THE ECONOMICS OF

INDIAN AGRICULTURE

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NARAYANASWAMY

AND

NARASIMHAN

PART I

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THE ECONOMICS OF

INDIAN AGRICULTURE

BY

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PREFACE TO THE FIRST EDITION

Our aim in writing this book has been to provide the undergraduates of our Universities with a comprehensive text-book on agricultural economics pertaining to conditions obtaining in our country. Much of the subject matter in books on rural economics published abroad has little relevance to the peculiar conditions and problems of Indian agriculture. There is no paucity of literature on the problems confronting Indian agriculture and the lines on which these can be successfully solved. Almost all the economic aspects of the agricultural problem in India have been thoroughly discussed in a number of classical reports published by the Government, such as the Reports of the Royal Commission on Agriculture in India, the Maclagan Committee on Co-operation, the Central Banking Enquiry Committee and the various Provincial Banking Enquiry Committees, the provincial committees on co-operation, and the reports of Sir John Russel on the Working of the Imperial Council of Agricultural Research and of Dr. N. C. Wright on the Development of the Cattle and Dairy Industries in India. But these sources of information are too voluminous and scattered. We have felt that there is a need for a book which will not merely give the student a comprehensive survey of the economic problems confronting Indian agriculture and their possible solutions, but will, at the same time, present these with a proper theoretical background. The improvement of the standard of living of the masses of the people in our rural areas is one of the urgent tasks which confronts our country. We have therefore endeavoured to provide the general reader with a convenient handbook which will give him an idea of all that has been done and remains to be done for the improvement of India's main industry.

A general textbook, we felt, should deal with the permanent rather than the temporary problems such as, for instance, the present acute shortage of food caused by the War. We have, therefore, confined our discussions to long-term trends. In the arrangement of the chapters, debt relief and rural financing have been discussed first, as we have felt that no real progress is possible so long as the farmer continues to be financially dependent.

In the preparation of the statistical statements relating to the co-operative movement in India, we have made full use of the Statistical Statements relating to the Co-operative Movement in India, 1940-41, published by the Reserve Bank of India.

MADRAS, B. V. N.
6—10—1943. P. S. N.

PREFACE TO THE SECOND EDITION

In this edition a new section on the effects of the War on India's food supply has been added, and the section on 'Nidhis and Chit Funds' has been entirely rewritten. We have also taken advantage of this opportunity to revise some of the sections dealing with the co-operative movement in view of the recent developments in land mortgage banking and the comsumers' co-operative movement. Attention has also been drawn to the scheme, proposed recently, for the allocation of a part of the profits of the Reserve Bank of India to finance rural reconstruction. Apart from these no substantial changes have been made.

MADRAS, B. V. N.
24—11—1944. P. S. N.

PREFACE TO THE THIRD EDITION

In this edition the text has been further revised and brought up-to-date, and a few tables have been added.

15—8—1946. B. V. N.
P. S. N.

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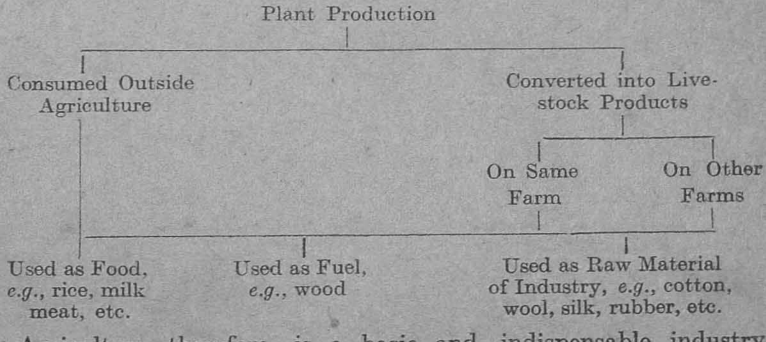
THE ECONOMICS OF

INDIAN AGRICULTURE

CHAPTER I

AGRICULTURE—ITS ECONOMIC BACKGROUND

§ **1. What agriculture is :** Agriculture includes not only the production of crops by the cultivation of the soil, but also the rearing of livestock. Thus milk, meat and wool are as much agricultural products as are wheat, rice and cotton. We must, therefore, use the word agriculture "to include every industry which aims at producing vegetables or animals by the cultivation of the soil."[1] Agriculture is of course primarily concerned with plant production, but the diverse uses to which plants may be put are well indicated by the following diagram.[2]



Agriculture, therefore, is a basic and indispensable industry providing not only most of the foodstuffs but also some of the essentials raw materials of industry. Agriculture is not one industry, but a complex of many different types of production and marketing. The unit of production, *viz.*, the farm, may be big or small, *e.g.*, it varies from over 1,000 acres in parts Australia[3] to an average of less than 3 acres in the United Provinces.[4] The farmer may produce one product, as, for example, the Brazilian coffee-grower, or, several, as in the dairying countries of England, where a farm often sells calves, pigs, sheep, wool, eggs, and wheat as well as liquid milk.[5] Within the same country there may be wide variations in land

1 *O'Brien :* Agricultural Economics, p. 1.
2 *Cohen:* The Economics of Agriculture, p. 7.
3 *World Agriculture :* An International Survey, p. 56.
4 *Jathar and Beri :* Indian Economics, Vol. I, p. 211.
5 *Cohen :* The Economics of Agriculture, p. 10.

tenures and the methods of production. Again, there are wide differences between the agricultural economy of the new countries like Canada, New Zealand, and Australia which have a 'surplus agriculture' (where farmers grow certain crops mainly for sale, usually to foreign buyers, and life is based on the profits from agriculture and not on the produce), and that of countries like India and China, where the majority of farmers produce mainly for subsistence.

Agriculture is both a craft and a business. Especially in the modern world, where production is more and more for the market, rather than for consumption, the income and standard of life of the agriculturist depend not only on his ability (as a craftsman) to raise a big crop, but also on his ability (as a businessman) to sell it at a good price. To be successful, the agriculturist should know when, where, and at what rate to borrow his working capital, and how to sell at the right time at a remunerative price. The successful Agriculturist should, therefore, be a sound businessman. The Indian farmer, for example, is poor, not mainly because he is inefficient as an agriculturist, but because he is a bad businessman. It is here that the economist comes in.

The study of farming as a business, and the suggestion of methods of improving it, are the main tasks of the rural economist. "agricultural economics may be defined as the application of general economics to the craft and business of agriculture." [6]

§ 2. The need for a special study of Rural Economics: There are a number of reasons why agricultural economics should be studied as a separate science.

(*a*) Agriculture is the world's most important industry. "In the less advanced countries up to two-thirds, or even three-quarters, of all persons capable of work are at the present moment engaged in providing themselves and others with food and primary materials, while it is not unusual for over one half, or for nearly one half, of the population in the more advanced countries to be devoted to these same agricultural pursuits." [7] Out of a total world population of 2013 millions, 1301 million persons are calculated to depend on agriculture.[8] Even the slightest improvements in agriculture are exceedingly worth while, as the majority of the world's population depends upon agriculture for its living.

(*b*) General economic theory was evolved in Europe during an age when industry was rapidly developing and eclipsing agriculture. The general framework of economic theory is, of course, as applicable to agriculture as it is to industry; thus, the analysis of the equilibrium of demand and supply and the explanations of value and distribution are valid in agriculture.

6 *O'brien :* Agricultural Economics, p. 2.
7 *Howard :* Labour in Agriculture, p. 29.
8 *Ibid.*

But some of the usual assumptions of economic theory are not as real in agriculture as they are in industry. For instance "that part of economic analysis which has been developed to explain the large scale organization typical of industry is less applicable to agriculture." On the other hand, perfect competition is far more real in agriculture than in industry, because farmers are so numerous that no individual farmer can affect price by altering his output. "The divorce between agriculture and economics has been detrimental to both sciences." The passionate belief of the 19th century economists in *laissez faire* and non-intervention was to a large extent the result of the Industrial Revolution, and made them ignore the fact, that some form of state intervention is necessary, if farmers, with their weak bargaining power, are not to be exploited by their creditors and by middlemen.

(*c*) A study of the application of the principles of economics to agriculture is likely to contribute to the development of general economic theory. The conclusions of economic theory can be verified by application to the facts of agricultural life and modified in the light of such verification. Economic doctrines, if they are to be really valid, must, "explain the facts of rural as well as urban life.'

(*d*) Agricultural economics is becoming more and more important on account of political reasons also. (i) With the spread of aggressive nationalism, national self-sufficiency has become the objective of almost all modern nations. In almost all industrial countries, such as Germany, England and Japan, the resuscitation of agriculture to make the country self-sufficient in times of war and reduce the dependence on foreign supplies of food and raw materials, has become the special object of governmental policy. (ii) Governments have also intervened to encourage agriculture with the object of creating a contented peasantry as the surest safeguard against revolution and as a counterpoise to the powerfully organized industrial labourers. Almost invariably the small scale farmers are conservative and oppose changes. (iii) In other cases State intervention has been due to sentimental considerations and the belief that agriculture is not only a business but a way of life, which should be protected at all costs, irrespective of economic considerations. "In recent years its intervention has become so important, in almost all countries, as to constitute a major factor in agricultural development."[9]

(*e*) The peculiarities of agriculture, and the consequent vital differences between manufacturing industries and agriculture are the main reasons, from the economic point of view, why the agricultural application of economic science should be studied separately These peculiarities are very important and deserve a detailed discussion.

