

THE CONCEPT OF THE PEOPLE'S BANK

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Introduction

The importance of banking in economic development need not be over emphasised. It is generally accepted that a country's economic development, and its banking development go hand in hand, one reacting on the other, converging on the basic objective of achieving a better standard of living for its populace. Societies where the banking habit have not developed has no option but to expand their banking services speedily in order to extricate themselves from the clutches of poverty and primitive isolation. In such societies the spread of the banking habit assumes a place of special significance, because not only does it help to increase the degree of monetization of economic activities which is the basis for modern capitalistic development, but it also enables resources to be drawn from elsewhere for the development effort. Therefore, any country which wishes to be in the forward march for economic advancement should necessarily achieve a rapid development of its banking system.

The objective of this paper is to assess the role of the People's Bank in providing banking services to the people of Sri Lanka. Special emphasis will be placed on examining its role in taking banking to the rural sector of the economy which was one of the primary objectives of establishing the Bank. The paper will begin with a discussion of the economic conditions and the banking facilities in the 1950's - the period immediately preceding the establish-

ment of the Bank. This will be followed by a brief resume of the germination of the idea of a new bank, its establishment and a statement of its objectives. The rapid growth of the Bank will be analysed thereafter. In the sections that follow, the Bank's contribution in selected fields such as the development of rural banking, financing of the co-operative sector and provision of agricultural credit will be examined. Whether the Bank has achieved its objectives as envisaged by its promoters and if not, the reasons for failure to do so, will be examined.

The Economy in the 1950's

In the period immediately after independence, Sri Lanka was essentially an agricultural economy with over two thirds of her population being directly dependant on agriculture, both for sustenance and employment. During this period, agriculture accounted for more than one half of Sri Lanka's Gross Domestic Product. The over whelmingly large majority of the population lived in rural areas. The rural sector in Sri Lanka consisted largely of small holdings, meaning that the type of engagement was subsistence agriculture and the income levels comparatively very low and hardly sufficient to generate savings for further investment. The Survey of Rural Indebtedness undertaken by the Department of Census & Statistics in 1957 disclosed that 54 per cent of the agricultural families were in debt and only a very minor share of their credit requirements was provided by institutional sources. The commercial banks as

such played a very negligible role in providing credit to the rural sector.

On the other hand, it was becoming increasingly clear that no meaningful balanced development of the economy was possible until and unless the rural population, which forms the large bulk of the population in the country, were made more productive in their economic endeavours. In order to raise the productivity of the rural population, two of the most important pre-requisites were to raise the level of input utilisation and rationalise agricultural operations, and these were unattainable without an adequate supply of institutional credit. The banking system of the country, therefore, had a special role to play in spearheading the drive towards achieving increased productivity in the rural sector and through it for improving the quality of living of the vast majority of people in that sector.

Banking in the 1950's

The banking system in the 1950's was characterized by the predominance of expatriate banks which were popularly known as Exchange Banks. These banks were almost exclusively catering to the requirements of the plantation sector and export/import trade. The Bank of Ceylon which was established in 1939 in order to cater to the needs of the indigenous population was also largely nurtured and developed on the lines of foreign banks, import/export trade figuring prominently in its loan portfolio. Its branch network was also predominantly urban based, being confined to Colombo and other principal cities. In 1960, there were 45 commercial bank branches in the country and with a very few exceptions all were either in Colombo or in other principal

cities. The rural sector which was so vitally important for the economic life of the country was almost totally left out of the banking scenario.

Closely akin to this development was the almost negligible presence of agriculture in the loan portfolio of the commercial banking system. There were no other institutions too to provide rural credit on a significant scale. There was the Co-operative Federal Bank of Ceylon with a network of Co-operative Provincial Banks and District Co-operative Banks but their scale of operations were of marginal relevance to the overall credit requirements of the rural sector. The Co-operative Federal Bank of Ceylon and the Provincial District Co-operative Banks which were small institutions were really co-operative societies registered under the Co-operative Societies Ordinance of 1936 and were governed by their own By-Laws. In the field of credit the Co-operative Federal Bank and the District Co-operative Banks were hampered by the insufficiency of resources. In the midst of this institutional credit gap, the rural sector remained generally impoverished, with rural indebtedness assuming massive proportions, both contributing to keep the rural sector in comparative isolation with respect to development.

A New Bank in the Shaping

It was in this background that the idea of setting up another indigenous bank to cater specially to the requirements of the rural sector was mooted. The Central Bank of Sri Lanka, in 1954, drew the attention of both the Minister of Finance and the Minister of Agriculture & Food, who was in charge of Co-operatives, to certain unsatisfactory features in

the working of the Co-operative Federal Bank and a drastic re-organization of the bank was suggested. Discussions between the Central Bank and the Ministry of Agriculture & Food resulted in an agreement to the effect that the Co-operative Federal Bank should cease to be a Co-operative Society and should be converted into a Corporation by special legislative enactment. Also while its primary objective should be finance of the co-operative movement and while it should have the power to accept demand deposits from the public, it should also operate branches in the rural areas without coming into conflict with the Co-operative District/Provincial Banks and that it should regulate its operations in such a way as to conform to the commercial banking standards.

