629	2932589
2004-05	225960	7.09	136359	4.28	362319	11.36	23.8	2826388	3188707
2005-06	217920	6.12	145011	4.07	362931	10.19	22.4	3199423	3562354
2006-07	217080	5.32	131684	3.23	348764	8.55	19.0	3730828	4079592
2007-08	289568	6.11	172755	3.65	462323	9.76	25.0	4276652	4738975
2008-09	301225	6.27	163970	3.41	465195	9.69	18.6	4336992	4802187
2009-10	433411	7.00	199327	3.22	632738	10.21	17.1	5562338	6195076
2010-11	476035	6.31	246789	3.27	722824	9.58	18.0	6819858	7542682
2011-12	538678	6.71	407818	5.08	946496	11.80	20.4	7076279	8022775

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

TABLE 5.6: MEDIUM-TERM LOANS ADVANCED BY THE PACs

(Rs in Lakhs)

Year	Credit Advanced to SC	% Share in Total Credit	Credit Advanced to ST	% Share in Total Credit	Credit Advanced to SC/ST	% Share in Total Credit	% Share Of SC/ST in Total Borrowers	Others	Total Loans
2002-03	82924	12.38	21687	3.24	104610	15.62	30.6	565305	669916
2003-04	51704	8.92	19983	3.45	71688	12.37	19.4	507647	579335
2004-05	62713	8.56	36928	5.04	99641	13.6	23.8	632822	732464
2005-06	42546	5.83	13361	1.83	55907	7.66	22.4	673698	729605
2006-07	87324	9.9	11696	1.33	99020	11.23	19.0	782659	881679
2007-08	100288	9.78	24699	2.41	124986	12.19	25.0	900287	1025273
2008-09	70786	6.58	34482	3.2	105268	9.78	18.6	971213	1076481
2009-10	111133	8.56	43730	3.37	154863	11.92	17.1	1143815	1298678
2010-11	113506	7.15	42201	2.66	155707	9.81	18.0	1431993	1587700
2011-12	99069	3.66	42789	1.58	141859	5.24	20.4	2565390	2707248

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

The average size of loan per borrower advanced to the SC/ST group too remained considerably lower than the loans accruing to the non SC/ST group as is shown in Table 5.7. The figures show that the average size of the loan advanced to SC/ST group borrowers was almost half that of the loans sanctioned to non-SC/ ST borrowers. However, the size of the loans for the former group increased after the year 2008 due to the following reasons:

a) Implementation of aforementioned schemes of the Government like interest subvention scheme, loan waivers and the financial recapitalization that sought to benefit the weaker sections.
b) Decline in the number of SC/ST borrowers. The period after 2007-08 saw the share of the SC borrowers decline from 15% in 2007 to 12% in 2011-12, while the share of ST borrowers declined from 10% to 8 % during the same period.
c) Natural calamities like the floods and droughts that affected various regions of the country during this period.

TABLE 5.7: AVERAGE SIZE OF LOANS PER BORROWER ADVANCED BY THE PACs

(In Rs)

YEAR	SC	%*	ST	%**	OTHER	TOTAL
2002-03	2666	40.11	1717	25.84	6646	5322
2003-04	3898	51.75	4235	56.23	7532	6851
2004-05	3980	39.53	5011	49.77	10068	8700
2005-06	3732	34.47	4759	43.95	10828	9315
2006-07	5368	46.13	4150	35.66	11637	10355
2007-08	5043	37.32	3923	29.03	13513	11286
2008-09	6808	48.22	6290	44.55	14118	12719
2009-10	7997	59.11	7113	52.58	13528	12531
2010-11	10410	54.21	7698	40.09	19203	17428
2011-12	11530	42.71	12366	45.80	26999	23905

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

NOTE: * Figures indicate credit per borrower from SC category as percent of credit per borrower from non-SC/ST category.
** Figures indicate credit per borrower from ST category as percent of credit per borrower from non-SC/ST category

Thus, the SC/ST group was not adequately represented in the PACs in terms of both members and borrowers. The bias is more prominent in terms of access of credit which is extremely skewed in favor of the non-SC/ST borrowers both in terms of the share of credit accruing to them and in the average size of the loans.

5.2 CREDIT TO AGRICULTURE

The Cooperatives were established with the vision of rural development and in a country where a majority of the rural population is dependent on agriculture, any attempt to revive the rural economy would be a futile exercise unless it centered around incorporating and developing the agricultural sector. The dwindling share of agriculture in the total GDP despite supporting more than half of the workforce draws attention to this sector. Agriculture remained relatively deprived of institutional credit despite several attempts to channelize credit to this sector. Census 1961 revealed that industry, which contributed 15% of the total national income, cornered over two-thirds of the advances from the commercial banks while agriculture despite contributing almost half of the GDP continued to starve for finance. Hence it is important to study the role of the Cooperatives in disbursing agricultural credit.

The following section focuses on identifying the role played by cooperatives in purveying institutional credit to agriculture. It examines the role of the Cooperatives from both the demand and supply sides of credit. The first part of the section makes a comparative analysis of different institutions in providing agricultural credit. The subsequent part focuses on the distribution of credit to agriculture by the different tiers of the rural cooperative structure.

5.2.1 ROLE OF COOPERATIVES IN INSTITUTIONAL FLOW OF CREDIT TO AGRICULTURE

The Cooperatives were established to provide formal credit to agriculture and to curb the reliance on informal sources that were inhibiting the growth of this sector. Immediately after independence, the agricultural credit disbursed by the Cooperatives reached only 3.3% of the rural cultivators and almost the entire agricultural credit was provided by the informal sector. The weak resource base of the cooperatives coupled with the failure of land reforms and the exclusionary member policy further hampered the percolation of formal credit down to the agricultural classes. However, with the Government's active intervention, the share of institutional credit to agriculture increased to 18.7% in 1961. (Table 5.8) The Cooperatives remained the only source of institutional credit for agriculture for almost two decades after independence but despite their network and outreach, they failed to adequately meet the credit needs of agriculture. Thus, the All Indian Rural Credit Review Committee (1966) emphasized the need to strengthen the cooperatives and called for a coordinated development of the Commercial Banks and the Cooperatives to channelize credit to agriculture. To further enhance the flow of credit to agriculture other policy initiatives like bank nationalisation (1969), Lead Bank Scheme (1969), establishment of the Agricultural Refinance Corporation (1963) were undertaken as part of the larger "social and development banking" initiative of the Government.

Data from NABARD reveals that the Cooperatives accounted for 93.22% of institutional credit to agriculture while the share of Commercial Banks accounted for a considerably smaller share (6.78%) in 1971-72. In terms of access to credit of the rural cultivator too the share of the Cooperatives rose to 22% (Table 5.8) but the dominance of the informal sector continued.

The decade that followed showed sustained efforts by the Government to provide agricultural credit through "directed credit programs", establishment of Regional Rural banks (RRBs) and NABARD. (1982). The outcome of adopting this "multi-agency approach" for disbursing agricultural credit was the share of cooperatives in institutional credit declined to 58.9% with that of the Commercial Banks steadily climbing to 36.6% and the RRBs to 4.4% in 1981-82. (NABARD)

TABLE 5.8: SHARE OF DEBT OF CULTIVATOR HOUSEHOLDS

(Source-wise)

(in per cent)

SOURCE OF CREDIT	1951	1961	1971	1981	1991	2002	2012
INSTITUTIONAL CREDIT OF WHICH:	**7.3**	**18.7**	**31.7**	**63.2**	**66.3**	**61.1**	**64**
COOPERATIVE SOCIETIES/BANKS	3.3	2.6	22	29.8	30	30.2	28.9
COMMERCIAL BANKS	0.9	0.6	2.4	28.8	35.2	26.3	30.7
NON-INSTITUTIONAL OF WHICH:	**92.7**	**81.3**	**68.3**	**36.8**	**30.6**	**38.9**	**36**
MONEYLENDERS	69.7	49.2	36.1	16.1	17.5	26.8	29.6
UNSPECIFIED	-	-	-	-	3.1		
TOTAL	100	100	100	100	100	100	100

SOURCE: All-India Rural Credit Survey, 1951-52; RBI, All India Rural and Debt Investment Survey, 1961-62 and NSSO, All-India Debt and Investment Surveys, (Various Issues) and Key Indicators of Debt and Investment in India (2014)

The sustained efforts of the policy makers through the adoption of progressive banking measures yielded results with the share of institutional credit to agriculture almost doubling in 1981. This was achieved as a result of the policies of the Government that led to the proliferation of rural bank branches and also by directing credit to agriculture and the weaker sections of the society. The social banking era was characterized by a steady decline in the share of the informal sector, especially the moneylenders.