9 *Cohen : The Economics of Agriculture, p, 162.*

§ 3. **The peculiarities of agriculture:** Agricultural production exhibits certain peculiar characteristics. These affect decisively the provision of agricultural credit as well as the marketing of agricultural products.

(i) *The greater applicability of the Law of Diminishing Returns:* In agriculture the Law of Diminishing Returns begins to operate at an earlier stage than in manufactures. After a certain stage has been reached, additional applications of capital and labour on a given piece of land lead to a less than proportionate increase in the output and thus to an increase in the costs of production per unit of produce. Agriculture, therefore, requires a larger proportion of land than manufactures and the scale of production tends to be smaller. The earlier operation of the law of Diminishing Returns also accounts for the wide scattering of the areas of production and the great importance of systems of land tenure in agriculture.

(ii) *Absence of differentiation of the factors:* The different factors of production are less clearly marked in agriculture than in the large manufacturing industries. For example, the Indian farmers usually own the land which they cultivate, and employ little hired labour. When prices fall, the manufacturer can reduce his costs by dismissing some labourers, but the farmer cannot, as he employs little hired labour. Even when the price of the agricultural product is very low, the farmer has, in most cases, to continue cultivating his land as he has no other means of earning a living; he, therefore, has often to submit to drastic reductions in his income, especially during periods of falling prices.

(iii) *Dependence on Nature:* Agricultural output ultimately depends on the processes of natural growth. The crops have to grow before they are harvested; Nature does the business and man is merely the manager.[10] This dependence on Nature affects agricultural output in the following ways: (*a*) *A long economic lag between the incurring of expense and the incoming of receipts.* "We may define the economic lag as the length of time during which costs are incurred before a crop is marketed."[11] Thus, the farmer who grows paddy has to go on spending effort and capital in its cultivation and wait for an interval of about six months before he can recoup his expenses by the sale of paddy. This lag between expenditure and receipts is less than a year in the case of crops; it extends from over a year to three years in the case of cattle and from about five years in the case of coffee to over 40 years in the case of timber forests. But during the interval, demand and price might change and completely upset the calculations of the farmer. (*b*) *Periodicity of agricultural operations.* Unlike the manufacturer, the farmer cannot start or stop cultivation when he likes. He has to sow at the right time, and harvest at the right time. All farmers,

10 *Howard:* Labour in Agriculture, p. 13.
11 *Belshaw:* The Provision of Credit to Agriculture. p. 64.

therefore, tend to harvest the crop at the same time and this leads to a regular glut in the market after the harvest is over. (c) *The uncertainty of output.* The farmer, unlike the manufacturer, is unable definitely to control his output. His attempts to restrict output by reducing acreage might be offset by a particularly good harvest. "If nature is tyrannously regular as to when she will give her products, she is superbly irregular as to how much she will give."[12] This uncertainty regarding yield adds a 'large element of unpredictable risk' to the difficulties already enumerated above.

(iv) *The intractability of agriculture*: On account of the predominant part played by nature, the time lag between effort and reward, the regularity of the harvest and the uncertainty of output, farmers find it difficult to adjust their output to changes in demand. For instance, when the price of paddy falls, the farmer cannot at once reduce his output, because he might already have begun cultivation and the harvest might be particularly good. Again, the farmer and his family usually have no other alternative occupations and when the price of paddy falls, they might actually try to produce *more* to secure the same money income. The factors of production employed in agriculture are often specialised and cannot be easily shifted to other occupations. In agriculture, especially during the short period, prime costs form only a small part of the total costs; and prices, therefore, may have to fall very substantially before the farmers give up production. All these factors tend to make agricultural production relatively more intractable than the production of manufactured goods. Supplies cannot be easily contracted when prices fall. Thus, during the world economic depression (1929-32), the total world output of manufactured goods, as measured by the League of Nations, fell by 37%, that of non-agricultural primary products fell by 31%, while agricultural production fell only 1%.[13]

(v) *The inelastic demand for agricultural products*: Agricultural products are mostly foodstuffs and the demand for food as a whole is inelastic. People, when they become richer do not consume proportionately more food. The demand for agricultural products, therefore, rises less rapidly than that for industrial products with a rising standard of life. The proportion of the population employed in agriculture is likely to decline with progress. "Thus the study of argriculture is the study of an industry where the numbers employed are falling."[14]

(vi) *The lag in instantaneous costs*: The lag in instantaneous costs is another peculiar feature of agricultural production. During periods of falling prices, the prices of agricultural products always

12 *Howard*: Labour in Agriculture, p. 6.
13 *Cohen*: The Economics of Agriculture, p. 112.
14 *Ibid.*

fall more rapidly than the prices of industrial products. The farmer, who is usually a buyer in industrial products, is, therefore, compelled to sell his produce cheap and buy his requisites dear. This disequilibrium is further intensified by the fact that the farmer has to sell his produce at wholesale prices which are usually lower than retail prices, and buy the goods he needs at retail rates. Retail prices do not fall as quickly as wholesale prices, when there is a general fall of prices.

(vii) *The instability of agriculture*: As we have already seen, the output of agricultural goods is erratic and responds only slowly to price changes, while demand is inelastic. The result is very wide fluctuations in the prices of agricultural products and in the incomes of the farmers. When the demand is inelastic, *i.e.*, less than unity, a small increase in the supply put on the market leads to a considerable fall in the price. It is not, therefore, unusual for a farmer to dispose of a bigger crop for a smaller total price. This explains why the Brazilian coffee-growers found it more profitable during the recent world economic depression to destroy part of their coffee crop and place only the remainder on the market. It is the farmers who suffer most during periods of depression, as it takes time for them to resist supplies. The trade cycle in agriculture becomes 'not a cycle in output, as it does in industry, but predominantly in prices and profits.'

§ 4. **The effects of the peculiarities of agriculture on agricultural credit and agricultural marketing:** The extreme dependence of agriculture upon nature and biological factors and the resulting element of unpredictable risk, the relatively small size of the farm, the intractability of agricultural production and the consequent inability of the farmer quickly to adjust himself to changes in demand, and the fact that agricultural produce is brought to the market at the same time by a large number of small farmers, all greatly weaken the bargaining position of the farmer. Like all other producers producing in anticipation of demand, the farmer needs credit. He has to bridge the gap between the initiation of production and the final sale of his crop, provide his own working expenses and maintain his family. But the farmer needs credit for a longer period, and, unlike the manufacturer who can stop both production and borrowing when the price of his product falls, the farmer may actually need more credit when the price of his product is falling, as he cannot stop production suddenly. The farmer's demand for credit is, therefore, inelastic. This opens the way for exploitation. Lending to agriculture is lending for relatively long periods to a number of unorganized small-scale producers, whose capacity to repay depends to a large extent on climatic conditions and whose assets like land, growing crops and livestock, are extremely difficult to assess. Lending to agriculture is, therefore, not a desirable risk from the point of view of the ordinary credit agencies like the joint-stock banks. Hence, in the absence of an alternative source of credit like a co-operative credit society, the farmer is driven to borrow from private lenders and dealers at heavy rates of interest. This places the farmer at the mercy of the money lender, who is often in the position of a monopolist. "In general......it may be said that no community, even the most refined, has up to the present wholly solved the problem of maintaining its agriculture without some dangers of exploitation of the agriculturist."[15].

If the farmer is often compelled to buy credit dear, he is also often compelled to sell his produce cheap. As we have already seen, all the farmers in a given locality harvest their crop at the same time and there is a periodical rush of supplies to meet an even and steady demand. This means "some one has to bear the great risk of fitting seasonal food supplies to a continuous human consumption, of feeding the ever-greedy machine with the fibre, the silk, the rubber, the oil, which nature, that unhurried force, produces only at intervals." The farmers are too numerous and are too poor to cope with these difficulties. Thus the Indian farmer has to convert all his crop into cash, as soon as the harvest is over, to pay land revenue to the Government and to meet his loan and interest obligations. This has greatly increased the importance of middlemen who have to pool the irregular supplies of innumerable small farmers, and make them available to the consumers in a steady stream. The fact that agricultural products are bulky, heavy and perishable, adds to the complexity of marketing and to the power of the middlemen. It is not unusual, therefore, for the wholesale traders in an agricultural area to be in the position of monopolists. This accounts partly for the stability of the marketing charges. Thus, when the prices of agricultural products fall, the margins taken by the middlemen tend to remain the same, so that the farmer has to bear the whole brunt of the fall in prices. Thus, in Great Britain, the retail price of potatoes was 264 sh. per ton in 1924-25; 142 sh. per ton in 1929-30. But the margin taken by middlemen, *i.e.*, the marketing charges, during both the years was 97 sh. per ton[16]. Hence, during depressions, the farm prices of agricultural products fall even more severely than the prices paid by the consumers. The middlemen, therefore, take a big slice off the price paid by the consumer and the farmers, when they are not organized, are hardly in a position to protest.