A draft Memorandum for legislation was prepared in 1957. The new institution was to be known as 'the Co-operative Development Bank which will serve as a more efficient financial institution in the co-operative movement and as a specialised credit institution for the development of rural banking and agricultural credit'. Thus, the basic features of the new bank were to finance the credit needs of co-operatives, to extend banking facilities in the rural areas and to provide necessary credit to agriculturists.

In the period that followed, further discussions were held on the basis of a Draft Bill prepared by the Legal Draftsman. Numerous amendments to the original draft were made during these discussions. By a conclusion reached at a meeting of the Cabinet held on December 02, 1960, "The People's Bank Bill" as finally amended by the Ministries of Finance, Trade, Food and Shipping was approved, printed and placed before the House of Representatives.

Thus designated as the "Co-operative Development Bank" in the Memorandum approved by the Cabinet in 1957, the new institution was called "The People's Bank" in the final Legislative Enactment.

Establishment

The Bank was established by the People's Bank Act No. 29 of 1961 and it commenced operations on July 01, 1961. The Bank was intended to take the place of the Co-operative Federal Bank of Ceylon Ltd. Accordingly, the assets and liabilities of the Co-operative Federal Bank as on July 01, 1961. The Bank was intended People's Bank. As stated previously the main objectives of the Bank were "to develop the co-operative movement of Ceylon rural banking and agricultural credit by furnishing financial and other assistance to co-operative societies, approved societies, cultivation committees and other persons". In introducing the Legislation in Parliament, the Minister of Commerce, Trade, Food and Shipping to whom the subject of the People's Bank had been assigned, asserted that the People's Bank Bill was designed "to set up an institution which would be of tremendous assistance to the vast majority of the people of this country and play a part in transforming the rural economy". It was further envisaged that the new bank would grant credit "mainly through co-operative societies rather than directly to individuals in rural areas". All co-operative societies were statutorily required to patronise the People's Bank exclusively so that the resources of the movement could be concentrated in the new financial institution. The expression 'co-operative societies' was used to denote societies registered under the Co-operative Societies Ordinance. In addition the new

bank was to be given the normal powers and functions of a commercial bank which were described in Section 5(1) (b) of the Act as "the kinds of business similar to those carried on and transacted by the Bank of Ceylon under the Bank of Ceylon Ordinance No. 53 of 1938, subject to such modifications and exceptions as may be prescribed". Furthermore, the authority to provide pawn broking facilities was also given to the Bank.

in keeping with the basic objectives of establishing the Bank, the ownership of the Bank was divided between the Government and the Co-operative sector. While the Government assumed a stake in the Bank by holding 50 percent of its shares, the balance 50 percent was made available for subscription by the Co-operative Societies. Thus, the Government and the Co-operative Societies were to be the only lawful subscribers to the share capital of the Bank. The Bank was to function under the general direction of a Board of Directors, while the Executive functions were to be carried out by the General Manager. Originally, the Board of Directors consisted of eight members but by the people's Bank (Amendment) Act No.61 of 1980 the membership of the Board was increased to ten.

Growth of the Bank

The People's Bank as a banking institution has recorded phenomenal growth which is almost unparalleled in Sri Lanka's banking history. The rapid growth of the institution is observed in many respects such as mobilization of deposits, grant of advances, numbers employed and the countrywide branch expansion drive. For these achievements, the Bank acquired the necessary structural strength by virtue of (1) Government participation in the share capital (2) provision to engage

TABLE : I
PEOPLE'S BANK
DEPOSIT MOBILISATION & DISBURSEMENT OF CREDIT

Rs. Million

End of Period	Deposits			Advances*		
	Banking System	People's Bank	Share of the P.B.	Banking System	People's Bank	Share of the P.B.
December 1961	923.1	25.3	2.7	548.6	17.0	3.1
December 1965	1,314.1	195.6	14.9	762.9	201.6	26.4
December 1970	2,394.0	603.5	25.2	1,547.7	592.4	38.3
December 1975	3,610.5	1,324.2	36.7	3,533.0	1,667.5	47.2
December 1980	17,291.3	6,317.7	36.5	17,000.2	6,179.0	36.3
December 1985	45,459.0	15,227.0	33.5	40,918.0	13,570.0	33.2

* Include cash items, investments, bills, loans and overdrafts.

in normal commercial banking, as well as in pawn broking, (3) provision to establish a branch network (4) Statutory provision for Co-operative Societies to exclusively bank with the People's Bank, and (5) Willingness of public sector institutions to patronise the Bank. As evident from Table 1, the Bank's total deposits grew from a meagre Rs.25 million at the end of 1961 to Rs. 15,227 million by the end of December, 1985. Perhaps the more spectacular achievement in the deposit mobilization front has been the Bank's success in taking a growing share of the deposits mobilized by the entire banking system. As at the end of 1961, the deposits of the People's Bank accounted for a mere 2.7 per cent of the total deposits mobilized by the banking system. However, the Bank's share of deposits in the total rose rapidly reaching a level of 36.7 percent by the end of 1975. Thus, within a very short period of less than 15 years the Bank had been able to account for more than one third of the total deposits mobilized by the banking system in the country. During the period 1980 - 1985, the Bank's share of deposits in the total declined reaching a level of 33.5 per cent as at the end of December, 1985. This

decline could be partly explained by the large number of new foreign banks, 14 in number, established since 1979, taking a fair share of the deposits of the banking system. In fact, the share of deposits of foreign banks (both old and new) was 22.0 per cent as at the end of 1985 as compared with 10.7 percent at the end of 1979.