The nineties were marked by an interlude with the initiation of the neo-liberal economic reforms that undermined all the achievements of the "social and development banking phase". This period not only witnessed a decline in the rural branches of the banks but also a decline in agricultural credit with a sharp decline in the number of agricultural loan accounts from 27.74 million in March 1992 to 19.84 million in March 2001.[60] This period also witnessed strengthening of the informal sources of credit that were on a decline during the social banking era.

Despite the neo-liberal policy shift, the Cooperatives continued to be the dominant agency in the field of agriculture till as late as 1995-96. (Table 5.9) Thereafter the share of the Cooperatives has declined consistently to 16% in 2013-14 with a corresponding rise in the share of the Commercial Banks. However in terms of access to credit by the rural cultivator, the Cooperatives continued to dominate the rural scenario. (Table 5.8)

The Government of India, taking cognizance of the dwindling share of advances to agriculture, launched a credit package in 2004 that sought to double credit flow to this sector over a period of three years from 2004-05 and ensure an annual growth of 30% for the years thereafter. This led to an increase in the number of agricultural loans peaking to 46.64 million in 2011.[61]

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[60] NABARD.(2014).*Agricultural Credit in India: Trends, Regional Spreads and Database Issues*

[61] NABARD.(2014).*Agricultural Credit in India: Trends, Regional Spreads and Database Issues*

TABLE 5.9 FLOW OF INSTITUTIONAL CREDIT TO AGRICULTURE

(In Rs. Crores)

Year	Cooperatives	% Share in Total	RRBs	% Share in Total	SCBs	% Share in Total	Total
1991-92	5800	51.8	596	5.3	4806	42.9	11202
1992-93	9378	61.8	831	5.5	4960	32.7	15169
1993-94	10117	61.3	977	5.9	5400	32.7	16494
1994-95	9406	50.2	1083	5.8	8255	44.0	18744
1995-96	10479	47.6	1381	6.3	10172	46.2	22032
1996-97	11944	45.2	1684	6.4	12783	48.4	26411
1997-98	14085	44.1	2040	6.4	15831	49.5	31956
1998-99	15957	43.3	2460	6.7	18443	50.0	36860
1999-00	18260	39.5	3172	6.9	24733	53.5	46268
2000-01	20718	39.2	4220	8.0	27807	52.6	52827
2001-02	23524	37.9	4854	7.8	33587	54.1	62045
2002-03	23636	34.0	6070	8.7	39774	57.2	69560
2003-04	26875	30.9	7581	8.7	52441	60.3	86981
2004-05	31231	24.9	12404	9.9	81481	65.0	125309
2005-06	39404	21.8	15223	8.4	125477	69.5	180486
2006-07	42480	18.5	20434	8.9	166485	72.6	229400
2007-08	48258	19.0	25312	9.9	181088	71.1	254658
2008-09	45966	15.2	26765	8.9	228951	75.8	301908
2009-10	63497	16.5	35217	9.2	285800	74.3	384514
2010-11	78007	16.7	44293	9.5	345877	73.9	468291
2011-12	87963	17.2	54450	10.7	368616	72.1	511029
2012-13	111203	18.3	63681	10.5	432491	71.2	607375
2013-14	118423	16.4	83307	11.5	521496	72.1	723225

SOURCE: NABARD: Annual Report (Various Issues)

NOTE: The data for credit disbursements is not strictly comparable to the earlier series after 2004-05 as the advances by the Commercial Banks include indirect lending like RIDF Deposits.

Here it is important to highlight that despite the doubling of credit to agriculture, this sector continues to stagnate because of three reasons.

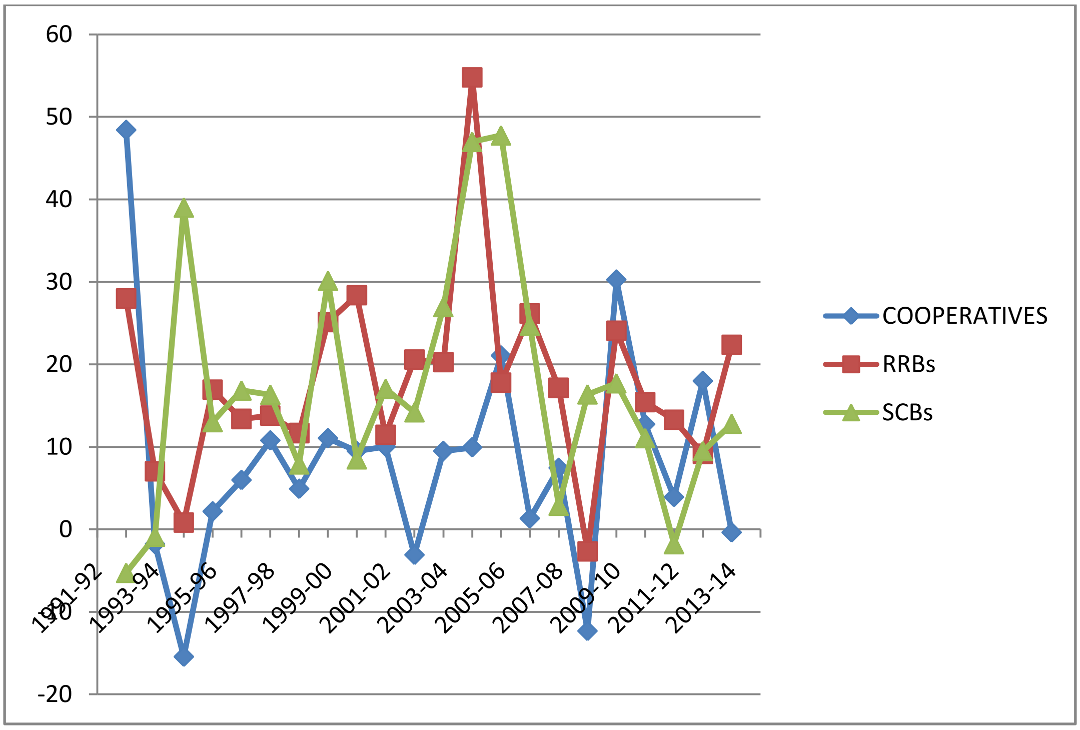
a) Although, the performance of the Commercial Banks seems to be quite impressive when judged through their fulfilling of Priority Sector Lending obligations and their rising share in agricultural credit, these achievements are a result of the dilutions and re-definitions of what constitutes "Priority Sector Lending".
b) There has been a disproportionate rise in the indirect component of credit advanced. The indirect component of finance does not accrue to the cultivators but to institutions that support agricultural production like big agribusiness firms, warehouse companies, input dealers etc which do not contribute in capital formation in agriculture.
c) The direct finance component of agricultural credit that accrues to the cultivators and producers has not grown like indirect finance and that too has favored only large borrowers as is evident from a decline in the loans advanced to small borrowers. (Chavan & Ramakumar, 2007)

Even the real growth of agricultural credit advanced by the Cooperatives remained considerably below that of the Regional Rural banks and the Commercial Banks. (Chart 5.2) The impact of the neo-liberal reforms was evident in the decline in the growth of agricultural credit but the Cooperatives were the worst affected by the reforms as they registered negative growth in their agricultural advances in the immediate aftermath of these reforms. After recovering in 1995-96, the growth of credit to agriculture averaged 7.5% till the droughts of 2002-03 led to a huge dip in credit advances. Consequent to the Doubling of Agricultural Credit Program (DACP) of 2004-05, there was a revival in the growth of credit advances to agriculture but a brief spell of recovery was offset by the global financial crisis and the diktats of the regulatory framework as the growth of credit advances of the Cooperatives plunged to a low of -12% in 2008-09. The financial recapitalization and the loan waivers contributed to a strong recovery in the subsequent year but were inadequate to sustain the growth resulting in the slackening of credit to this sector.

Thus, these figures establish that despite the nominal growth of agricultural credit, the real growth of credit (especially for the Cooperatives) has been very sluggish. Also, despite the quantum of credit advanced by the formal sector, there is a persistence of the informal sector and the reliance of the rural cultivator on these sources due to the failure of the formal institutions to adequately reach out to this segment.

CHART 5.2: REAL GROWTH IN GROUND-LEVEL CREDIT TO AGRICULTURE

(In per cent)



SOURCE: Estimated from the various issues of the Annual Report, NABARD and Handbook of Statistics on the Indian Economy (2014-15), RBI

5.2.2 AGRICULTURAL CREDIT BY THE RURAL COOPERATIVE STRUCTURE

As discussed earlier, the implementation of prudential norms and capital adequacy stipulations for the rural credit cooperatives has significantly reduced their resources for credit disbursal and has also altered the lending patterns of these institutions. There has also been a distinct shift in the proportion of investments with a corresponding decline in the share of loans advanced. In this regard, it is important to note that agriculture has for long suffered as it remained neglected and starved of finance despite of supporting the bulk of the country's population. The credit situation for agriculture could worsen further on superimposing these norms as it is perceived to be riskier and unprofitable and could adversely affect their profitability by burdening their balance-sheets with overdues. Thus the implementation of the so called "international best practices" renders the goals of socio-economic development subservient to profitability and commercial viability and alters the character of an institution.