Farmers are thus peculiarly liable to exploitation by money-lenders and middlemen when the State follows a policy of complete *laissez faire* or non-intervention. In periods of depression, they may even fail to recoup their expenses of production. It has often been maintained that 'the world as a whole has been fed below cost for the last 100 years if one takes into account the proper

15 *Howard*: Labour in Agriculture, p. 10.
16 *Cohen*: The Economics of Agriculture, p. 142.

elements of cost.' The danger of exploitation is particularly great in India, where the farmers are mostly ignorant and illiterate and alternative sources of credit like co-operative credit societies are not adequately developed. No wonder the Reserve Bank of India refers to agriculture in India as a "deficit economy."

If agriculture, the main occupation of the majority of the world's population, is to be really a paying industry, and agriculturists are to be assured a reasonable standard of life, some form of State intervention, to offset the weak bargaining power of the farmers, seems to be essential. "The mistake," says Mrs. Howard, in her book *Labour in Agriculture*, "perhaps has been to take things for granted, to suppose that history will put all groups of society in their place, and will bestow on each man, by some unconscious force, his right reward." Can the economic interests of the farmer be adequately safeguarded by voluntary co-operation, or, does such safeguarding require the intervention of the State, is a question to which modern experience has not yet given a definite answer. In every modern country, such as Great Britain, the United States of America, Canada and Australia, the State is intervening more and more to secure for the farmer cheap credit and a fair price for his product. The modern tendency, therefore, seems to be to depend more and more upon State action to secure for the farmer his rightful place in the national economy. *Laissez faire* is, therefore, a wholly undesirable ideal as regards agriculture.

CHAPTER II

THE NEED FOR DEVELOPMENT IN INDIAN AGRICULTURE

§ 1. Agriculture is India's main industry: Agriculture is India's most important industry. The predominant majority of the population in India is employed in agriculture. But more important than this is the steady rise in the proportion of the population dependent on agriculture. This proportion rose from 61 per cent in 1891, to 66 per cent in 1901, and to 73 per cent in 1921.[1] The proportion was 6[illegible] per cent in the 1931 census, but this decrease, according to the Census Commissioner, is apparent rather than real as a number of women supported by agriculture have wrongly been returned as domestic servants.

There has been a steady increase in the population in India and the additional population instead of being absorbed in industry has actually fallen back on agriculture. In fact, side by side with the increase in population, the Indian farmer lost one by one all

1. *The Indian Central Banking Enquiry Committee:* Report par. 58

his subsidiary sources of income. Carting for hire he lost to the motor bus, and the processing of crops, like grinding floor and milling rice, to the mills in towns. The indigenous cottage industries were driven to the wall by the competition of cheap, mass-produced, machine-made goods imported from abroad, and their decline drove the small artisans to seek their livelihood from land. Thus, while industrialisation meant for the Western countries the starting of industries within the country and the provision of more and more employment, for India it meant the destruction of all the indigenous industries with no offsetting increase in employment at home. Though during the past few years, especially after the adoption by India of the policy of discriminating protection in 1923, there has been a gradual development of manufacturing industries, the pace of industrialisation has not been rapid enough to absorb the increase in population. The rural population as a whole increased between 1921 and 1931 from 285 to 313 millions.[2] The steady increase, in India, in the number of people engaged in agriculture is illustrated, even better, by the following figures.

Table I

THE NUMBER OF PERSONS OCCUPIED IN PASTURE, AGRICULTURE, AND INDUSTRIES.[3]

In thousands

	1901	1911	1921	1931
Pasture and Agriculture ...	90,917	105,822	105,349	109,730
Cultivation of special crops	...	1,202	1,450	1,693
Industries ...	...	17,506	17,715	15,352

2 Industries, therefore, provide employment in India to less than 11 per cent of the total workers, and only about 1·5 per cent. of the total workers are supported by organised industries. The total volume of industrial employment has not increased during recent years and, as Mr. Ghate points out, it is highly unlikely that even under the most favourable conditions industrialisation in India will decisively reduce the number of people dependent on agriculture. Agriculture is, and must remain, for many years to come, India's most important industry.

3 Agriculture, again, produces practically all the foodgrains consumed in the country, though in the matter of rice, during recent years, especially after the separation of Burma, India has become a net importer. The major portion of our national income comes from agriculture, and agricultural products like cotton, tea, jute,

2 *The Reserve Bank of India:* Bulletin on Co-operative Village Banks, p. 6.

3 *B. G. Ghate:* Changes in the Occupational Distribution of the Population, pp. 21 and 26.

oil-seeds, etc., provide the majority of our exports as the following tables will show.

Table II

EXPORTS FROM INDIA OF SOME IMPORTANT AGRICULTURAL PRODUCTS IN 1938-39 and 1939-40

	1938-39		1939-43	
	Value in thousands of Rupees.	Percentage of total exports of merchandise.	Value in thousands of Rupees.	Percentage of total exports of merchandise.
Jute (raw) ...	13,39,67	8·22	19,73,18	9·70
,, (manufactured) ...	26,26,11	16·12	48,68,78	23·93
Cotton (raw and waste) ...	24,66,65	15·14	31,04,15	15·26
,, (manufactured) ...	7,11,79	4·37	8,57,58	4·22
Tea ...	23,42,47	14·38	26,07,78	12·82
Seeds ...	15,09,22	9·26	11,89,53	5·85
Grain, Pulse and Flour	7,74,12	4·75	5,07,37	2·49
Oil cakes	3,01,20	1·85	2,02,92	1·00
Tobacco	2,75,63	1·69	2,52,81	1·24
Fruit and Vegetables ...	2,26,86	1·39	2,36,94	1·16
	125,73,72	77·17	158,01,04	77·67

Table III

AGRICULTURAL PRODUCTION AND INDUSTRIAL PRODUCTION (QUANTITY AND VALUES)[4]

Average of the two years 1934-35 and 1935-36

Agricultural Production.			Industrial Production.		
	Quantity	Value in crores of rupees		Quantity	Value in crores of rupees
Rice (Million tons)	29·0	504	Cotton Yarn (Millions of lbs.)	1030	128·3
Wheat ,,	9·6	174	Cotton Cloth (Millions of yds.)	3483	139·3
Sugarcane ,,	5·5	138	Jute bags (Millions)	637	29·3
Jowar ,,	6·2	103	Jute bags (Millions) of yds.)	1239	24·3
Bajra ,,	2·6	45	Sugar (thousands of tons)	784	36·8
Maize ,,	2·3	31	Coal (Millions of tons)	20·8	18·7
Gram ,,	3·8	71	Cement (thousands of tons)	835·0	4·4
Barley ,,	2·4	50	Paper ,,	46·4	2·2
Groundnuts ,,	2·1	63	Pig iron ,,	1442·0	5·0
Linseed (thousands of tons)	402·0	10	Steel ,,	652·0	11·7
Rapeseed ,,	972·0	22			
Sesamum ,,	433·0	13			
Tea (Million lbs.)	398·0	23			
Cotton (Million bales)	5·4	100			
Jute ,, ,,	8·0	43			
Total Value of Agricultural Production		1390	Total Value of Industrial Production		401

4. Based on *P. J. Thomas and N. Sundararama Sastry:* Indani Agricultural Statistics, Tables VIII and IX.

4 It is also necessary to remember that in India no policy of industrialisation can succeed unless it is based on a prosperous and sound agriculture. India, during recent years, has been following a policy of discriminating protection and gradual industrialisation. For instance, the textile and sugar industries have been developed in India by the imposition of protective tariffs on competing imports. But agricultural and industrial development are closely inter-related. Industrialisation will help Indian agriculture by providing for the raw materials produced by agriculture, such as cotton and sugar-cane, a stable and expanding internal market. It will also make more and more capital available for permanent improvements to land, as a part of the profits earned in industries is likely to flow into agriculture. The development of industries will also help to raise wages in agriculture, by providing the agricultural labourers with alternative employments. But the prosperity of industries, in its turn, depends on agriculture. The big agricultural population constitutes the main market for the products of Indian industries and some of the industries, such as the textile and sugar industries, depend on agriculture for their main raw materials. Thus industries and agriculture are complementary to each other rather than rivals in India, and the development of large manufacturing industries will be facilitated by improvements in agriculture.

5 Indian public finance, like private finance, is vitally affected by agriculture. Land Revenue is the mainstay of provincial finance and the yield of the other sources of provincial revenue, such as restrictive excise and stamp duties, also depends to a large extent on the condition of agriculture. When the harvests fail, the provincial Government has to face a decline not only in the yield of land revenue but also in the receipts from excise and stamp duties; it has at the same time to find more money for expenditure on famine relief. Nor is the Central Government independent of fluctuations in the prosperity of the farmer. During an agricultural depression there is a decline in the transport of agricultural crops and in the purchasing power of the farmers. These lead to a fall in railway receipts and in the customs revenue as there is less demand for imported goods from foreign countries. Thus 'agricultural prosperity or depression is the permanent warp of Indian finance, and when the farmers are unable to balance their budgets, the Governments also find it difficult to balance theirs.