On the advances front, the performance of the People's Bank had been even more striking than in the case of deposits. The total advances of the Bank rose from a negligible figure of Rs. 17 million at the end of 1961 to a level of Rs.1,667 million by the end of 1975 and thereafter to Rs.13,570 million as at the end of December, 1985. The Bank's share in the total advances of the banking system rose spectacularly from a level of 3.1 per cent in 1961 to reach 47.2 per cent by the end of 1975, thus accounting for very nearly half of the total advances of the banking system as at that time. The greater success in the grant of advances can be partly explained by the very aggressive branch expansion programme of the Bank, on the one hand; and a greater involvement of the Bank in the disbursement of credit under the Central Bank's refinance schemes, on the other. Its share in the total advances,

however, had declined thereafter dropping to a level of 33.2 per cent as at the end of December, 1985. As in the case of deposits, this is largely explained by the competition from the newly established branches of foreign banks after 1980.

It may be pointed out that in the initial stages the Bank was helped by a number of favourable factors in its growth and development. First, by the Finance Act No. 65 of 1961, the opening of new bank accounts of Sri Lankans was restricted to domestic banks, which effectively meant the People's Bank and the Bank of Ceylon having a monopoly on new bank accounts. This restriction was in force until it was modified by the Finance (Amendment) Act No. 36 of 1968. Second, from its inception until 1975, the People's Bank enjoyed concessionary treatment with respect to the maintenance of reserves against deposits with the Central Bank. Until 1985, the Bank was exempted from the special reserve requirement of 38 percent on marginal increases of deposits which the other banks were required to maintain from February, 1961. In 1985, the Bank was brought within the fold of the special reserve requirement but at a lower rate of 28 percent which concession the Bank enjoyed until 1975, when the special reserve requirement was withdrawn. Third, a large number of public sector accounts was maintained with the Bank. Fourth, the Bank took-over the network of Co-operative District/Provincial Banks which were already in operation.

Perhaps, from an overall economic viewpoint what is even more important than the overall growth in advances, is its distribution among different sectors of the economy. It might be mentioned that the larger

TABLE II
PEOPLE'S BANK
PURPOSE-WISE CLASSIFICATION OF ADVANCES AS AT 30.06.85

Rs. Million

Purpose of Loans	Banking System		People's Bank	
	Amount Outstanding	% Share	Amount Outstanding	% share
1. Commercial	18,127.6	49.8	4,082.7	34.4
2. Financial	824.0	2.3	118.7	1.0
3. Agricultural	3,088.4	8.5	1,518.0	12.2
4. Industrial	8,888.8	24.4	3,333.6	28.1
5. Tourism	761.4	2.1	234.2	2.0
6. Housing	2,595.4	7.1	1,608.7	13.6
7. Consumption	585.6	1.6	364.6	3.1
8. Other	1,503.0	4.2	596.1	5.0
	36,374.2	100.0	11,856.7	100.0

Source: Central Bank of Sri Lanka, People's Bank

the share of advances going into directly productive sectors, the bigger would be the linkage effects in creating additional growth and employment. It is in this respect that the contribution made by the Peoples's Bank for the economic development of the country could be considered more commendable. As is evident from Table II, an admirable share of the Bank's advances had gone to directly productive sectors and for essential purposes. For instance, whereas the share of advances granted to agriculture in the entire banking system was only 8.5 percent as at the end of June, 1985, the People's Bank's share of agricultural credit in its total advances was 12.8 percent. Of the total credit granted for agricultural purposes by the banking system amounting to Rs. 3,088 million, the People's Bank accounted for very nearly 50 per cent.

Similarly, as on the same date the People's Bank had given 28.1 percent of its advances for industrial purposes, as against an overall share of industrial advances amounting to 24.4 percent. In the case of housing

too, which is considered a very essential sector for maintaining the quality of life in the country, the People's Bank has occupied a prominent place. The share of advances of the People's Bank for housing purposes as at the end of June, 1985 was 13.6 percent, as against 7.1 percent by the entire banking system. Although commercial considerations had been important to the Bank, so as to maintain its financial viability, the Bank's share of commercial advances was only 34.4 per cent as at the end of June, 1985, as against an overall share of 49.8 percent in the entire banking system. Thus, the distribution of advances shows that the People's Bank's policies in this regard had been influenced by socio-economic considerations to a much greater extent than the banking system taken together.

The total number of employees of the Bank rose very rapidly with the expansion of the scale of operations of the Bank, as well as its rapid branch expansion programme. As at the end of 1961 the total number of employees of the Bank stood at 149. This figure rose rapidly reach-

ing a level of 3,841 at the end of December, 1975 and further to 10,041 as at the end of December, 1985.