In this context, it is important to examine the loan portfolios of the rural credit cooperatives and evaluate their role in providing credit to agriculture.

PRIMARY AGRICULTURAL COOPERATIVE SOCIETIES (PACs)

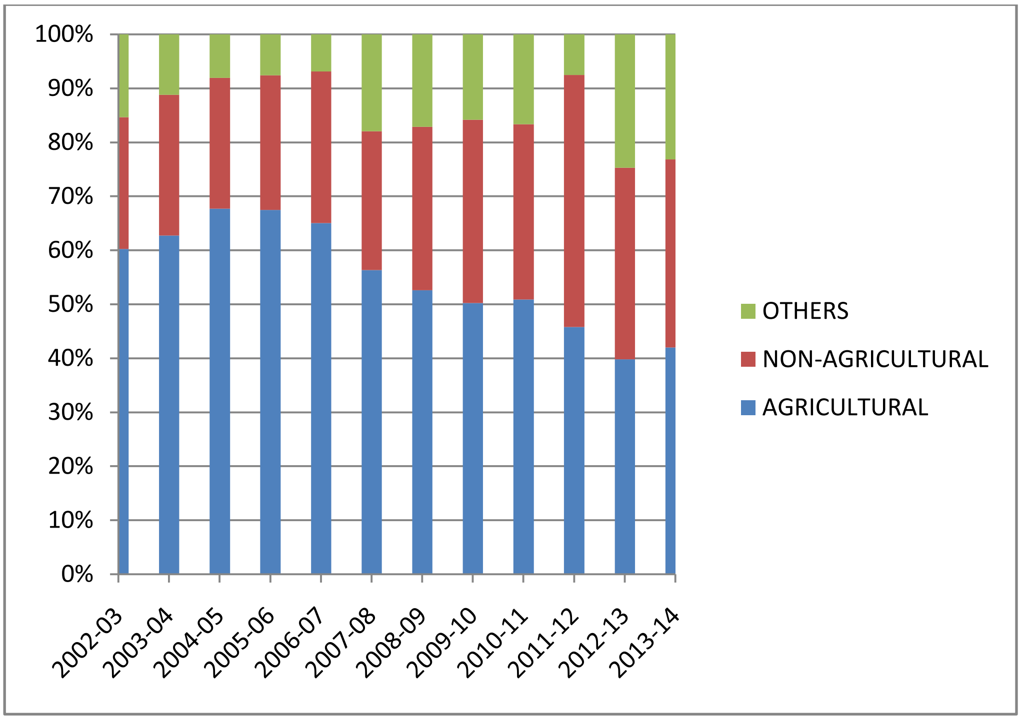
The Primary Agricultural Cooperative Societies were set up as conduits for providing rural credit. Thus, the loans advanced comprised primarily of agricultural loans. The total loans advanced by the PACs have grown from Rs 7510 crores in 1993-94 to Rs 171,420 crores in 2013-14.But this increase in the quantum of loans advanced conceals a disturbing trend with a declining share of agriculture and allied activities in the total loans.

In 2002-03 about 60% of the total loans advanced were for agricultural purposes. The period between 2002 and 2005-06 was marked by a sharp increase in the loans advanced for agriculture owing to the Government's policy to double credit to this sector. However, the period marked by the global meltdown saw a massive decline in the proportion of loans advanced to agriculture. From the year 2008 onwards, the PACs received assistance for recapitalization as advocated by the Vaidyanathan Committee but despite the financial infusion, the share of agricultural loans in the total loan portfolio nosedived to 39.84% in 2012-13 making only a marginal recovery in the subsequent year. (Table 5.10)

The shift away from agricultural loans to non-agricultural loans could be viewed as a move to hedge against risks by diversifying the loan portfolio. It could also be a consequence of the implementation of stringent prudential norms or the obligation to meet capital adequacy norms that view agriculture as a risky proposition. The adherence to such norms puts undue pressure on the PACs to accord primacy to profitability over their mandate to channelize credit to areas like agriculture. Either way this tendency cautions against a "strategic drift" away from the targeted clientele and the purpose of establishment.

CHART 5.3: COMPOSITION OF LOANS ADVANCED BY THE PACs

(in per cent)



SOURCE: Performance of Primary Agricultural Credit Societies, NAFSCOB

TABLE 5.10 COMPOSITION OF LOANS ADVANCED BY PACs

(In Rs Lakhs)

YEAR	AGRICULTURAL LOANS	% IN TOTAL	NON-AGRICULTURAL LOANS	% IN TOTAL	OTHERS	% IN TOTAL	TOTAL LOANS ISSUED
2002-03	2047686	60.23	830979	24.44	520921	15.32	3399586
2003-04	2202527	62.72	916725	26.10	392672	11.18	3511924
2004-05	2655756	67.73	948384	24.19	317032	8.09	3921172
2005-06	2895470	67.46	1070291	24.94	326204	7.60	4291965
2006-07	3226034	65.02	1394113	28.10	341128	6.88	4961275
2007-08	3247755	56.34	1480574	25.69	1035922	17.97	5764251
2008-09	3091533	52.59	1781584	30.31	1005558	17.11	5878674
2009-10	3762480	50.21	2547771	34.00	1183503	15.79	7493754
2010-11	4646981	50.90	2961131	32.43	1522270	16.67	9130382
2011-12	4912721	45.78	5010790	46.70	806511	7.52	10730023
2012-13	6449920	39.84	5745120	35.48	3995875	24.68	16190915
2013-14	7204335	42.03	5970171	34.83	3967581	23.15	17142087

SOURCE: Estimated from various issues of Performance of Primary Agricultural Credit Societies, NAFSCOB

DISTRICT CENTRAL COOPERATIVE BANKS (DCCBs)

The loans of the DCCBs are provided for both agricultural and non-agricultural purposes. Further depending on their duration, the loans can be broadly categorized as short term agricultural loans, medium term agricultural loans, short term non-agricultural loans and medium term non-agricultural loans. The short term agricultural loans are advanced for activities like seasonal agricultural operations (95.23%), marketing (1.17%) and activities like distribution (3.60%). The medium term agricultural loans are advanced for minor irrigation and animal husbandry. The short term loans for non-agricultural purposes are advanced for meeting expenditures like consumption, industrial activities and other allied activities.

The total loans advanced by the DCCBs have grown from Rs 28,491 crores in 1993-94 to Rs 217,941 crores in 2013-14. The agricultural loans comprised only 40% of the total loans advanced in 2002-03 but with the introduction of the "Doubling of Agricultural Credit Program" (DACP) by the Government in 2004, their share has grown in the total credit advanced. The loans accruing to agriculture continued to grow until the global financial crisis of 2007 after which its share declined marginally.

TABLE 5.11 (a): COMPOSITION OF LOANS OF THE DCCBs

(In Rs Crores)