Agriculture, therefore, is the backbone of the Indian economic system; the economic prosperity of India is inextricably bound up with the prosperity of Indian agriculture.

§ 2. **The present position of Indian agriculture:** But unfortunately, India's most important industry is also one of her most depressed industries. "In India," says Dr. Clouston, once Agricultural Adviser to the Government of India, "we have our depressed classes; we have, too, our depressed industries, and agriculture, unfortunately, is one of them." The outstanding feature of the Indian rural economy is the appalling poverty of the cultivators. According to the Indian Central Banking Enquiry Committee, the average income of an agriculturist in India is not higher than Rs. 42, or a little over £3 a year. When we compare this with the *per capita* income of £95 in Great Britain, the contrast is startling.[5]

There are many reasons for the extremely low *per capita* income of the Indian farmer. One is the extremely small size of the holdings. When the farm becomes too small it fails to give full and profitable employment to the farmer and his equipment; cultivation becomes more and more uneconomic. But what is even worse, even this small holding is held not in one compact block, but in fragments scattered throughout the village area.

Another reason is the extreme dependence of the Indian farmer on climatic conditions. Farmers, throughout the world, are affected by changes in the weather, but, the monsoons in India are proverbially irregular. Over vast tracts, where there are no irrigation facilities, the farmer depends mainly on the monsoon which 'has all the proverbial caprice of the Eastern potentate.' This has made him fatalistic and reduced the incentive to improvement. Frequent failures of crops due to drought and floods, and the low vitality and the high mortality of the livestock, render the economic position of the farmer inherently unstable.

The extremely low yield per acre is another feature of Indian agriculture. According to Sir M. Visweswarayya "the average production of British India, including irrigated crops, cannot be more than twenty-five rupees per acre; in Japan it cannot be less than a hundred and fifty."[6] As regards sugar, the actual outturn per acre in India is less than one-third that of Cuba, one-sixth of Java and one-seventh of Hawai.

But the yield per acre, by itself, cannot be a satisfactory test of the agricultural prosperity of a country; for, in new countries with plenty of land, the maximum income per head is secured when the farmer cultivates extensively a large area of land. But in India where the size of the farm is extremely small, the low yield per acre means a very low income per head.

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5 *The Indian Central Banking Enquiry Committee:* Majority Report, par. 57

6 *Sir M. Visweswarayya:* Reconstructing India, p. 174.

Table IV

Country.		Wheat[1] lbs. per acre.	Rice[2] lbs. per acre.	Cotton[3] lbs. per acre.	Groundnut[4] lbs. per acre.
Canada	...	972	...	...	...
United States	...	846	...	169	...
Europe	...	1146	...	...	...
Italy	...	...	4743	...	...
China	...	...	...	...	1600
Egypt	...	...	3719	397	...
India	...	636	828	85	900
Japan	...	...	2988	...	...
Australia	...	714	...	...	...
Mauritius	...	...	...	...	2200

The poverty of the Indian farmer is also due to the almost 4 complete absence of subsidiary occupations, which can enable him to eke out his slender income from agriculture. This complete dependence of the cultivator on the produce from the soil renders him particularly vulnerable to famine. Almost all the village industries on which the farmer relied in the past, when the village economy was self-sufficing, have been wiped out by the competition of cheap machine-made goods.

5 The defective marketing system adds to the woes of the Indian farmer. With the commercialisation of agriculture, the Indian cultivator 'is being drawn slowly but steadily into the sphere of influence of markets, both national and international. But the Indian farmer has neither the ability nor the organisation to protect his own interests in a competitive market. Nor has he agencies which will finance him to hold back his crop for a better price when the prevailing price is abnormally low. The buyers of agricultural produce such as the cotton mills and sugar factories and exporting firms are, on the other hand, often well organized. The result is, that in most cases the Indian farmer is unable to secure a fair price for his produce. The essence of successful business is to 'buy cheap and sell dear.' The Indian farmer often buys dear and sells cheap.

On account of all these reasons, the cultivator often does not earn enough to maintain himself till the next harvest. This inadequacy of income, and expenditure on social ceremonies demanded by custom, force the cultivator to borrow. These credit needs are satisfied only at ruinous prices. But such unproductive borrowing does not add to the income of the farmer and thus create

1 From the Report on the Marketing of Wheat of India.
2 ,, the Report of the Land Revenue Commission, Bengal. Note of dissent by Dr. Radha Kumud Mookerji.
3 ,, the Handbook of Commercial Information for India.
4 ,, the Report on the Marketing of Groundnuts in India.

its own means of repayment. The result is, once in debt, the farmer in India is always in debt. This has led to a large mass of unproductive debt estimated at more than a 1000 crores of rupees. When a farmer is a debtor, his right to the land he cultivates becomes precarious; often he loses his liberty to dispose of his crop at a fair price, and he has to pay exorbitant rates of interest which eat into the profits from agriculture. He, therefore, loses all incentive to improvement.

The troubles of the Indian farmer are aggravated by his illiteracy, which prevents the rapid spread of improvements and facilitates exploitation by unscrupulous middlemen.

Thus, judged by whatever standard, Indian agriculture is in a bad way. As the Royal Commission on Agriculture in India have summed up so well, "To a very great extent the cultivator in India labours not for profit nor for a net return but for subsistence. The crowding of the people on the land, the lack of alternative means of securing a living, the difficulty of finding any avenue of escape, and the early age at which a man is burdened with dependents, combine to force the cultivator to grow food wherever he can and on whatever terms he can."

As we have seen, agriculture is India's most important industry. It is, therefore, imperative that measures should be undertaken to improve the organisation of agriculture, to put the industry on a paying basis, and to increase the *per capita* income of the Indian farmers. If India is to be prosperous, the incomes of the cultivators should be raised by wise economic planning.

§ 3. **Is the food supply in India adequate?**[7] There has been, during recent years, a growing volume of opinion that in India the food supply of the country has not kept pace with the rapid increase in population. It is, of course, true that a country need not raise all the food that it needs for consumption; what is really relevant is the total volume of wealth, both agricultural and industrial, that it produces, and a country may concentrate on manufactures and import part of its food supply. But India is on the whole self-sufficient with regard to food supply, and imports normally provide only a very small proportion of the food available. If, therefore, it can be proved that the food supply raised within the country has increased only at a slower rate than the increase in population, it can rightly be held that in India, population is pressing on the means of subsistence, and that there is over-population in the strict sense of the term.

Though statistics regarding the total volume of food-production in India are inaccurate and unreliable, and little is known regarding the actual diet needs of the people, estimates have often

7. Normally India is a net importer of food grains. She has a small surplus of wheat offset by a deficit in rice to the extent of 1·5 million tons.

been made regarding its adequacy. Thus, according to Dr. Radhakamal Mukerji, India's present food supply is 280.4 billion calories, whereas the total food needs of the people amounts to 321.5 billion calories. He therefore holds that there is a calorie shortage of 41.1 million calories and concludes that 12 per cent of the population of the country must be going without food.[8] Again, Mr. P. K. Wattal, in his Presidential Address at the All-India Population Conference of 1938, points out of that during the period 1913-14 to 1935-36 while population increased at the rate of nearly 1 per cent per annum, crop production increased by only 0.65 per cent per annum, and suggests that the population has outrun the means of subsistence.[9]

On the other hand, Dr. P. J. Thomas holds that food supply in India has more than kept pace with the increase in population. According to him, while population increased only by 12 per cent between 1911-14 and 1930-34, the available food supply increased by 20 per cent.

Table V[10]

Commodity.	Weight.	1911-14	1915-19	1920-24	1925-29	1930-34
Rice ...	52	100	115	107	104	114
Wheat ...	15	100	104	107	104	116
Barley ...	5	100	97	89	76	77
Maize ...	3	100	118	105	108	112
Bajra ...	4	100	118	120	128	127
Jowar ...	8	100	125	143	164	164
Gram ...	7	100	109	126	104	212
Sugar ...	6	100	118	116	123	173
All Commodities.	...	100	113	111	110	120
Population ...	...	100	105	101	107	112

But he rightly points out that, to form a correct estimate of the economic condition of the people, what is relevant is the total

Table VI[11]

	1920-21 to 1921-22 (Average)	1934-35 to 1935-36 (Average).
Population	100	115
Agriculture	100	121
Industrial Production ...	100	267

8 *Dr. Radhakamal Mukerji*: Food Planning for Four Hundred Millions.

9 *Jathar and Beri :* Indian Economics, Vol. I, p. 78.

10 *P. J. Thomas and N. Sundararama Sastry:* Indian Agricultural Statistics, p. 90.

11 *ibid.*, p. 97.

volume of production and not merely the food supply. There has been a striking increase in industrial production during recent years, and he holds that in India, the total volume of production has actually increased more rapidly than the increase in population.

If the majority of the population in India are undernourished this must be, according to him, due not to the rapid increase in population, nor to any lag in the food supply, but probably to the bad distribution of the present income.