Perhaps, the contribution made by the Bank in creating employment opportunities cannot be gauged by the employment directly offered by the Bank. Here the Bank's role as a financial intermediary should be considered more significant. Accounting for approximately one third of the deposits and advances of the banking system at present and for a much larger share in the decade of the 1970's, the Bank has contributed very considerably to the generation of employment opportunities in the country. Such employment opportunities were both in industrial and other enterprises which depended heavily on the Bank for advances and also in the form of self employment in the agricultural sector. The fact that the larger share of the Bank's advances has gone to directly productive sectors than the average for the entire banking system itself suggests that the Bank's role in employment creation was far more pervasive than the direct employment figures would suggest.

standing when considered from the viewpoint of growth of branch banking in Sri Lanka. As at the end of 1961, the year of its establishment, the Bank had only 9 branches accounting for 16.7 percent of the total number of bank branches in the country. The Bank proceeded on an aggressive branch expansion programme which is unparalleled in the annals of Sri Lanka's banking history, taking its total number of branches to 158 by the end of 1975 and to 293 by the end of 1985. As at the end of 1975 the Bank accounted for 60.1 percent of the total number of bank offices in the country. This indicates in no uncertain terms that the People's Bank had been the most predominant bank in making available banking services to the population at large, particularly in the rural sector as evident from the fact that the large bulk of its branches are in that sector. In recent years, however, the Bank's predominance in branch banking has suffered a setback and its share of bank offices in the total number of bank offices in the country had declined to 48.8 percent by the end of 1985. The latter development had been partly due to the

number of branches of the Bank in the Northern and Eastern provinces temporarily, in view of the escalation of terrorist activities. Despite this, the Bank still continues to be the dominant bank in terms of the number of banking outlets that it provides to the public.

Rural Banking.

The development of "rural banking" is one of the primary objectives of the People's Bank, as set out in the Act. In order to discharge this function, the Bank almost from its inception, proceeded on a vigorous branch expansion programme to which reference was made in the previous section. It is observed that the Bank's branch expansion programme had been fairly wide-spread with all twenty five districts of the country sharing in it.

A district-wise distribution of bank branches of the banking system and that of the People's Bank, is given in Table IV. With a very few exceptions, the Bank has figured prominently in the more remote districts of the country. Thus, what is more important than the total number of branches is the fact that the majority of the branches had been opened in small towns with large rural hinterlands which hitherto have had no banking facilities. As is evident from the local authority distribution of the branch net-work shown in Table V, only 96 branches or 33 percent of the branch net-work are situated within the limits of Municipal Councils and Urban Councils, which could ordinarily be classified as urban areas. On the other hand, as many as 197 or 67 percent of the branches are situated within Town Council and Village Council areas, which could be generally classified as rural areas. Of the latter category, branches in Village Council areas at

TABLE: III
GROWTH OF BRANCH BANKING IN SRI LANKA
1961-1985

Year (As at end December)	Banking System No. of Branches*	People's Bank No. of Branches	Percentage Share of People's Bank
1961	54	9	16.7
1965	97	48	49.5
1970	165	93	56.4
1975	263	158	60.1
1980	489	271	55.4
1985	600	293	48.8

Source: Central Bank of Sri Lanka, People's Bank

* Excludes Agricultural Service Centres of Bank of Ceylon and Co-operative Rural Banks.

The growth of the People's Bank and its contribution to the provision of banking services to the public at large appear to be most out-

number of new foreign banks opening branches in the country since 1979 and partly to the need to either suspend operations or merge a

TABLE IV
DISTRICT-WISE DISTRIBUTION OF BANK BRANCHES
AS AT DECEMBER, 1985

Name of the District	No. of Bank Branches		
	Banking System	People's Bank	% Share of People's Bank
1. Colombo	131	48	36.6
2. Kandy	37	20	54.1
3. Galle	28	13	46.4
4. Gampaha	41	20	48.8
5. Kalutara	27	14	51.9
6. Kegalle	25	15	60.0
7. Kurunegala	38	19	50.0
8. Jaffna	21	10	47.6
9. Trincomalee	08	04	50.0
10. Ratnapura	27	14	58.3
11. Matale	15	08	53.3
12. Matara	25	14	56.0
13. Nuwara Eliya	20	10	50.0
14. Anuradhapura	29	16	55.2
15. Polonnaruwa	15	07	46.7
16. Puttalam	19	09	47.4
17. Ampara	12	06	50.0
18. Batticaloa	13	08	61.5
19. Badulla	30	17	56.7
20. Hambantota	16	09	56.3
21. Mannar	03	01	33.3
22. Mullaitivu	02	01	50.0
23. Moneragala	12	07	58.3
24. Vavuniya	03	01	33.3
25. Kilinochchi	03	02	66.7
	600	293	48.8

Source: Central Bank of Sri Lanka, People's Bank.

135 or 46 percent predominated in the branch banking scene. It is therefore seen that the Bank has played a significant role in taking banking facilities to the rural sector, perhaps to the extent that no other financial institution in Sri Lanka has so far done.