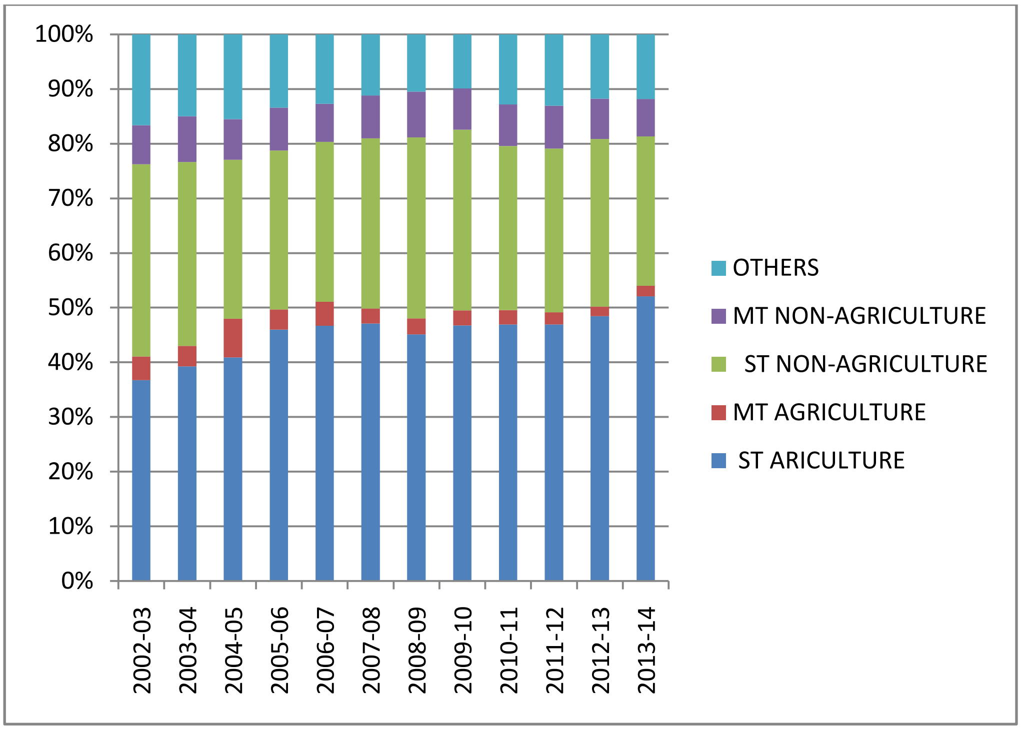
YEAR	Agriculture	% in TOTAL	Non-Agriculture	% IN TOTAL	Others	% IN TOTAL	Total
2002-03	24468	41.0	25259	42.3	9936	16.7	59663
2003-04	24729	43.0	24135	42.0	8630	15.0	57495
2004-05	31340	48.0	23838	36.5	10144	15.5	65322
2005-06	34621	49.7	25697	36.9	9339	13.4	69657
2006-07	39195	51.1	27775	36.2	9730	12.7	76700
2007-08	43536	49.9	33984	38.9	9763	11.2	87282
2008-09	42304	48.0	36550	41.5	9207	10.5	88061
2009-10	54707	49.5	44907	40.6	10915	9.9	110529
2010-11	68288	49.6	51848	37.6	17618	12.8	137754
2011-12	79940	49.2	61428	37.8	21190	13.0	162557
2012-13	105086	50.2	79685	38.1	24600	11.7	209371
2013-14	117650	54.0	74524	34.2	25767	11.8	217941

SOURCE: Basic Data on Performance of District Central Cooperative Banks, NAFSCOB

The loans to agriculture increased between 2009 and 2014 due to the implementation of schemes like the interest rate subvention scheme, agricultural loan waiver scheme and the financial recapitalization of the Vaidyanathan Committee that sought to benefit agriculture and the small and marginal farmers.

CHART 5.4: COMPOSITION OF LOANS OF DCCBs

(in per cent)



SOURCE: Basic Data on Performance of District Central Cooperative Banks, NAFSCOB

A closer scrutiny of the loan portfolios of the DCCBs (Table 5.11 (b)) reveals that this increase in credit to agriculture is on account of the short-term agricultural loans primarily the loans advanced for undertaking seasonal agricultural operations. However, there has been a steady decline in the proportion of medium term loans to agriculture from 7.1% in 2004-05 to 1.9% in 2013-14. Thus while the loans to agriculture have increased, capital formation in agriculture continues to suffer due to lack of funds for purposes like minor irrigation, animal husbandry etc.

The pattern of lending of DCCBs was also influenced by the following:

a) The refinance rates of the NABARD that charges interest at 4.5% per annum for seasonal agricultural operations but a higher interest rate for other loans (7.5%-10.5%),
b) The introduction of a separate credit window for the DCCBs and their affiliated PACs to seek direct refinance assistance in 2010-11. The quantum of outstanding credit through this line of credit increased from Rs 910 crore in 2012 to Rs 2011.61 cores in 2014. [62]

[62] NABARD.(2014)*Annual Report,2013-14*

TABLE 5.11 (b): COMPOSITION OF LOANS OF THE DCCBs

(In Rs Crores)

YEAR	AGRICULTURE				NON-AGRICULTURE				OTHERS	TOTAL
	SHORT TERM	% IN TOTAL	MEDIUM TERM	% IN TOTAL	SHORT TERM	% IN TOTAL	MEDIUM TERM	% IN TOTAL		
2002-03	21883	36.7	2585	4.3	20996	35.2	4263	7.1	9936	59663
2003-04	22595	39.3	2134	3.7	19357	33.7	4778	8.3	8630	57495
2004-05	26727	40.9	4613	7.1	19041	29.1	4798	7.3	10144	65322
2005-06	32028	46.0	2594	3.7	20246	29.1	5451	7.8	9339	69657
2006-07	35819	46.7	3376	4.4	22421	29.2	5354	7.0	9730	76700
2007-08	41137	47.1	2399	2.7	27153	31.1	6830	7.8	9763	87282
2008-09	39745	45.1	2559	2.9	29148	33.1	7401	8.4	9207	88061
2009-10	51682	46.8	3025	2.7	36576	33.1	8330	7.5	10915	110529
2010-11	64604	46.9	3684	2.7	41351	30.0	10497	7.6	17618	137754
2011-12	76311	46.9	3629	2.2	48645	29.9	12783	7.9	21190	162557
2012-13	101416	48.4	3670	1.8	64233	30.7	15453	7.4	24600	209371
2013-14	113493	52.1	4157	1.9	59560	27.3	14964	6.9	25767	217941

SOURCE: Basic Data on Performance of District Central Cooperative Banks, NAFSCOB

STATE COOPERATIVE BANKS (StCBs)

The composition of loans and the pattern of lending of the StCBs are similar to the DCCBs. However due to their position at the apex, the StCBs have easier access to funds through grants and refinance facilities from the Government, Commercial Banks and NABARD. The total loans advanced by the StCBs have grown from Rs 22399 crores in 1993-94 to Rs 110208 crores in 2013-14.

Like the DCCBs, the share of agricultural loans of the StCBs constituted only 38.6% of the total loans advanced in 2002-03. The agricultural loans rose in 2003-04 after the droughts of the previous year and the failed monsoons, after which there was a fall in their share in the total advances.

With the implementation of the Prime Minister's relief package[63] in 2006-07 the share of agricultural advances increased briefly but declined again following the global economic crisis. The rehabilitation package introduced in 2006 was further extended in 2008 by the Union Government for two more years. The rise in the agricultural loans (especially short term loans) in 2011-12 was on account of an additional refinance of 10% provided to the Cooperative Banks for that year. In general, the period after 2009-10 saw a phenomenal growth in the share of agricultural loans to almost 70% of the total loans advanced in 2013-14. (Table 5.12 (a))

[63] The Prime Minister's Relief package was introduced in 2006-07 to provide aid and relief to farmers of 31 distressed districts in states like Andhra Pradesh, Karnataka, Kerala and Maharashtra. The scheme entailed interest waiver on farmer loans as well as rescheduling of debts.

TABLE 5.12 (a): COMPOSITION OF LOANS OF StCBs

(In Rs Crores)

YEAR	AGRICULTURE	%	NON-AGRICULTURE	%	OTHERS	%	TOTAL
2002-03	15131	38.6	22363	57.0	1709	4.4	39203
2003-04	16090	46.2	17893	51.3	881	2.5	34864
2004-05	17708	40.0	17057	38.5	9559	21.6	44325
2005-06	21078	43.2	19067	39.1	8659	17.7	48803
2006-07	23872	50.7	16122	34.3	7075	15.0	47069
2007-08	23464	44.0	19663	36.9	10186	19.1	53314
2008-09	27326	52.7	21370	41.2	3170	6.1	51866
2009-10	25508	42.7	33378	55.8	898	1.5	59784
2010-11	38922	56.8	27593	40.3	1966	2.9	68481
2011-12	49012	60.1	30679	37.6	1832	2.2	81523
2012-13	55603	61.8	32219	35.8	2139	2.4	89961
2013-14	77586	70.4	30599	27.8	2022	1.8	110208

SOURCE: Basic Data on Performance of State Cooperative Banks, NAFSCOB

But like the DCCBs, the rise in agricultural loans are on account of short term loans while the advances for purposes like minor irrigation and animal husbandry have fallen from 5.9 % of the total in 2003-04 to 1.3% in 2013-14.