Views, therefore, are extremely divergent, and statistics of production have been used to support totally divergent views. To find out whether the food supply in India is adequate or not we must know accurately, (*a*) the total quantity of food available for consumption, and (*b*) the actual diet requirements of the people, and, with regard to both, the information we possess is extremely inadequate.[12] But there are certain accepted facts which might help us to arrive at a conclusion. Firstly, during the past few decades, while the population of British India has been increasing steadily, the increase in the net area sown with crops has been extremely slow and gradual. A study of the available statistical data strongly suggests that there has been a steady decline in the *per capita* area sown.

Table VII

NET PER CAPITA SOWN (BRITISH INDIA)

Year	Population (Millions)	Average net area sown (Million acres)	Per capita area sown (acres)
1911	231·6	208	0· 9
1921	233·6	205	0·88
1931	256·8	211	0·82
1941	295·8	215	0·72

2 Secondly, the proportion of the total area under food crops has declined while that under commercial crops has increased. The acreage under food crops has not kept pace with the growth in population and there is an actual fall in the acreage per head. "During the period 1908-09 to 1917-18, 0.89 acres per head of population were devoted to food crops, while during the period 1928-29 to 1932-33 the acreage had sunk to 0.79 per head. The population had increased by 28.7 millions but the area under food crops went up only by 2.6 million acres, only 0.09 acres per head. The non-food crops have on the other hand kept pace with the population, the acreage per head being 0.044 in the earlier and 0.057 in the later of the two periods. The decline in the acreage

12 A more accurate determination of the statistical facts in relation to India's food supply is absolutely essential for the formation of a successful food policy, according to the Food Grains Policy Committee.

13 The Famine Inquiry Commission—Final Report (1945), page 78.

per head under food crops is revealed even more clearly by the following estimates made by Dr. W. Burns[14].—

Table VIII

Year	Acreage per head under food crops including all food grains, sugarcane, vegetables, fruits condiments and spices.
1911	0·83
1921	0·86
1931	0·79
1941	0·67

3 The decline in the acreage per head under food crops might not mean a smaller food supply per head if it had coincided with an increase in the yield of crops, but there is little evidence to show that the yield per acre has increased during the past few years. The spread of improved varieties has been very slow and research has been concentrated hitherto more on commercial than on food crops. It is, therefore, difficult to accept Dr. Thomas's conclusion that the food supply in India has increased more rapidly than the increase in population. We are rather inclined to agree with Sir John Russell that "the statistics are not good enough to show how much the total production of food has varied and whether it has kept up with the population." But all the available information suggests very strongly that there is in India a widening gap between the amount of food necessary to provide her population an adequate and well-balanced diet and the actual food supply available. There is also little doubt that in India more people depend on land than it can support on a reasonable standard of life.

Even in the absence of adequate statistical data, we can recognise the presence of a pressure on land and an agricultural over-population by certain symptomatic phenomena, all of which are present in India. These are, the progressive decline in the size of the holdings due to successive subdivisions, increasing fragmentation and the emergence of dwarf holdings, the high percentage of food crops to the total cultivated area and the low unit yield per acre. All these lead to a state of chronic under-nutrition, which undermines the health and vitality of the farmers and eats away into their spirit of enterprise.

We can, therefore, conclude that India is suffering from agricultural over-population. The remedy lies in two directions, *viz.*, a rationalisation of agriculture which will increase the yield from land, and an industrialisation of the country which would take away the surplus people from land. Attempts should be made to increase the yield from land (by the adoption of better

14 Technological Possibilities of Agricultural Development in India. p. 21

methods of production, mixed farming, better systems of crop rotation, etc.,) to revive cottage industries, and to reclaim new land by the provision of irrigation facilities and by schemes of agricultural colonisation.

There is another aspect of the problem of food supply to which reference should be made before we conclude this discussion. Researches of experts like Dr. Akroyd indicate that what India needs is really not more of cereals such as wheat, rice and ragi, but a more balanced diet. According to Sir John Russell "The well balanced diet does not require more but less cereals than at present, but it includes more of everything else, especially of vegetables, fruit and milk." The objective, therefore, in India should be to produce more of these supplementary and protective foods, and to release more and more land for their production by increasing the yield of the food grains on the lands on which they are cultivated. As Sir John Russell suggests, a nutritional survey should be undertaken in each province to decide the chief deficiencies in the dietary, and the medical authorities and agricultural experts should decide together the crops to be grown in the province to remedy the deficiencies. The Agricultural Departments should then encourage the cultivation of these crops by all means in their power.

§ 4. **The War and India's food supply:** The precarious nature of India's food supply, the inadequacy of the internal production to secure for the people of India even mere freedom from hunger, and the disastrous consequence of the absence of a positive agricultural policy on the part of the State, have all been demonstrated clearly by the impact of the present war on India and the food crisis of 1943.

The food crisis of 1943 was accentuated by factors operating on both the supply and the demand sides. On the *side of supply*, firstly, the loss of Burma deprived India of her annual imports of rice which in the pre-war years had averaged at about 1·5 million tons. Secondly, one of the worst cyclones in Bengal's history and one of the worst fungus epidemics on record, destroyed over a million tons of Bengal's ripening crops. Thirdly, the war with its demand on the transport services made difficult imports from other areas to make up for local shortages. On the *side of demand*, there was the shock administered to public confidence by the rapid advance of Japan and the loss of Burma, the steep rise in prices caused by the inflation of currency which made it profitable for the cultivators to hoard grain instead of rupee notes, the increased consumption by the cultivators who after years of depression were now realising better prices, the speculative purchases by traders speculating against a rising market, and the feverish buying by the relatively well-to-do consumers to insure themselves against a future breakdown in the supplies. The shortage was further aggravated by exports of food grains to Ceylon and the Middle East, the influx of more than a million evacuees and war-prisoners, and purchases for the large foreign army stationed in India. Naturally food prices soared to unprecedented heights; towards the close of 1943 rice was selling in Bengal at ten times its pre-war price, and food prices in general had reached levels at which it became impossible for the average consumer to satisfy his food requirements. Before the famine in Bengal could be brought under control more than three million lives had been lost due to starvation and disease.

The famine of 1943 has brought home the urgent need in India for the adoption of a bold and comprehensive food policy by the Central and the Provincial Governments. Obviously, if such crises are not to recur in the future and if the people of India are to be ensured an adequate and well-balanced diet there should be a well-planned drive to increase the food production in India. This campaign for increased food production should naturally be made up of two distinct programmes: one a short-term programme to be implemented immediately to enable the country to achieve a decisive increase in its food production with the least delay to meet the shortage caused by the war, and the other a long-term plan which will secure a better balance between the population and the food supply in India, and also a better balance between the agricultural and industrial production.

Any short-term programme to increase rapidly the food supplies available in India, if it is to yield the maximum results, should include the following features. (i) A government guarantee of the prices of food grains: It is essential that in the present period of transition from war to peace, the prices of foodgrains should be established at a predetermined minimum if their production is to be expanded. It is idle to expect the farmer to break up new land and to increase output when the future is uncertain and a flood of imports might at any time break up the agricultural price levels. (ii) A regular supply to the farmers, at specially low prices, of the prime requisites of agricultural production, such as improved seeds, fertilisers, agricultural implements and cattle, to facilitate intensive cultivation. (iii) The extension of credit facilities to farmers who want to improve their holdings or to break up new lands and the provision by the State of the necessary technical guidance. (iv) Subsidies to agriculture, as in the United Kingdom, to encourage the extension of cultivation and to keep down the prices of the essential foods. (v) Government purchase of all the food grains offered, at the guaranteed minimum prices to ensure a steady market. The control of civilian consumption necessitated by the war time shortages might also be used to educate the tastes of the people in the matter of food and to accustom the people to a more balanced diet.

This short-term programme designed to meet the war-time shortage in food supply must be dove-tailed with a long-term programme which will correct the underlying long-term trend in India towards progressive food shortage and malnutritions. This long-term programme must aim at securing for India, (i) a decisive increase in the agricultural output and in the *per capita* income of the Indian farmers; (ii) a proper balance between the commercial crops and the food crops; and (iii) the ideal balance between agriculture and large-scale industry.

How quickly progress can be made in this direction by a determined effort on the part of the State is demonstrated clearly by war-time experience in the United Kingdom. Since the out-break of World War II in September 1939, the United Kingdom has been able to increase the area under cultivation by 45%, and has achieved a 50% increase in her output of cereals. By a system of subsidies to farmers new areas have been brought under the plough and food prices, especially the prices of protective foods, such as milk, have been kept down. By a system of rationing, which was introduced on the very out-break of the war in 1939, an equitable distribution of the available supplies of food has been ensured, and according to the testimony of Sir John Boyd Orr, the poorer sections of the people of the United Kingdom are actually better fed today than before the war. Nothing can show more clearly how quickly results can be achieved by a good system of agricultural planning.