Considering the fact that rural banking is not all that attractive commercially and that most banks have been shy of going to the rural sector in Sri Lanka, the performance of the People's Bank in this respect is commendable.

The available data also show that the Bank had been successful to a considerable extent in getting the rural sector involved in banking business. Of the total volume of deposits mobilized by the Bank as at the end of 1985, amounting to Rs.15,227 million, the rural sector comprising town council and village council areas had accounted for Rs.5,147 million or 33.8 percent. In the case of advances, the rural sector's share was Rs.4,709 million or 34.7 percent out of a total figure of Rs.13,570 million. It would appear that no

other single banking institution in the country has been involved in the rural sector to the same extent, both in relative terms, as well as in overall magnitudes.

The Role of Co-operative Rural Banks

Perhaps, the Bank's overall contribution to rural banking cannot be measured only by the number of branches that it has opened in the rural areas or the volume of deposits or advances that it has been able to mobilize or grant. Here, the establishment and extension of the Scheme of Rural Banks which are the banking departments of Co-operative Societies also need recognition. On the basis of the findings of the survey on "Rural Indebtedness in Ceylon-1957" the co-operative structure was re-organised by establishing an island-wide network of Multipurpose Co-operative Societies (MPCS) with the object of promoting, *inter-alia*, rural credit on a commercial basis. The established view at that time was that the multi-purpose form of society, where credit, marketing, provision of consumer goods and other services were combined, was superior to the single purpose form of Co-operative. The MPCS's were expected to operate as village banks providing credit, mobilizing savings and playing a catalytic role in stimulating the overall development of the village. The year 1963 witnessed the introduction of a People's Bank sponsored Extended Rural Credit Scheme which provided credit through the Multi-purpose Co-operative network. However, this scheme failed to perform in the expected manner which led to the setting up of a specialised institution called "The Co-operative Rural Bank" (CRB) to cater to the overall financial needs of the rural sector.

TABLE V
PEOPLE'S BANK – DISTRIBUTION OF BRANCHES AND
OPERATIONS BY LOCAL AUTHORITIES
DECEMBER, 1985

	<i>Municipal Councils</i>	<i>Urban Councils</i>	<i>Town Councils</i>	<i>Village Councils</i>	<i>Total</i>
No. of Branches ..	52	44	62	135	293
% Share ..	18	15	21	46	100
Deposits ..	7,552.6	2,527.7	2,436.3	2,710.4	15,227.0
% Share ..	49.6	16.6	16.0	17.8	100.0
Advances ..	6,486.4	2,374.8	2,279.8	2,429.0	13,570.0
% Share ..	47.8	17.5	16.8	17.9	100.0

The functions of the CRB's included acceptance of savings and fixed deposits from members and non-members in a better organised manner and its lines of finance covered agricultural production, animal husbandry, cottage industries, debt redemption, electrification, consumption and credit during periods of distress. It also functions as a banking agent of the People's Bank and the means for disbursing rural credit for cultivation and other purposes specified by the Government. These banks also undertake pawn-broking business as agents of the People's Bank. They are, however, not permitted to accept demand deposits or operate checking accounts. The People's Bank has to play a crucial role by way of providing financial, managerial, supervisory and technical assistance to enable the rural banks to overcome their shortcomings and function as viable self-sufficient units. The People's Bank on its part gains knowledge of conditions in the rural areas which helps to build up effective contacts with the rural clientele. The growth and expansion of rural banking are depicted in Table VI. It is observed that the

number of rural banks increased very modestly from 8 in 1970. A decision was taken in 1971 by the Co-operative Department to permit all MPCs to have credit departments or rural banks. Thereafter there was a sharp expansion in the number of rural banks in the country, the number rising to 641 by 1980 and to 907 in 1985. The total deposits of rural banks rose from Rs.0.5 million in 1965 to Rs.1,054 million in 1985, while advances increased from Rs.1.2

million to Rs.554 million over the same period. The surplus deposits of the rural banks are invested with the People's Bank, while those short of funds draw from the Bank, which is another way whereby the People's Bank contributes to the promotion of rural banking.

Financial Assistance to Co-operative Sector

As already stated, the provision of financial assistance to the co-operative societies was one of the chief functions of the People's Bank under the provisions of the Act. The Bank assumed the place of the Co-operative Federal Bank Ltd., which was the apex organisation of the financial structure of the co-operative system. At the time the Bank was established the co-operative system which began in 1911 had been fully developed, moving from consumer societies to production and sales societies and later to multipurpose societies, integrating credit with marketing. As at the end of December, 1960, the year immediately preceding the establishment of the People's Bank, there were 13,990 registered co-operative societies suggesting both the need and the

TABLE VI
GROWTH OF RURAL BANKS

<i>End of Period</i>	<i>Number of Rural Banks</i>			<i>Total Deposits Rs. Million</i>	<i>Total Advances Rs. Million</i>
	<i>Rural Banks</i>	<i>No. of Special Branches</i>	<i>Total</i>		
1965 ..	08	—	08	0.5	1.2
1970 ..	90	—	90	16.9	9.1
1975 ..	338	109	447	74.2	87.3
1980 ..	284	357	641	368.4	176.7
1985* ..	286	621	907	1,054.0	554.0

* as at end, September, 1985

Source: People's Bank.