The lending patterns of the StCBs can be better understood in the light of various policy measures that were undertaken during this period. Some of them are listed below:

a) The disproportionate rise in the proportion of short term loans could be attributed to the Government's decision to provide crop loans (upto Rs 3 lakhs) to farmers at 7% through the interest subvention scheme of 2007-08. This scheme was extended further in 2011-12 owing to the natural calamities affecting various parts of the country.
b) The interest subvention scheme was facilitated by the NABARD that provided refinance facilities to the StCBs and the DCCBs at 3 %-4.5% per annum. Both the StCBs and the DCCBs also benefited by refinance facilities at concessional rates for other short-term activities like marketing of crops, short term agricultural loans, pisiculture, provision of working capital to weavers etc.[64]
c) The Doubling of Agricultural Credit program (2004) that sought not only to raise the quantum of agricultural credit but also entailed debt relief measures, waivers and financial assistance to the farmers.
d) The Prime Minister's Relief Package that was announced in 2006 that sought to benefit farmers of 31 districts across primarily four states. (Andhra Pradesh, Kerala, Karnataka and Maharashtra). This scheme was extended in 2008 and had disbursed a cumulative amount of Rs 719.92 crores by 31st March 2014.[65]
e) The Agricultural Debt Waiver and Debt Relief scheme (2008) that sought to benefit the small and marginal farmers by waiving off all their overdues on all short-term production loans[66]. The other farmers too benefitted by a "one- time settlement" scheme. It also made them re- eligible to seek fresh loans.

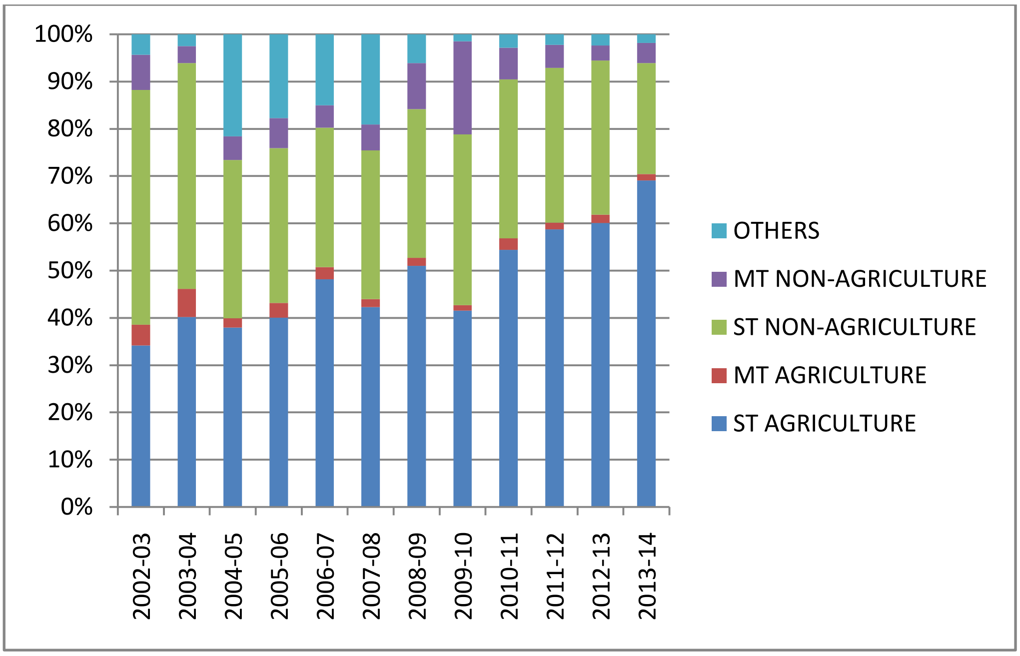
[64] NABARD.(2012).*Annual Report, 2011-12*
[65] NABARD. (2014).*Annual Report, 2013-14*
[66] The Short term production loans refer to crop loans that need to be repaid within 18 months.

f) The financial recapitalization scheme advocated by the Vaidyanathan Committee that strengthened the financial position of the rural cooperative credit structure.

g) The Expert Committee to examine Three Tier Short-Term Cooperative Credit Structure (2013) under P.Bakshi recommended that atleast 70% of the total advances of the DCCBS should be directed to agriculture. And if the StCBs and The DCCBs were found underperforming in meeting their targets they would be treated as Urban Cooperative Banks.[67]

CHART 5.5: COMPOSITION OF LOANS OF THE StCBs

(in per cent)



SOURCE: Basic Data on Performance of State Cooperative Banks, NAFSCOB

[67] The Committee recommended that if the StCBs and the DCCBs failed to provide atleast 15% of their total advances to agricultural credit in their operational area, they would be treated as Urban Cooperative Banks.

TABLE 5.12 (b) COMPOSITION OF LOANS OF THE StCBs

(in Rs Crores)

	AGRICULTURE				NON-AGRICULTURE						
YEAR	ST	% IN TOTAL	MT	% IN TOTAL	ST	% IN TOTAL	MT	% IN TOTAL	OTHERS	% IN TOTAL	TOTAL
2002-03	13391	34.2	1739	4.4	19446	49.6	2917	7.4	1709	4.4	39203
2003-04	14023	40.2	2067	5.9	16656	47.8	1238	3.5	881	2.5	34864
2004-05	16810	37.9	898	2.0	14835	33.5	2222	5.0	9559	21.6	44325
2005-06	19563	40.1	1515	3.1	15969	32.7	3097	6.3	8659	17.7	48803
2006-07	22663	48.1	1210	2.6	13884	29.5	2238	4.8	7075	15.0	47069
2007-08	22554	42.3	910	1.7	16771	31.5	2893	5.4	10186	19.1	53314
2008-09	26474	51.0	852	1.6	16332	31.5	5038	9.7	3170	6.1	51866
2009-10	24853	41.6	656	1.1	21607	36.1	11770	19.7	898	1.5	59784
2010-11	37271	54.4	1651	2.4	23045	33.7	4548	6.6	1966	2.9	68481
2011-12	47898	58.8	1114	1.4	26730	32.8	3949	4.8	1832	2.2	81523
2012-13	54076	60.1	1526	1.7	29353	32.6	2867	3.2	2139	2.4	89961
2013-14	76137	69.1	1449	1.3	25934	23.5	4665	4.2	2022	1.8	110208

Source: Basic Data on Performance of State Cooperative Banks, NAFSCOB (Various Issues)

Thus, the data suggests that although the advances to agriculture by the DCCBs and the StCBs have increased over time, the benefits have failed to percolate to the targeted clientele through the PACs. Also, the proportion of agricultural loans shrinks at every subsequent tier of the rural cooperative credit structure. So while the share of total advances to agriculture of the StCBs stood at 70% of the total advances, it accounted for only 54% for the DCCBs and 42% for the PACs. This could be because of the rising costs of borrowing that get added to the costs of borrowing funds in the form of interests and margins at every tier.[68] This implies that while it is easier for the StCBs to mobilize funds at lower costs due to its position as the apex body, the lower tiers usually receive these funds at greater costs. The higher costs of borrowing coupled with the obligation to comply with prudential norms and capital adequacy norms, induces risk averseness that leads to diversion of funds away from agriculture because of its risky nature and the associated costs of defaults. Thus, despite efforts of channelizing credit to agriculture, the rural credit cooperatives have failed to make much difference at the grass-root level.

5.3 DISPLACING THE INFORMAL SOURCES OF CREDIT

The Indian rural credit market has for long remained dominated by the informal sector led by the moneylenders who maintained a strong hold over the rural credit portfolios due to their familiarity with the local people and their flexibility in providing credit according to the rural needs. The informal sector for credit comprises primarily of moneylenders (agricultural and professional), traders, landlords and relatives. The authoritarian presence of the moneylenders at the helm of affairs in the village thwarted any attempts to dislodge the informal sector. The usurious and exploitative practices of the informal sector and the interlocking of markets trapped the rural borrower into a vicious cycle of debt and poverty. The growing agrarian distress triggered the Deccan Riots of the nineteenth century wherein the peasants protesting the unfair practices of the moneylenders destroyed decrees, documents and

[68] The data from NABARD reveals that in 2010-11, the StCBs as a group earned a financial margin of 1.92 % while the DCCBs earned a margin of 2.51%. These costs and margins at every subsequent tier raises the costs of borrowings for the ultimate borrowers of the PACs.

ledgers in possession of the moneylenders to free themselves of their bondage. This led to the establishment of institutions that could protect the rural population from the exploitative practices of the moneylenders. Thus, the emergence of the Cooperatives was a response to the victimization of the rural poor and the need to provide an alternate channel of credit that could dislodge the informal sector.

During the colonial times and immediately after independence, there was great reliance on the informal sources of credit that accounted for almost 93% of the total credit advanced. The Cooperatives that had been into existence for almost fifty years accounted for only 3% of the total rural credit. This was partially because of the neglect of the British rulers, autocratic attitude of the Registrars of the Cooperative societies and the dominance of the ruling elites that prevented the Cooperative movement from gathering momentum and spreading to the rural masses. The All India Rural Credit Survey (1951) took cognizance of this and with active State intervention helped the Cooperatives consolidate their position in disbursing institutional credit. Consequent to this, the share of the cooperatives rose to 9.1% in the total rural credit but the monopoly and the stranglehold of the moneylenders remained unchallenged due to the reasons discussed earlier. (Chapter 1) The All India Rural Credit Review Committee (1966) reckoned that the cooperatives lacked adequate resources to meet the then growing credit needs and thus recommended a coordinated development of the cooperatives with the commercial banks to bridge the demand for credit.