§ 5. **The initiative for improvement has to come from the Government**: The economic regeneration of agriculture, which occupies nearly three-fourths of the population, is almost the only way by which the *per capita* income and standard of life in India can be raised. The objective of agricultural policy in India should be to enable the farmer not only to raise a bigger crop per acre but also to sell it for a better price. The majority of the ryots in India, as we have already seen, are illiterate peasants following traditional, antiquated methods of productions, cultivating small farms. The disappearance of the self-sufficient village economy and the commercialisation of agriculture have projected the Indian farmer into a competitve system which he does not fully understand. Thus the farmer looks on helplessly when the price of the paddy he has produced falls because of the competition of imports from Indo-China and Siam. The cultivators in India have neither the education nor the organisation necessary to protect their own interests in a competitive market. No wonder, with their weak bargaining power, they are exploited by almost all the parties who deal with them.

The poverty and illiteracy of the ryots preclude their taking the initiative in agricultural improvement themselves. Such initiative has, therefore, to come from the Government. Any scheme for the improvement of agriculture in India has to tackle and solve four fundamental problems, *viz.*, the crushing burden of agricultural debt, the small size of the farm, the low yield per acre and the extremely low income of the farmer, and the defective marketing organisation which robs the farmer of the just rewards of his labour. As was seen in § 2 of this chapter, so long as the farmer continues to be fettered by the shackles of debt he will have no incentive for improvement. No one likes to sow where another is likely to reap. Also, in the absence of cheap credit facilities, it is futile to expect the farmer to adopt better methods of cultivation and better implements, and to invest capital in the improvement of livestock. In the subsequent chapters, therefore, we shall examine the rural debt problem and the different methods adopted in India to reduce the burden of agricultural debt and to provide cheap credit to the farmer; the part played by land in agriculture and the size of the farm; the methods by which the yield from land and the incomes of the farmers can be raised in India; the general theory of agricultural marketing, the defects in the marketing organisation in India and the possible remedies, and the different types of land tenure and the relationship of the particular type of land tenure to efficiency in agricultural operations.

CHAPTER III

RURAL INDEBTEDNESS IN INDIA

1. Rural indebtedness—its causes: The indebtedness of the Indian farmer is proverbial. At no time in his life is the Indian peasant able to dispense with the money-lender. To purchase seedings, to maintain himself and his family during the pre-harvest season and during years of drought, and to meet the expenses necessitated by the tyranny of long-standing social customs, the peasant invariably seeks the aid of the money-lender. Just as he inherits his father's lands, so he often inherits his parents' debts. The encumbrances of the deceased father frequently affect the life of the son adversely.

The agriculturist fights shy of mortgaging his lands lest his social position should be damaged. He is, therefore, ready to borrow by the simple process of affixing his signature to a bond, however high the rate of interest may be. The money-lender is also tempted by the high rate of interest to make reckless advances; but he does not necessarily undertake great risks by giving unsecured loans, as usually he is adequately compensated by the high rate of interest he receives. Also, "he has ample security in the triple chain of caste, custom and character which necessarily binds the peasant to the soil"; and as long as the peasant holds the land the money-lender can enrich himself.

Thus from generation to generation the Indian peasant has been haunted by the nightmare of the debts. He may slave all his life but he can never free himself from the grip of the money-lender. The result is "the Indian peasant is born in debt, lives in debt, dies in debt and bequeaths debt." The existence of debts is one of the root causes for the degeneration of the peasant in India. The future of the country cannot be rosy when the tiller of the soil, the custodian of the national wealth, is in this melancholy plight.

Why do peasants run into debts? A variety of reasons account for the immersion of the Indian peasantry in debt. Some stress the fact that the Indian peasant has a tendency to borrow for unproductive purposes, some complain of the burden of ancestral debts, while others trace the peasant's financial difficulties to the uncertainty of the Indian monsoons and to the uneconomic nature of the ryot's small holdings. Some of the more important causes of the agriculturist's indebtedness deserve detailed discussion.

1. The excessive subdivision and fragmentation of holdings so common in India leads to much wastage. When the holdings are too small, cultivation ceases to be economical and the yield from land becomes insufficient for the maintenance of the farmer and his family. Hence the cultivator is driven to the necessity of depending on the money-lender not only for unforeseen but even for his living expenses. Thus, the root cause of agricultural debt is the insufficiency of agricultural income.

2. The decline of the handicrafts in India, and the consequent unemployment of the ryot for part of the year, is another important cause of rural indebtedness. If the handicrafts were as prosperous as they were once, they would act as safety-valves for the population depending on agriculture. But, as conditions are at present, the peasants have no subsidiary occupation to which they can turn during their spare time. This enforced idleness during a part of the year impoverishes the poor peasant still further. The bulk of the rural population has thus to depend on land and land alone. The income from land is too meagre to meet the needs of the large number of persons depending on it. Hence the peasants are forced to seek the money-lenders' expensive aid.

3. Agriculture in India is said to be a gamble on the monsoon. A large part of the country depends on rain for cultivation, but the monsoon is extremely uncertain. When the rains fail, the poor peasant is in distress. There is almost a regular cycle in the yield of the crops. It has thus been estimated that on an average, for every five years, there is usually one good year, one bad year and three years of neither good nor bad. This constant variation in the yield of the land and the consequent instability of agricultural income also forces the agriculturist to borrow to meet his expenses during lean years.

4. Another contributory cause is the periodic loss of cattle through diseases which every year levy a heavy toll upon the agriculturists' possessions. The peasants have to borrow money to replace cattle.

5. Diseases such as malaria, which often ravage the villages, permanently undermine the efficiency of the peasants. Malaria is a very common fever in the waterlogged agricultural tracts. This tells upon the vitality of the agriculturist, lowers his efficiency and thereby his earning capacity.

6. The Indian agriculturist is said to have a fancy for litigation and he wastes a good deal on marriages and social functions. But though these might occasionally lead to debts they can hardly be the main causes of rural indebtedness. Social and domestic functions such as marriages are but occasional events. What makes the ryot indebted is mainly the annual budget of his own household and, as we have seen, this is invariably a deficit budget.

7. Ancestral debts are one of the chief causes of rural indebtedness. On account of the heavy rates of interest charged and the practice of charging compound interest, the borrowing ryot is hardly able to clear his debts during his lifetime and it is thus passed on to his son. The bearing of ancestral debt is considered a sacred obligation in Hindu India; and accordingly most ryots desist from seeking legal protection, even when this is possible, to save themselves from the clutches of the usurious money-lenders.

8. Yet another reason for the ryot's indebtedness is the security afforded by a stable government. The establishment of Pax Britannica and of ordered government, the development of communications and the opening up of foreign markets led to a steady rise in the value of land and facilitated borrowing on the security of land. The improvident Indian ryot limits his borrowing, not by his wants but by his opportunities, and the ease with which loans could be raised on the mortgage of land led to a tremendous increase in the volume of agricultural debt.

9. The money-lenders' demoralising system of uncontrolled credit is yet another cause. Peasants are generally illiterate and the money-lenders are able to exploit them easily. Accounts are often fraudulent and the interest charged is invariably usurious; hence, however much a peasant may try to clear off his debt, he finds himself under a perpetual liability to the money-lender.

As will be evident from the causes of indebtedness enumerated above, the farmers in India do not, in general, contract debts for productive purposes. The money expended on the improvement of land accounts only for a meagre proportion of the total debt. It cannot be maintained that the land revenue demand has been oppressive; that a large number of debts are contracted on the security of land is adequate proof that land is still a secure source of investment and that the assessment is not in any way oppressive when compared to the yield of the land. But it has to be admitted that the inelasticity of the land revenue demand has compelled peasants occasionally to borrow for the payment of land revenue, especially during periods of falling prices.

§ 2. **Estimates of rural debts:** Accurate statistics are not available of the total rural indebtedness in the country. Various estimates have been offered but in almost all these there is a large element of guess-work. Sir Edward Maclagan estimated in 1911 the total rural indebtedness of British India at about Rs. 300 crores. During recent years the various provincial Banking Enquiry Committees have estimated the rural indebtedness of the different provinces as follows.

Table IX

	Total Rural Indebtedness	
Assam	Rs.	22 crores
Bengal	,,	100 ,,
Bihar and Orissa	,,	155 ,,
Bombay (including Sind)	,,	81 ,,
Central areas	,,	36 ,,
Coorg	,,	35 to 55 lakhs
Madras	,,	150 crores
Punjab	,,	135 ,,
United Provinces	,,	124 ,,

Thus the total rural debt of British India was about Rs. 900 crores in 1929. Since then the agriculturists have had to pass through one of the worst economic depressions, and there has been a steady increase in the rural debt which at present is estimated to exceed Rs. 1,200 crores for British India alone.[1] In fact this tendency of the rural debt to increase steadily has been one of the most disturbing features of the agricultural situation in India for decades. For instance, the total agricultural debt in the Punjab increased from Rs. 90 crores in 1921, to Rs. 135 crores in 1929. The Royal Commission on Agriculture in India draw particular

1. Little accurate information is available as to the effects of the War on agricultural indebtedness in India. Agricultural prices have, of course, risen but the prices of the manufactured goods needed by the farmer, such as cloth, have risen even more. Again, the rise in the prices of agricultural produce must have been largely offset by the rapid rise in the costs of cultivation caused by the steep rise in the prices of manure, fodder, draught cattle, and agricultural implements and in the cost of transport. Also, while the larger landlords must have benefitted to a greater or smaller extent by the war-time rise in prices, it is extremely doubtful whether the small cultivator has actually benefitted by the war, and our doubts are confirmed by the prevailing distress in many rural areas.

attention to this fact. "It is more than probable" they write, "that the total rural indebtedness has increased in the provinces. Whether the proportion it bears to the growing assets of the people has remained at the same level, or whether it is a heavier burden or lighter burden on the more prosperous cultivator than of old, are questions to which the evidence we have received does not provide an answer."

