Inclusive Credit and the Co-operatives in Post-war Northern Sri Lanka: Analysing the Expansion and Regulation of the Co-operative Credit System

A. Kadirgamar
University of Jaffna
ahilank@univ.jfn.ac.lk

INTRODUCTION

This paper addresses the possibilities of the co-operative credit system consisting of Co-operative Rural Banks (CRB) and Thrift and Credit Co-operative Societies (TCCS) towards providing credit for those excluded and/or exploited by the financial system in post-war Northern Sri Lanka. Such inclusive and equitable access to credit through the Northern co-operative system, with its vibrant history in the country, has gained national attention following the microfinance indebtedness crisis in the Northern Province. In particular, the Ministry of Finance through the national budgets of 2018 and 2019 made significant allocations towards co-operatives in the Northern Province marking a significant shift towards co-operative credit. In fact, the “Aravanaippu Loan” scheme was initiated with a Treasury contribution of LKR 292 million and matched by LKR 144 million in co-operative funds have circulated over 40,000 small loans since the inception of this programme in late 2018. Furthermore, the Central Bank of Sri Lanka revamped regulations, including an interest rate cap on microfinance of 35% in December 2018, restricting the role of finance companies in tandem with these co-operative initiatives in the North. In this context, with credit co-operatives in the Northern Province gaining attention with the rural indebtedness crisis over the last decade, and a revival of interest in co-operatives more generally in Sri Lanka, the issue of inclusive and equitable access to credit is of significance.

The objectives of this paper are to analyse the recent interventions of credit co-operatives in the Northern Province with respect to those who cannot access the commercial banking system and those who are affected by predatory microfinance schemes of finance companies. The paper will also articulate the current state of financial stability and mechanisms of regulations, including the setting of interest rates for credit co-operatives, given that they are regulated by the Department of Co-operative Development and not the Central Bank of Sri Lanka.

Finally, the paper proposes elements of a model of inclusive credit through the co-operative credit system at the provincial level focusing on this case in the Northern Province.

METHODOLOGY AND FINDINGS

Quantitative and qualitative analysis based on secondary sources and first-hand engagement with credit co-operatives is central to a political economic methodological approach of this paper analyzing the co-operative credit system. The political economic methodology considers broader social relations related to livelihoods and rural income streams in relation to credit co-operatives, addressing both sociological concerns and financial factors in relation to access and disbursement of credit. The paper draws on data compiled from co-operative societies, the Northern Co-operative Development Bank (NCDB) and the Department of Co-operative Development of the Northern Province, and the Annual Reports of the Central Bank of Sri Lanka, to analyze the rural credit system in the Northern Province. In particular, the data set consisting of three years of data on the "*Aravanaippu* Loan" scheme and two years of data on the various loans provided by NCDB will be utilized to analyze the workings of the co-operative credit system. Secondary historical sources on the co-operative credit system are used to analyze the regulatory and interest rate setting mechanisms of credit co-operatives. Finally, the experience of working with credit co-operatives in creating rural credit schemes for livelihoods of financially excluded sections of society is used to articulate elements of a model of co-operative credit.

The findings from data collected with the expansion of co-operative credit in the Northern Province in recent years, signify the possibility of rapid ramp up and reach of credit to different regions, including isolated locations in the rural periphery. Such expansion is possible due to the presence of 110 CRBs and 580 village-level active TCCSs in the Northern Province; the total number of registered village level TCCSs are 1,404 societies many of which could be activated. This vast rural credit system provides a range of loans to members from emergency loans, livelihood loans for agriculture, fisheries and livestock, and self-employment loans. However, there are also limitations with credit co-operatives in terms of both inadequate staffing, including a limited number of field officers, and low salary scales affecting the motivation of staff. Furthermore, credit schemes are arbitrarily created and interest rates are set in an ad-hoc manner by the Board of Directors of each co-operative as well as through proposals by donors and Government bodies when grants are provided. Thus, interest rates for co-operative borrowings and lending are characterized by a broad spread ranging from 4% to 20% raising questions about the stability of the credit system. The reserves in the credit co-operatives in relation to their loan portfolios also drastically differ. Systematic programmes and mechanisms for researching and instituting banking practices for these credit co-operatives are lacking.

Secondary historical research on credit co-operatives provides critical input on regulatory and interest rate analysis of co-operatives towards building a model of co-operative credit regulation and interest rate setting that can create a stable and inclusive rural credit system. Monitoring of credit co-operatives and training of staff are crucial for better management and governance. Furthermore, there is a need for a central institution that looks into the financial stability of the credit co-operatives given that they don't come under the purview of the Central Bank of Sri Lanka.

CONCLUSIONS

The paper while considering the co-operative possibilities for inclusive and equitable co-operative credit recognizes the need for further research to understand the problems that could emerge with the expansion of the co-operative credit system. In particular, the current regulatory institutions for credit co-operatives have significant limitations and there is a need for new institutions internal to the co-operative movement that should be built to both regulate and set the benchmarks including interest rates for credit co-operatives. This study of the co-operative credit system in the Northern Province has implications for inclusive and equitable credit in the post-war Eastern Province as well as revamping the co-operative credit system nationally; historically, the North has had a vibrant co-operative movement that has provided insights for the national co-operative movement. Finally, with concerns raised about the exploitative character of microfinance in recent studies internationally, the credit co-operative alternative to address rural indebtedness has implications for solutions for rural credit in many other countries.

REFERENCES

De Livera, R. D. (2002). Co-operative Rural Banks Left in a State of Isolation. *Economic Review,* 58-63.

Economic Review (1988). 25 Years of Co-operative Banking. *Economic Review*, 3-27.

Hulme, D. and Montgomery, R. (1994). Cooperatives, credit and the poor: private interest, public choice and collective action in Sri Lanka. *Savings and Development*, 359-382.

Marga Institute (1974). *The Co-operative System and Rural Credit in Sri Lanka.* Swastika Press.