TABLE VII
PEOPLE'S BANK – SECTORAL DISTRIBUTION OF
LOANS AND ADVANCES

Rs. Million

End of Period	Co-operative Sector		Corporation Sector		Private Sector		Total	
	Amount	% of share	Amount	% of share	Amount	% of share	Amount	% of share
1961	—	—	—	—	17.0	100.0	17.0	100.0
1965	50.1	24.8	33.2	16.5	118.3	58.7	201.6	100.0
1970	142.2	24.0	224.6	37.9	225.7	38.1	592.5	100.0
1975	387.4	23.2	713.3	42.8	566.8	34.0	1,667.5	100.0
1980	708.9	11.5	1,707.2	27.6	3,762.9	60.9	6,179.0	100.0
1985	922.8*	6.8	2,076.2*	15.3	10,571.0*	77.9	13,570.0	100.0

* Provisional.

Source: People's Bank.

potential for credit.

A sectoral distribution of the People's Bank's loans and advances is shown in Table VII, from its inception at five-yearly intervals. It is observed that for most of the period the Bank had been able to maintain its share of loans and advances to the co-operative sector at or around 24 percent of total credit granted by it, which is not altogether unsatisfactory considering the fact that the deposit mobilization from the co-operative sector had been extremely poor. In the event, the ratio of co-operative advances to co-operative deposits had been greater than that of advances in the private sector to private deposits or advances in the corporation sector to corporation deposits. This meant that the Bank was using deposits generated from other sectors (Government, corporation and private sector) to finance the co-operatives. This was in keeping with the intentions of the framers of legislation whose view was that "the commercial business of the Bank should be used as a source for financing the co-operative sector"

However, in more recent years the share of co-operative advances had drastically declined reaching a level of 11.5 percent by 1980 and 6.8 percent by 1985. Thus, the credit picture by 1985 was such that co-operative advances no longer seemed to figure prominently in the loan portfolio of the Bank, being relegated to a position of minor importance in relative terms, although in absolute terms there had still been a marginal increase. On the other hand, the private sector which had been taking a declining share of the Bank's credit until the mid-1970's has since increased share taking the bulk of the credit disbursed by the Bank and by 1985 its share had risen to as high as 78 percent. This pattern of development of the Bank's loan portfolio seems to suggest that a rapid expansion in the Bank's operations since mid-1970's had been associated with a sharp relative decline in the Bank's involvement in financing the activities of the co-operative sector, leading to the inevitable conclusion of the Bank having strayed considerably away from its original objectives.

In recent years, like most other commercial banks, the People's Bank too had tended to concentrate on financing the trade and distribution sectors. Such activities are certainly important and vital for the health of the economy. However, a bank adopting such easy options on considerations of financial viability, to the neglect its basic objectives, exposes itself to the charge of having failed in its mission. Perhaps there could very well have been some compelling reasons for this development. This will be the subject matter of our examination in the penultimate section of the paper.

Agricultural Credit

As mentioned previously, the provision of agricultural credit was also among the basic objectives in the establishment of the People's Bank. There is little doubt that agriculture here means domestic agriculture consisting of paddy and other subsidiary crops, to the exclusion of plantation crops of tea, rubber and coconut, which have had major banking problems. We also observed that the development of the co-operative sector was also another principal objective of the Bank. As many of the peasants engaged in the cultivation of paddy and subsidiary crops are members of the co-operative societies, two of the basic objectives of the People's Bank, viz, the development of co-operative societies and provision of agricultural credit, are in fact, overlapping and coinciding. It must also be stated that the People's Bank was indentified as the chief channel through which two of the most important refinance facilities of the Central Bank, designed for the benefit of the agricultural sector, were to be implemented. The first is for the provision of short-term production loans under which the

Central Bank provides refinance facilities to commercial banks at concessionary rates of interest in respect of credit granted for to commercial banks at concessionary rates of interest in respect of credit granted for the cultivation of paddy and subsidiary food crops. Under this programme, the New Agricultural Credit Scheme (NACS) was introduced in 1967 which was later termed the Comprehensive Rural Credit Scheme (CRCS) in 1973. Under the CRCS, the Central Bank provides refinance to participatory banks at a rate of interest amounting to 1½ percent per annum. These banks lend funds to co-operative societies at 5 percent per annum which in turn lend the funds to the farmer at 9 percent per annum. Alternatively, commercial banks could lend the funds directly to the farmer at a rate of interest of 9 percent per annum.

The second was the refinance facility in respect of loans for the marketing of agricultural crops under the Guaranteed Price Scheme (GPS) and the Floor Price Scheme (FPS) to enable commercial banks to provide short-term credit for the purchase of paddy and subsidiary food crops. Under this scheme, commercial banks grant advances against Goods Receipts backed by Usance Promissory Notes, the latter being pledged to the Central Bank at a rate of interest of 3 percent per annum for the purpose of obtaining refinance.