But more serious is the fact that most of this debt has been incurred for unproductive purposes. Even in the Punjab only five per cent of the total agricultural debt is estimated to have been borrowed for productive purposes. A loan borrowed for an unproductive purpose does not create its own means of repayment and results in a reduction in the net income of the borrower.

§ 3. **Why should agriculturists be protected by debt legislation? Government policy in India till the world economic depression**: In a predominantly agricultural country like India peasants form the back bone of the national economy. "The lesson of universal agrarian history from Rome to Scotland is that an essential of agriculture is credit. Neither the condition of the country nor the nature of the land tenures, nor the position of agriculture, affects the one great fact that agriculturists must borrow."[2] The Indian agriculturist in his anxiety to borrow money invariably falls into the trap of the usurer, as he has too little bargaining power to protect his own interests under a regime of *laissez faire.* There is ample justification, therefore, not only for enacting laws to extricate the peasants from the clutches of the money-lenders, but also for devising such machinery as will provide cheap credit facilities to the agriculturists.

The steady increase in the volume of the agricultural debt, the discontent caused by the exploitaton of cultivators by money-lenders, and the increasing realisation of the fact that the illiterate peasant with his inelastic demand for credit had neither the capacity nor the bargaining power to protect his own interests while dealing with the money-lender, forced the Government in the seventies of the last century to intervene with measures to help the indebted farmers. Firstly, improvements were made in the civil law with a view to reducing the exploitation by money-lenders of ignorant agriculturists. Secondly, by educating the ryots to take a business-like view of borrowing, by remitting the land revenue assessment during years of scarcity, and by inducing thrift, the Government tried to make the farmers avoid unnecessary debts. Thirdly, by placing restrictions on the alienation of land it tried to prevent the wholesale transfer of land from the agriculturists to the money-lenders.[3] Lastly, the Government undertook

2. *Nicholson.* Report regarding the possibility of introducing land and agricultural banks in the Madras Presidency, 1895.
3. These have been discussed in detail in Chapter VI § 7.

a number of measures with a view to providing alternative sources of credit and reducing the hold of the money-lenders. Thus the Government first tried to finance the farmers directly and began to advance both short and long-term credit under the Agriculturists' and Land Improvements Loans Acts (1884 and 1885).[4] But soon it was realised that it was not desirable for the Government directly to take up the responsibility of financing the farmers. This led to the passing of the Co-operative Credit Societies Act in 1904. By encouraging the starting of co-operative credit societies and of land mortgage banks, the Government have tried to give relief to the indebted farmers.[5]

§ 4. **Post-depression debt legislation:** But the economic depression which set in, in 1929, gravely affected the repaying capacity of the agriculturists and necessitated more drastic measures. Prices of agricultural produce fell and the real burden of the debts increased. Provincial Governments were, therefore, forced to devise ways and means to reduce the burden of rural debts and the result was an enormous amount of debt legislation during the decade 1930–40 with the following three objectives:—

(*a*) The provision of relief to the cultivators by scaling down and lightening the crushing burden of the standing debt ;

(*b*) the regulation of the money-lending business and the creation of systematised rural financing agencies ; and

(*c*) the provision of safeguards for the protection of the person and property of the debtor against exploitation by the creditors.

Emergency Measures: To give immediate and speedy relief to the indebted agriculturists three types of laws were enacted:—

(*a*) Moratorium laws.

(*b*) Laws to reduce the burden of the interest liabilities.

(*c*) Laws to scale down the principal of the debt and devise convenient methods of repayment.

§ 5. **Moratorium laws**: The catastrophic fall in prices during the years after 1929, as seen above, made it extremely difficult for agriculturist debtors to honour their obligations. The money-lenders rushed to the courts of law and wanted to 'take their pound of flesh' in the form of land. There was the imminent danger of the lands being sold up at the extremely low depression prices to the creditors. No Government, especially in an agricultural country like India, can afford to contemplate with equanimity the economic ruin of the large mass of its peasants and the passing of their lands into the hands of a class of absentee landlords. Legislation to protect the agriculturist debtors, therefore, became

4 See Chapter V § 3.

5 See Chapters VII and X.

inevitable. But some device was necessary to prevent the creditors from forestalling such laws by instituting suits for the recovery of their dues while the legislation was pending. To check the rush of creditors to the law courts, to prevent the immediate execution of decrees for the sale of lands, and to give some relief to the agriculturists until the enactment of comprehensive debt legislation, moratorium laws were passed in different provinces.

The United Provinces Temporary Regulation of Execution Act (1934) was enacted with a view to stay the execution of proceedings against judgment debtors who were agriculturist. The small agriculturist, for whose benefit the Act was intended, could stop the execution of decrees against them and apply for a revision of the decreed amount according to the provisions of the Act. The Act provided for the scaling down of the debts due from the small cultivators to 40 to 50 per cent of the amount due. It also laid down that the debt could be paid off in five annual instalments. In 1937, the Congress Ministry, which had in view the framing of a comprehensive scheme for the scaling down of the debts of tenants and small landholders, passed the Temporary Postponement of the Execution of Decrees Act to prevent the rush of creditors to courts of law while the debt relief legislation was being framed. It provided for the postponement, for a period of six months of proceedings against agriculturists who paid as land revenue less than Rs. 1,000 and who were not assessed to income-tax. Those whose land revenue payments exceeded Rs. 250 could get execution proceedings stayed only by depositing one-fifth of the amounts for which the decrees were executed. By another provision of the Act, agricultural debtors who were sent to prison for non-payment of debts were released, Similarly, the Temporary Relief of Small Holders Act was passed in Bombay in 1938 to prevent creditors and landlords from forestalling laws which the Government were contemplating for the protection of agriculturist debtors and tenants. The Act applied only to the small holders (*viz.*, individuals who held less than six acres of irrigated land or eighteen acres of non-irrigated land) and was to be in force for one year.[6] All proceedings for the sale of the land were to be stayed, provided the debtor merely paid the interest on the sum for which the land was to be sold.

The Madras Government brought forward a moratorium bill in October, 1937, but it had to be withdrawn owing to wide-spread criticism. But in the Agriculturists' Relief Act passed soon after, provisions were included to revise the decrees awarded by the courts in the cases of agriculturist debtors, during the period between the publication of the moratorium bill and the passing of the Agriculturists' Relief Act. Thus all the execution proceedings taken

6 This Act is still in force, and in March 1945, its life was extended for another two years.

by courts between 1st October, 1937, and 22nd March, 1938, were declared invalid. The agriculturist debtors could have the decreed amount revised according to the provision of the Agriculturists' Relief Act. All sales of land in execution of decrees during this period were to be set aside.

§ 6. **Measures to reduce the burden of interest liabilities:** But the main problem was to grant relief, by some kind of scaling down of the debts due from them, to the large mass of indebted agriculturists who were only partially solvent. One way of giving such relief was to scale down the interest and to credit excess payments towards the principal.

The amounts due by way of interest from agriculturist debtors have been scaled down in the various provinces in one or more of the following three ways. Firstly, the principle of Damdupat, that arrears of interest should not be decreed for a sum larger than the principal, has been incorporated in some of the Money-lenders' and Debt Relief Acts. Secondly, in some of the provinces a scheduled rate of interest has been prescribed for the depression period and the excess interest paid is to be adjusted to the principal. Thirdly, all arrears of interest on loans contracted before a certain date have been cancelled.

Acts passed in the United Provinces, the Central Provinces, Bombay and Madras have prescribed special rates at which interest is to be calculated for the depression period on depression and pre-depression loans. The Agriculturists' Relief Act of the United Provinces (1934) provided that from 1st January, 1930, to a date fixed by the Local Government, the rate of interest charged on debts could exceed the rate at which the Local Government could borrow from the Central Government by only a certain percentage prescribed by the Local Government. The excess paid under interest was to be credited to the principal.

In the Central Provinces, the Central Provinces and Berar Relief of Indebtedness Act of 1938 authorises the Debt Relief Courts to re-open all transactions made 12 years before the last transaction or before 1st January, 1932, whichever is earlier, to calculate interest on the original principal, at 7 per cent simple interest in the case of secured debts and 10 per cent simple interest in the case of unsecured debts, and to adjust excess payments under interest to the principal. The Act also provides that arrears of interest shall not be awarded for sums greater than the outstanding principal.