Thus in the year 1969, the country ushered into the "social and development banking phase" with bank nationalization, directed credit program, lead bank scheme, expansion of rural bank branches being some of the policy initiatives aimed at dislodging the deep rooted informal sector.

TABLE 5.13 : SHARE OF BORROWING OF RURAL HOUSEHOLDS (SOURCE-WISE)

(in per cent)

YEAR	1951	1961	1971	1981	1991	2002	2012
Institutional Agencies	**7.2**	**14.8**	**29.2**	**61.2**	**64**	**57.1**	**56**
Government	3.3	5.3	6.7	4	5.7	2.7	1.2
Co-op. Society/bank	3.1	9.1	20.1	28.6	18.6	28	24.8
Commercial bank incl. RRBs	0.8	0.4	2.2	28	29	22.7	25.1
Insurance	--	--	0.1	0.3	0.5	0.3	0.2
Provident Fund	--	--	0.1	0.3	0.9	1	0.1
Others institutional agencies*	--	--	--	--	9.3	2.4	4.6
Non-Institutional Agencies	**92.8**	**85.2**	**70.8**	**38.8**	**36**	**42.9**	**44**
Landlord	1.5	0.9	8.6	4	4	1	0.7
Agricultural Moneylender	24.9	45.9	23.1	8.6	6.3	10	5
Professional Moneylender	44.8	14.9	13.8	8.3	9.4	19.6	28.2
Traders and Commission Agents	5.5	7.7	8.7	3.4	7.1	2.6	0.1
Relatives and Friends	14.2	6.8	13.8	9	6.7	7.1	8
Others	1.9	8.9	2.8	4.9	2.5	2.6	1.9
Total	100	100	100	100	100	100	100

SOURCE: All India Rural Credit Survey (1951), NSSO, All India Debt and Investment Surveys (Various Issues), Key Indicators of Debt and Investment in India (2014)

NOTE-The other institutional agencies include financial corporations and other financial companies.

By 1971, the Cooperatives' share in rural credit had risen to 20.1% with the share of the commercial banks growing to 2.2%. Corresponding to this, the share of the informal sector declined to 70.8% with a drastic decline in the share of the moneylenders. (Table 5.13)

With the State's active interventionist role and the social banking practices gaining ground, in 1981, the informal sector's share was reduced to only 38.8%. The Cooperatives and the Commercial Banks succeeded in overtaking the moneylenders in meeting the credit needs of the rural households. The formal institutions of credit continued to make significant strides in reaching out to the rural population and the share of the informal sector declined further to 36% in 1991.

However, the nineties witnessed a paradigmatic shift in favor of neo-liberal policies. The Narasimham Committee Report in consonance with the neo-liberal economic reforms dismantled the social banking structure on grounds of financial soundness and "efficiency". This sought to completely reverse all the achievements of the last two decades with a decline in the number of loan accounts and rural branches of banks. The most disturbing outcome of the neo-liberal reforms of the nineties was the re-emergence of the informal sector (especially the moneylender) after being reduced to almost 36% during the social and development banking phase. This was attributed majorly due to the retreat of the Commercial Banks in purveying rural credit. In 2012, the Commercial Banks made a marginal recovery but the subsequent weakening of the cooperatives strengthened the position of the moneylenders.

Thus, the Cooperatives had managed to curb the reliance of rural households on the informal sector for credit (primarily the moneylenders) during the social banking era aided by the Government and the Commercial Banks. However, with the policy reforms of the nineties that led to a rationalization of bank branches and diversion of credit away from the rural areas, the rural population has begun to revert to its old practices of borrowing from the moneylenders and is likely to slip back into the trap of debt and poverty. And although, the Cooperatives still continue to be an important agency of rural credit, their role has been overshadowed by the informal sector.

Some of the reasons why the informal sector offers stiff resistance to institutional credit are:-

- The familiarity of the moneylenders with the local population and conditions and their presence in the rural countryside helps reduce the costs of transactions and monitoring. The moneylender would often assume the role of a trader, landlord or an employer and through the nexus of the interlocked markets use his position for exacting a payment from the borrowers. (Shah, Rao & Shankar, 2007)
- A large proportion of the demand for credit of the rural borrowers arises out of expenses like societal obligations, health and education and other consumption needs which are not met by the formal institutions of credit. Hence, despite the presence of the formal institutions of credit in rural areas, there is a greater reliance on the informal sector for meeting these credit requirements.
- The demand for collateral, tedious documentation and procedures followed by the formal banking sector dissuades the rural poor from approaching these institutions for credit. In contrast, availing loans from the informal sector was easier and quicker for the rural borrowers.

5.4 EMERGENCE OF MICROFINANCE

It is believed that the retreat of the State from the provision of rural credit and the inability of the formal institutions of credit to reach out to the marginalized sections of the society paved the path for microfinance. The RBI defines microfinance as "the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their living standards."[69]

The microfinance programme in India rose to prominence in the backdrop of neo-liberal reforms and was influenced by the successful experiences of other developing nations like Bangladesh, Indonesia, Philippines and Thailand.

[69] RBI. (2009).*Report on Trends and Progress in Banking in India, 2008-09* (pp 148)

Prior to microfinance, it was believed that the high risk, uncertainty and costs associated with the lending to the rural poor deterred the formal institutions from lending to them. On the other hand, the borrowers too were discouraged from approaching the formal institutions of credit due to factors like high costs (transaction costs, bribes etc), demand of collateral, lack of requisite documents and the reluctance of banks to finance consumption expenditures. It was this institutional gap that was exploited by the informal sector to maintain their hold on rural credit.

Microfinance institutions, sought to alleviate these problems through group formation which served the twin purpose of collateral and monitoring and reduced the costs arising from the asymmetry of information. It also reduced substantial time and costs on account of minimal documentation. Thus many proponents of micro-finance hailed it as the system of mass outreach as it was believed to be an embodiment of the reliability of the formal institutions with the flexibility and convenience of the informal sources. (Basu & Srivastava, 2005)

In India, the microfinance programme can be broadly classified as consisting of the Self Help Group-Bank Linkage (SBL) initiative and the establishment of microfinance institutions. (MFIs)

5.4.1. SHG-BANK LINKAGE (SBL)

The SHG –Bank linkage started with small NGOs that organized the rural poor into Self-Help groups in the 1980s. However, their operations were limited in scale and were confined to a few southern states. Realizing their immense potential, the SHG-Bank linkage initiative was introduced in 1992 by NABARD. This model that is unique to India began as a pilot project with 500 SHGs in1992 and has grown to become the largest microfinance programme in the world with 8 million SHGs in 2014-15.[70]

The programme was envisaged to extend banking facilities to the poorer sections of the society that was considered beyond the purview of the formal banking sector. In 1996, RBI classified the self-help group linkage programme under the Priority Sector Lending activity.

[70] NABARD.(2015).*Status of Microfinance in India, 2014-15*

The SHG-Bank linkage is a hybrid variety of financial intermediation wherein the formal credit institutions in close alliance with the SHGs attempt to advance credit and other financial services to the people. It entails formation of small groups, inculcating in them the habit of thrift and then linking the group to a bank. The savings and the guarantee of the group are used as collateral for accessing funds from the banks. Depending on the performance of the members and the group, the bank increases the quantum of funds sanctioned to the group. The funds are then distributed and rotated among the members usually at 24 per cent per annum

The SHG-Bank linkage can be further classified into two models. While in the first model the Banks are involved directly in the process of group formation, training and the provision of loans to the SHGs, in the other model there exists an agency (usually an NGO) that mediates between the rural poor and the banks. It is this agency that is responsible for organizing the rural borrowers into groups, disciplining them and then facilitating credit provision.