The volume of credit granted by the People's Bank for agricultural purposes is shown in Table VIII. Starting from a very negligible level in 1961, credit granted for agricultural purposes had progressively risen over the years reaching a level of Rs.344.8 million in 1975, representing 20.7 percent of the total advances granted by the Bank as at that year. Although

TABLE VIII

PEOPLE'S BANK - GRANT OF AGRICULTURAL CREDIT
AMOUNTS OUTSTANDING

Rs. Million

End of Period	Agriculture		Other		Total	
	Amount	% share	Amount	% share	Amount	% share
1961	0.6	3.5	16.4	96.5	17.0	100
1965	14.3	7.1	187.3	92.9	201.6	100
1970	117.7	19.9	474.7	80.1	592.4	100
1975	344.8	20.7	1,322.7	79.3	1,667.5	100
1980	1,020.2	16.5	5,158.8	83.5	6,179.0	100
1985 (June)	1,518.0	12.8	10,339.0	87.2	11,857.0	100

Source: People's Bank.

Achievements with Respect to Objectives

Although the extent of credit had risen thereafter in volume terms, in percentage terms it had declined to a level of 12.8 percent, by June, 1985. It would appear that having provided approximately 20 percent of the advances for agricultural purposes in the initial period after stabilization of the Bank, thereafter it appears to have shown lesser interest in this sector of the economy.

Although, as seen from Table II, the People's Bank's involvement in the agricultural sector had been much more prominent than other commercial banks in the country, it still needs to be pointed out that the share of credit which had gone to the agricultural sector was incommensurate with what was expected from a bank created specially to cater to the requirements of the rural sector. Furthermore, several credit schemes were formulated under the aegis of the Central Bank to divert credit to the rural agricultural sector with liberal refinance facilities, to which reference was made earlier. The performance of the People's Bank in this sphere seems to suggest that its role in the provision of credit to the rural agricultural sector,

which was somewhat encouraging in the 1970's has since suffered a serious setback. Some of the reasons for the Bank's poor credit disbursement records with respect to agriculture will be discussed in the Section to follow.

Achievement with Respect to Objectives

As stated previously, development of the co-operative movement in Sri Lanka, promotion of rural banking and provision of agricultural credit were the three basic objectives of establishing the People's Bank. The Bank was also authorised to do kinds of business similar to those carried on and transacted by the Bank of Ceylon, meaning that it could engage in normal commercial banking activities. The latter, of course, meant that the Bank had the potential for a diversion and expansion of its activities into fields other than those identified as its basic areas of operation, if it chooses to do so. Experience has shown that right from the beginning the percentage of loans and overdrafts granted to the private sector exceeded the share of advances granted to the co-operative sector. It is also seen that in recent years, the

share of advances granted to the domestic agricultural sector had been, of a very minor order in relation to the total advances granted by the Bank. It is perhaps unfortunate that the success achieved in terms of branch expansion and the growth in the scale of operations were not matched by improvements in supply of credit to the rural sector. While there would have been serious problems in concentrating excessively in the rural sector where prospects for profitable operations were generally poor, yet the fact that over the years there had been a marked change in the perceptions with regard to the basic objectives of the Bank has to be recognised. In fact, from the very early times, it was felt that the Bank might not proceed on a path so as to achieve its basic objectives as set out in the Act. Realizing this, the Commission on the People's Bank, which was sitting only about four years after its establishment, observed in 1985 that " while we agree that commercial business, such as export/import business, is a legitimate operation of the People's Bank to undertake under the Act, and that it is a lucrative field of business, its rapid expansion had within it the danger that the real purpose for which the People's Bank was established might be overlooked, and that was intended to serve only as a means by which those purposes might be achieved, might become its main objective. In other words, the People's Bank, which was created as primarily a bank for the development of the rural economy, might constitute itself as yet another commercial bank on the conventional pattern". The fears so expressed by the Commission appear to have been somewhat well founded.

Let us now consider some of the factors which lead the Bank to deviate from its declared objectives.

First, within a very short period after its establishment, the Bank appeared to have realized that there was limited possibility of collecting a sizeable volume of deposits from the rural sector and the co-operative sector to enable a sizeable volume of credit to be disbursed to those sectors. Although the percentage of advances to co-operatives in relation to total deposits was small, it was considerably in excess of the percentage of co-operative deposits to total deposits. This meant that the Bank had to use deposits from other sources to finance the co-operative sector. In other words, the Bank was forced to use commercial business as a source of funds to finance the co-operative sector, because the latter was incapable of generating sufficient funds for the purpose. Exclusive concentration of its activities in the co-operative sector would have meant a serious resource constraint for the achievement of its declared objectives. Thus, the very nature of operations required to achieve its objectives carried with them the danger of the Bank easily deviating from its basic objectives.

Second, there were inherent weaknesses in the working of the co-operatives which manifested themselves in the recording of losses due to inefficient management and/or misappropriation. In such an atmosphere, excessive concentration of the loan portfolio in the co-operative sector would have meant serious recovery problems for the Bank, leading to liquidity problems initially and viability problems thereafter.