The popularity of the SBL initiative reflects the vested interests of the banks as it serves the twin purposes of garnering quick profits at lower risks of defaults (than their regular portfolios) and also fulfills their "social responsibility criterion". Basu and Srivastava (2005) note that SHG lending reported default rates of less than 1 per cent as opposed to 11-12% in the regular lending by banks. A report by the RBI reveals that the recovery rates of all the bank groups (other than private banks) through the SHG lending programme was as high as 80-94 per cent while for the private banks it was above 95 per cent.[71] Another study by NABARD confirms that the transaction costs incurred in such a lending programme were lower by 21-41% than the regular lending practices of the banks.[72]

5.4.2 MICROFINANCE INSTITUTIONS (MFIs)

The MFI model of microcredit is more popular internationally and rose to prominence in India only after the successful expansion of the SBL programme. The MFI model in the country consists of different forms like:

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[71] RBI. (2009).*Report on Trends and Progress of Banking in India, 2008-09*

[72] NABARD.(2002).*Institutional Credit to Indian Agriculture : Defaults and Policy Actions. Occasional Paper 23*

- trusts registered under the Indian Trust Act, 1882/Public Trust Act, 1920;
- societies registered under the Societies Registration Act, 1860;
- Co-operatives registered under the Mutually Aided Cooperative Societies Acts of the States; and
- nonbanking financial companies (NBFC)-MFIs, which are registered under Section 25 of the Companies Act, 1956 or
- NBFCs registered with the Reserve Bank."[73]

The MFIs are usually driven by the pursuit of profits and view the rural credit market as an avenue for unexploited commercial gains. The mass suicides in Andhra Pradesh in 2010 brought to light the unethical banking practices and coercive recovery mechanisms of these institutions that adversely affected their business operations. Hence, the RBI fixed interest rates, processing fees and also capped the margins of the MFIs. The operations of these institutions are now regulated by the MUDRA Bank. This model is expected to expand further with the emergence of the NBFC-MFI linkage and with the classification of loans to these institutions as contributions to priority sector.

5.4.3 BANKING CORRESPONDENT/ BANKING FACILATATOR MODEL (BCs/BFs)

In order to enhance financial and banking facilities to the rural population in the country, the RBI advocated the Banking Correspondent/ Banking Facilitator model in 2006. Under this model, the Banks were permitted to form alliance with NGOs or other agencies to provide financial and banking facilities to the rural population

In this model, the Business facilitators are vested with the responsibility of providing "non-financial services" like identification of borrowers, processing of documents etc, while the Banking Correspondents are responsible for carrying out "financial services" like disbursal of loans, collection of interest or installments, sale of financial products like micro-insurance etc.

[73] RBI. (2008) *Report on Trends and Progress in Banking in India, 2007-08*

However, this model that aims at lower transaction costs and ease of credit access to its clients, (like earlier experiments in the form of pygmy deposits and mobile banks) runs the risks of frauds, leakages and trust issues.

5.4.4 WHY MICROFINANCE IS NOT "THE ALTERNATIVE" IN RURAL CREDIT

There is a lot of euphoria surrounding microcredit and many believe that it may even be an alternative to the formal institutions of credit in reaching out to the rural poor. However, today both the SHGs and the MFIs are dependent on these institutions for their funds and growth and hence their own success is crucially linked to the existence and performance of these institutions of credit. This claim also seems fairly exaggerated on the following grounds:

- The micro credit programme (including the SBL Linkage programme) is limited in its coverage and is concentrated in four major southern states. It fails to reach out to other backward regions of the country and is no match for the expansive network of the Cooperatives. By 31st March 2014, more than 74.30 lakhs SHGs were linked under the SHG-Bank linkage scheme covering over 9.7 crore households.[74] However these figures too appear dwarfed as compared to the Cooperative institutions with a membership of over 12 crores.
- The claim of lower transaction costs under the micro-credit programme too stands refuted as both the SHGs and MFIs cannot match the economies of scale of the formal credit institutions. The administrative costs of the MFIs were found to escalate with an increase in scale and were positively correlated to the repayment rates. The rise in the operating costs was shifted to the borrowers in the form of higher interest rates. (Swaminathan, 2007).
- The MFIs charge exorbitant rates of interest on their loans. The high cost of borrowing reduces the effective return to the borrower which results in lower incomes and savings and further hinders capital

[74] NABARD.(2014),.*Status of Microfinance in India,2013-14*

formation. The high interest rates at which the funds are made available also invites high rates of defaults.

- The loan amount sanctioned under the microcredit programme is usually very small to undertake large investments. This hinders productive investments with long gestation periods due to prompt repayment clauses built into the loan conditionalities. Thus, instead of repaying the loans through the stream of income generated by the investment, most borrowers are forced to borrow from other sources (like the moneylenders) to meet their debt obligations, thus getting deeply entrenched in the vicious trap of debt. This has further worsened the situation of the poor which is evident from the rising suicide rates in the rural areas.
- The high rates of recovery disguise the abusive and exploitative loan recovery practices. The unfortunate episode of suicides in Andhra Pradesh in 2010 is a reminder of the ramifications of the unchecked tendencies of microfinance.
- Many studies have revealed that the microcredit programme can be extremely exclusionary as the acutely poor and vulnerable are left out in the process of group formation as they are considered bad credit risks. (Hermes & Lensink, 2007)
- Most of the banks under the microfinance programme tend to advance credit in bulk to the affiliated SHGs/NBFCs/MFIs to further lend to the target group due to staff shortages and due to the non-viability of providing several small loans. These funds are often diverted, misused or misappropriated. Hence there is an inherent risk of frauds and scams under such an arrangement.[75]
- Many have advocated the Cooperatives-SHG linkage but this alliance too is beset with problems, the most obvious being the non-compatibility of goals. The overriding objective of the Cooperatives is the socio-economic growth and development of its members, unlike the microfinance institutions that are motivated by commercial interests.

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[75] Planning Commission (2011).*Report of Working Group on Outreach of Institutional Finance, cooperatives and Risk mitigation*

Thus, despite its claims, it is quite evident that the primary objective of microfinance is not rooted in social development or poverty eradication but is driven by commercial viability and profitability. And although the microfinance programme has contributed to women empowerment, it has failed in contributing to the larger goals of equity and development. Due to its inability to displace the informal sector, address market imperfections or bring about technological change, it is safe to conclude that microfinance is definitely not an alternative to the formal institutions of credit especially now when their own fates are tied to these institutions. (Swaminathan, 2007) Hence the rural credit policy should be based on a strong banking structure instead of inherently unsustainable microfinance institutions. In this regard, it becomes even more important for the State to strengthen and support the Cooperatives to tap their immense potential in reaching out to the rural poor through their expansive network and their commitment to achieve the goals of socio-economic development.

CONCLUSION

The study was an attempt to outline the broad contours of the evolution of the rural cooperative credit institutions in the country, to address the various issues pertaining to them and the role played by them in integrating the weak and marginalized sections of society into the larger development strategy through the provision of formal credit.

The Cooperatives were central to the development process after independence, and with the cooperative movement gathering momentum during the social banking era, they emerged as important conduits for credit geared to achieving socio-economic development. However, the neo-liberal reform policy-shift of the nineties not only undermined the importance of these institutions but also subsequently led to their deterioration. With the State's role being viewed as "intrusive and inimical to growth", there was a move to curtail all forms of support extended by the State to the Cooperatives. The omnibus reforms entailed a homogenization of financial structures that included implementing prudential norms and bringing the Cooperatives under a common Model Cooperative Law in blatant disregard of the historic evolution and the specific character and objectives of these institutions.

The lackadaisical attitude of the authorities resulted in the subsequent neglect of the Cooperatives. This coupled with the imposition of prudential norms weakened the foundations of the credit cooperatives further and led to a systemic atrophying of these institutions.

Many Committees were constituted during this period to address this problem but while some of them were rendered ineffective due to bureaucratic inaction, the others made only cosmetic changes without addressing the inherent financial fragility of these institutions. The Task force on the Revival of Cooperative Credit Institutions constituted in 2004 and headed by Prof. A. Vaidyanathan was a departure from its predecessors as it introduced a comprehensive package of reforms along with a financial recapitalization plan. However, most of the recommendations of this Committee were in keeping with the neo-liberal agenda.

Some of its recommendations like the retirement of State equity, centralization of banking operations and the implementation of capital adequacy norms would not only deteriorate the resource base of these institutions further but also have far reaching implications for the long term sustainability and functioning of the rural credit cooperative structure.

In prescribing prudential and regulatory norms for the Cooperatives, many Committees failed to recognize that these are specialized institutions rooted in local conditions and the local environment. Given the nature of their lending and the targeted clientele, there are limits placed on their operation, risk diversification and resource mobilization which constrains their growth and sustainability. Hence subjecting them to stringent norms and regulations would severely impair their functioning and curtail their autonomy. To make matters worse, the imposition of capital adequacy norms (CRAR) pre-empts a part of the scarce resources in the form of regulatory capital that earns no interest. The problem is further compounded by raising the CRR rates of the StCBs and DCCBs which also do not earn any interest on these balances. Thus the imposition of these counter-productive regulatory norms on these institutions coerces them to allocate resources to those sectors where they earn higher returns while compromising on their objectives of reaching out to the weak and marginalized sections.