Third, the co-operative sector itself has suffered a set-back in recent years in terms of its activities. This sector which enjoyed a monopoly in the distribution of certain essential commodities before 1977,

has had to face competition from the private sector since the introduction of liberalised economic policies in that year. Furthermore, in the period that followed Government subsidy schemes were rationalised resulting in a sharp decline in the number of people entitled to such subsidies, the main channel of implementation of which was the co-operative sector. These policy changes had a severe adverse impact on the co-operative society reducing its importance as an economic unit and decreasing its patronage by the people.

Fourth, there were the difficulties encountered in the recovery of agricultural loans which had been one of the most serious limiting factors in disbursement of agricultural credit in Sri Lanka. From the time that the credit schemes for the co-operative sector and for rural agriculture were being administered by the Government Departments, the rate of recovery of the loans granted to these sectors had been generally very low. Although the situation improved after the credit schemes were brought under the commercial banking system, such as under the Comprehensive Rural Credit Scheme, still the rates of recovery left much to be desired. The rate of recovery of cultivation loans granted by the commercial banks under the Comprehensive Rural Credit Scheme was only marginally above the 50 percent level during the early 70's. Thereafter, there was a marked drop in the recovery of loans, the rate dropping to as low as 29 percent during the cultivation year 1977/78.

Part of the blame for the low recovery rate of course, should go to the commercial banks themselves as there was a high degree of lethargy on their part for the recovery of these loans in view of the existence

of a Government Guarantee of 75 percent on them. After the 1977/78 debacle, the Government guarantee was withdrawn and thereafter a considerable improvement in the recovery rates was observed. However, the rate of recovery of cultivation loans was still considerably lower than the normal recovery rate applicable to commercial bank advances. The upshot of this experience is that any commercial bank fully concentrating in the co-operative sector and the rural agricultural sector in its loan portfolio would have encountered serious liquidity problems thereby impairing its commercial viability. There is little doubt that the recovery problem of agricultural loans would have been a serious limiting factor which stood in the People's Bank's way in playing its proper role in the agricultural sector.

Lastly, perhaps by far a major reason for the bank showing lesser interest in its original objectives was the liberalised economic policies followed since 1977. Those policies soon contributed to significant structural changes in the economy. One major change was the agriculture sector becoming more market oriented, thereby reducing the involvement of Government sponsored schemes for the marketing of agricultural crops. Further, increased activity in the manufacturing sector, growth in the service sector and higher value added in wholesale and retail trade, were some of the major factors responsible for the up-turn in economic activity since 1977. Also, foreign exchange transactions expanded very sharply with the liberalisation of policy on trade and payments. These developments, in turn, had their impact on the banking system with an increasing share of its resources being diverted to these sectors to cater to changing requirements. Perhaps, there was no way in which the People's Bank could have escaped this general

euphoria for newer approaches to development and banking.

Summary

In the period immediately preceding the establishment of the People's Bank, Sri Lanka was an extremely under-banked economy, particularly with respect to rural banking. The People's Bank was established in July, 1961 with a view to catering to the banking requirements of the rural sector. More specifically, the main objectives of the Bank were to develop the co-operative movement, promote rural banking and grant agricultural credit so as to bring about an element of resurgence to the rural sector of the economy. The Bank was also authorised to carry out normal commercial banking functions, as a back-up for its specialised operations.

The Bank achieved very rapid growth within a relatively short period of its establishment, becoming one of the premier banking institutions in the country by the mid-1970's. The rapid growth is observed in respect of mobilisation of deposits, grant of advances and expansion of the branch network. In the case of advances, perhaps what is more important than the overall magnitudes is the fact that its distribution pattern had been more growth-oriented—a larger share of its advances going into directly productive sectors such as agriculture and industry, than the average for the banking system as a whole. In the case of branch banking, not only did it become the leading banking institution in the country with the largest number of banking outlets, but also the Bank saw to it that its branch expansion programme is more rural oriented, the larger bulk of the

branches being established in rural areas. Apart from this direct involvement, the Bank also contributed very considerably to the promotion

of rural banking through its efforts in developing the scheme of Co-operative Rural Banks.

In the initial years of its establishment, the Bank had been somewhat successful in gearing its operations to achieving the basic objectives that it was designed to achieve. However, there is evidence to show that in more recent years the Bank had strayed away very considerably from its original objectives—a greater thrust now being made in normal commercial banking functions. Several factors appear to have contributed towards this development, which seems to suggest that the deviation was partly unavoidable. Among them were the Bank's inability to generate sufficient funds from the rural sector to back its operations compelling it to mobilise funds from other sources to remain viable, the inherent weaknesses in the working of the co-operative system in Sri Lanka, the setback to the co-operative sector in more recent years due to the rationalisation of Government's welfare policies, the serious recovery problem of agricultural loans which constituted a limiting factor in the disbursement of agricultural credit, and last but not the least, the radical change in economic policy resulting in a change in the focus of banking business on areas and activities which hold out to be more promising under the changed environment. It would appear that the People's Bank would have found it difficult to escape from this general desire for re-orientation of interest into areas and activities where the prospects of financial rewards were more promising.

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