In the neo-liberal regime, the focus of the discourse on the Cooperatives shifted to their financial performance rather than their role in pursuing the goals of financial inclusion, disbursal of agricultural credit and reducing the dependence on the informal sector of credit. In this context, this study attempted to make an assessment of both these parameters and made the following observations:

a) The financial performance of the Cooperatives has shown appreciable signs of improvement after the reforms and the financial recapitalization advocated by the Vaidyanathan Committee.
b) In terms of financial inclusion, the Cooperatives have shown an active participation by the rural artisans and the small and marginal farmers. However, in terms of ensuring financial inclusion of the socially

disadvantaged sections, the PACs failed to overcome their elite bias or transcend the caste barrier. The SC/ST community was not adequately represented in the PACs either in terms of members or borrowers. The bias was evident not just in the low borrower-member ratio of the SC/ST group but also in their access to credit from these institutions which was reflected in the skewed distribution and the size of loans accruing to these groups.

c) The share of Cooperatives in providing institutional credit to agriculture has declined from its peak of 62% in 1992-93 to 16% in 2013-14. In terms of access to credit of the rural borrower, the Cooperatives continued to be a dominant agency; however, their share in agriculture has declined gradually due to a diversification in their lending portfolios as necessitated by prudential norms. .

d) Although the credit advances of the StCBs and the DCCBs to agriculture have grown from 38.6% to 70.4% and 41% to 54% respectively between 2002-03 and 2013-14, the benefits failed to percolate to the targeted clientele through the PACs whose credit advances to agriculture declined from 60% in 2002-03 to 42% in 2013-14. The sectoral shift in credit in favor of non-agricultural loans could be viewed as a move to hedge against risks by diversifying the loan portfolio. It could also be a consequence of the obligation to meet prudential norms based on the perception that agriculture is a “risky proposition”, which prompts the diversion of funds away from agriculture to sectors with greater returns. Either way it cautions against a “strategic drift” away from the targeted clientele and the purpose of establishment.

e) The growth in agricultural credit too was disproportionally in favor of short-term loans with the medium term loans constituting only a miniscule share of the total loans advanced which would adversely affect capital formation in agriculture.

f) The primary objective of the credit Cooperatives as institutions was to supersede the informal sector. Although the cooperatives managed to curb the growth of this sector with the support of the Commercial Banks during the social banking era, they failed to supplant it. Today, although the Cooperatives act as an important agency of formal credit in the rural areas, their role has been overshadowed by the informal sector.

g) Although the reforms sought to strengthen the Cooperatives, they have in practice only weakened their resource base through the implementation of stringent prudential norms and regulations. The reform period also witnessed a reduction in resources for credit disbursal through a disproportional shift in funds to investments with a corresponding decline in the share of loans advanced. It significantly altered the lending patterns of the Cooperatives by according primacy to projects based on commercial success over the larger goals of development and equity. Thus, sectors like agriculture and the weak and the marginalized sections of the population that were earlier the targeted beneficiaries of the cooperatives lost out eventually as a result of the "reforms".

Here it is important to note that the turnaround in the financial performance of the rural Cooperative structure was driven by the following factors:

a) The reforms introduced by the Vaidyanathan Committee in the form of technical change, human resource development and capital infusion resulted in a considerable improvement in financial indicators like productivity, viability etc. It also helped strengthen the capital base of the Cooperatives not just through capital infusion but also by attracting depositors by extending voting rights to them.
b) But the improvement is largely an outcome of the Cooperative Banks deviating from their stated objectives and their role as specialized agents to disburse credit to agriculture and the weaker sections of the society. The Cooperative banks seem to have lost sight of their mandated objectives and their "Cooperative character" and have metamorphosed into profit-seeking entities compelled by the dogmatic implementation of prudential norms and regulations.
c) Another word of caution that needs to be expressed is that the turnaround in most of the financial indicators like profitability, recovery rates, decline in NPAs etc have come as result of a "one-time

recapitalization" and due to the initiatives of the Government in the form of the Agricultural Debt Waiver and Debt Relief scheme (2008), interest subvention scheme etc to combat the global economic downturn and the natural calamities that affected the country. But most of these initiatives were "once for all" solutions and only temporarily resolved the inherent weakness of the Cooperatives. Some indicators (like the increased reliance on borrowings) have begun to show signs of weakness after a brief period of recovery that actually hints at the possibility of a worsening situation for these institutions in the future in the absence of State support. Thus, it is too early to ascertain whether the turnaround in the financial indicators of the Cooperatives is sustainable and feasible in the long run with the minimal support from the State.

In this background, the other issues that warrant immediate attention are listed below:

FUTURE OF THE COOPERATIVES

a) The rural credit Cooperatives particularly the PACs have for long been confronted by the problem of a poor resource base. This problem is likely to worsen in the future as the Vaidyanathan Committee mandated the retirement of State equity. Another setback to the StCBs came with an RBI circular (5^{th} June 2014) that derecognized the deposits of the DCCBs with the StCBs as SLR requirements. Currently, a major share of the resources of the StCBs comprises of deposits from the DCCBs, but after this amendment, the resource base of the StCBs is likely to be shrink further resulting in a greater reliance on borrowings.

b) The credit creation capacity of the cooperatives is adversely affected by the implementation of prudential norms in the form of capital adequacy norms that pre-empt resources. Besides this, these norms have also resulted in the diversion of funds from disbursal of loans to investments. This tendency is further fuelled by a new RBI Circular (5^{th} June 2014) that mandates the DCCBs and the StCBs to invest in

Government securities. Not only will it further shrink the resources available for credit disbursal but will also force the Cooperatives to venture into unfamiliar terrain. The outflow of funds from the apex tier of the Cooperatives would also hamper the credit flow to the lower tiers and the viability of these banks.

c) The Vaidyanathan Committee made provisions for the PACs to seek refinance or financial aid from any institution governed by the RBI but the failure to amend corresponding laws like the Banking Regulation Act has effectively rendered these provisions meaningless. The borrowings and refinance facilities of the rural cooperative structure could also suffer a major setback as NABARD (the principal refinancing agency of the credit cooperatives) too is faced with a severe resource crunch due to inadequate support from the Central Government and RBI especially after the withdrawal of the General Line of Credit facility from December 2006.[76] In the absence of adequate State support, the NABARD has resorted to the dangerous tendency of raising resources from market borrowings through Corporate Bonds, Commercial Papers, Certificate of Deposits etc.[77] This is in turn is going to adversely affect the borrowings and the interest structure of the Cooperative Banks. (Mitra, 2014)

d) Another reason for the weak resource base of the Cooperatives is that the retained earnings of these institutions are taxable under the Cooperative Laws. Thus, the cooperatives are dis-incentivized to retain their earnings to evade taxes. Hence, the Cooperatives should be exempted from paying income taxes to facilitate their growth and development through the accretion of reserves.

e) The network of PACs, despite its reach and its membership, is not covered by the Deposit Insurance and Credit Guarantee Corporation (DICGC) which is a prime reason why it fails to instill faith and confidence among the depositors and results in low deposits and resources. It also explains the diversion of funds to other institutions despite the rural presence of the PACs. In view of this, the NABARD

[76] GOI. (2009).*High Powered Committee on Cooperatives*
[77] NABARD.(2014).*Annual report ,2013-14*

has formulated an “Institutional Protection and Deposit Safety Scheme” for the depositors of the PACs. If this is implemented promptly then the Cooperatives could get rid of the problem of being “borrower-centric institutions” and could encourage mutuality in terms of savings and borrowings from its members.

f) Although the technical upgradation of the StCBs and DCCBs is a welcome development, however, it needs to be received with caution in the light of the recent scams and frauds. By March 2015, there were 2589 reported cases of scams of the StCBs/DCCBs amounting to Rs 877.7 Crores (Gandhi, 2016) which recommend the need for reassessing internal control and risk management systems.

Thus, these issues hint at an underlying tendency which if left unchecked, could threaten the entire edifice of the rural cooperative structure. It also indicates that the turnaround could just be a brief interlude before the systemic collapse of the Cooperatives. This country has seen a similar decimation of the development finance institutions in the past and is witness to the ramifications of reckless adherence to neo-liberal reforms and regulations. Thus, it needs to draw lessons from the past and address these impending issues.

Also, if the Cooperatives fail to revive, then not only would they have faltered in their role as agents of social transformation but also as commercial financial enterprises. The worst affected by such an outcome would be the weak and the marginalized segment of the population for whom these institutions have served as an important source of formal credit. Thus, the Government should encourage and support the Cooperatives to sustain their growth and development. The Cooperatives in turn need to reclaim their role in serving the masses and accord primacy to its mandate of ensuring socio-economic development over myopic goals of garnering quick profits. The active membership and participation of the weaker and the marginalized sections also needs to be encouraged to realize the goals of financial inclusion. Hence the verdict of the Royal Commission (1928) -“If the Cooperatives fail, there will fail the best hope of rural India” holds even more relevance in these times.

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