The Bombay Agricultural Debtors' Relief Act, 1939, provided for the reduction of the interest burden in three ways:— (i) "The Debt Relief Boards were authorised to allow interest at 12 per cent per annum, simple interest, on debts contracted before 1st January, 1931. (ii) The interest calculated in this way and found due on 1st January, 1931, was to be reduced by 40 per cent if the loan was contracted before 1st January, 1930 ; and by 30 per cent if it was contracted between 1st January, 1930 and 1st January, 1931. (iii) Interest was allowed to be calculated at 9 per cent per annum simple interest or the agreed rate, whichever was lower, after 1st January, 1931, till the date of the application for relief."[7]

The Madras Agriculturists' Relief Act (1938) treated differently the pre-depression and the post-depression debts. (i) All arrears of interest on debts incurred by the agriculturists before 1st October, 1932, outstanding on 1st October, 1937, were cancelled. (ii) The rate of interest on loans contracted after the 1st of October, 1932, was not to exceed 5 per cent simple interest up to October, 1937. (iii) No debt incurred by an agriculturist after the 22nd of March, 1938, was to bear more than $6\frac{1}{4}$ per cent per nnum simple interest.

Another method by which the provincial Governments tried to reduce the payments towards accumulated interest was the adoption of the principle of Damdupat. Bengal (1933), the United Provinces (1934), Madras, Bihar, Bombay and Sind (1938) adopted this principle. In Madras, under the principle of Damdupat, a debtor need not pay anything further towards the debt if he has already paid twice the principal of the loan, whereas in some other provinces the payment of a sum greater than the outsanding principal tewards the arrears of interest is prohibited.

§ 7. **Debt Conciliation**: Side by side with the scaling down of the amount due by way of interest, measures were also undertaken in the various provinces to secure the scaling down of the debts due from the agriculturist debtors.

The best method of bringing about such a scaling down is a voluntary agreement between the agriculturist debtor and his creditors through the agency of Debt Conciliation Boards. Attempts at debt conciliation (*i.e.*, scaling down the debts to bring them within the repaying capacity of the debtors, by a voluntary agreement between the parties) had been made as early as 1897-1900 in the Central Provinces, and between 1906 and 1912 in the Ranchi District of Bihar. The Central Banking Enquiry Committee, reporting in 1931, had seen that the majority of the ryots were only partially solvent and could not repay in full all their debts; it had, therefore, warmly advocated the appointment, in each district, of special officers, to bring together the agriculturist debtor and his creditors and to make the latter agree to some kind of scaling down, which would bring the amount within the repaying capacity of the debtor, and accept payment by instalments. The economic depression and the disastrous fall in agricultural prices made debt relief measures extremely urgent and the Central Provinces led the way with the Central Provinces Debt Conciliation Act of 1933.

7. *Abhyankar*: Provincial Debt Legislation in relation to Rural Credit, p. 10.

The lead given by the Central Provinces was soon followed by the Punjab, Bengal, Madras, Assam[8] and some of the Indian States; the Acts passed in these provinces have followed, in the main, the lines laid down by the Central Provinces Act.

Debt Conciliation Machinery: Under these Acts provincial Governments have been authorised to set up Conciliation Boards to scale down the debts of the agriculturist debtors with the consent of the creditors. The Boards consist of not less than 3 and not more than 12 members, and include representatives of the money-lending and borrowing classes. The class of agriculturist debtors who can apply to these Boards for the conciliation of their debts has been defined in the Acts. Thus in Bengal, the Act is restricted to "rayats and under-rayats whose primary means of livelihood is agriculture," and to those "who cultivate the land themselves or by members of their families or hired labourers or by produce-sharing tenancies."[9] Again, the debts owed by the agriculturist to some agencies have been excluded from the jurisdiction of the Debt Conciliation Boards. Thus debts due to the co-operative societies have been excluded by the Punjab Act, while in the Central Provinces, Madras, Assam and Bengal they can be settled by the Debt Conciliation Boards only with the previous consent in writing of the Registrar. Also, debts due to the banks have been excluded from the jurisdiction of the Debt Conciliation Boards in the Punjab and Bengal.

Any agriculturist debtor who is entitled to relief under the provincial enactment (or any creditor) can apply for a settlement of his debts to the Debt Conciliation Board working in the area in which the debtor resides. The Board will then call upon every one of his creditors to submit to it, within a specified time a statement of the debts due from the debtor with proofs for the debts such as documents, entries in accounts, etc. The Board then tries to persuade the parties to come to an amicable settlement and if an agreement is reached with creditors to whom a certain minimum percentage of the total debts is owing (*e.g.*, 40 per cent in the Central Provinces, 50 per cent in Madras), the agreement is reduced to writing by the Board, is registered within a month and takes effect as if it were a decree of the Civil Court. The Boards have further been authorised to fix the number of instalments in which the scaled down debt is to be repaid.

Penalities for unreasonable creditors: The Debt Conciliation Boards, as can be seen from the above discussion, can secure a scaling down of debts only when at least a part of the creditors are willing to come to an amicable settlement. They have no powers

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8 The Punjab Relief of Indebtedness Act of 1934; the Bengal Agricultural Debtors' Act of 1935; the Assam Debt Conciliation Act of 1935; and the Sind Debt Conciliation Act of 1939.

9 *K. G. Sivasawmy*: Legislative Protection and Relief of Agriculturist Debtors in India, p. 269.

to compel creditors to agree to a settlement. But to prevent refractory creditors from sabotaging the effective working of the Debt Conciliation Boards, certain disabilities are imposed on such creditors. In almost all the provinces, the Debt Conciliation Boards have been authorised to grant a certificate to the debtor when they consider that an agreement has been prevented by the unreasonable attitude of the creditor. Thus, in the Central Provinces when a Debt Conciliation Board is satisfied that the creditor has refused a fair offer, it can grant the debtor a certificate. When such a certificate has been issued the creditor cannot claim costs in suits for the recovery of the debt, nor can he secure more than 6 per cent per annum, simple interest. Again, a mild pressure is brought to bear on the creditors by a number of concessions to the more amicable creditors who have agreed to the settlement sponsored by the Debt Conciliation Board. Such creditors are given a prior charge on the properties of the debtor up to the amount awarded to them by the Board, and they are helped in the recovery of the instalments due to them by the revenue officers.

Refractory creditors against whom a certificate has been granted to the debtors by the Debt Conciliation Boards are subjected to even greater penalties in Bengal. Thus, such creditors can execute any decree they might secure in a court of law against the debtor only "after the expiry of such period not exceeding ten years as may be specified in the certificate." The Boards in Bengal have been further empowered to pass an order *settling the amount* due from the debtor to the refractory creditor, when they feel that the debtor has made a fair offer and when creditors to whom 40 per cent of the total debts of the agriculturist debtor are owing have agreed to an amicable settlement.

The Debt Conciliation Boards in the Central Provinces, the Punjab and Bengal have achieved a certain measure of success in scaling down the debts of the agriculturist debtors. The depression and the resulting insolvency of the large mass of ryots had made it difficult for the money-lenders to realise their assets and the low price of lands discouraged the recovery of loans by bringing them to sale. Many creditors, therefore, were willing to consider a scaling down of their claims in return for a lump payment in full settlement of the accounts. Again, the Debt Conciliation Boards offered the creditors a quicker and cheaper method of collecting their dues: expenditure by way of court fees, fees for lawyer, etc., was considerably reduced, and the Boards took less time to settle the case. Thus the period immediately after the depression was psychologically very opportune for the initiation of debt conciliation measures. In the Central Provinces agricultural debts amounting to Rs. 5·63 crores had been scaled down to Rs. 2·93 crores up to the end of June, 1937, thus achieving remission of 48 per cent. The Debt Conciliation Boards in the Punjab have secured, for the agriculturist debtors whose debts they have been able to conciliate, a remission of seven annas in the rupee."

The main merit of debt conciliation is that it is a voluntary method, securing for the debtor some relief without infringing on the rights of the creditors. Again, unlike the compulsory methods discussed below, this method enables each individual case to be dealt with on its own merits, according to the size of the debt, the economic condition of the debtor and the creditor, and the capacity of the former to repay. Thus, a rich landlord who can easily repay his loans can hardly secure any concession from the Debt Conciliation Boards, while a poor ryot who has borrowed at usurious rates can secure a decisive scaling down of his debts. But experience soon proved that little immediate relief could be given to the majority of indebted farmers by voluntary debt conciliation. The Debt Conciliation Boards could do little when the creditors were unreasonable and refused to accept a scaling down of the amounts due to them. Very often the penalties provided, such as the issue of a certificate, had few terrors for the creditors, especially to those who had lent on the security of immovable property which they could attach with the help of the civil courts if the borrowers failed to repay. The Debt Conciliation Boards were, therefore, able to scale down only unsecured debts. Also, the majority of farmers failed to approach the Boards for a scaling down of their debts as this would have meant the estrangement of the local money-lender, their main source of credit. Again, any measure for scaling down debts is like a surgical operation; it has to be carried into effect quickly if it is to be really effective in giving relief to the debtors facing insolvency, and if the normal credit machinery is not to break down. The debt conciliation machinery was extremely slow, and its working was uneven, as the more unreasonable creditors could always refuse to accept a scaling down. This led, therefore, to an increasing demand for a scaling down of debts by compulsory legislation.

§ 8. **Compulsory scaling down of the Principal of the loan:** Here Madras led the way with the Agriculturists' Relief Act of 1938.[11] The Act makes a clear distinction between debts incurred before 1st October, 1932 (pre-depression debts) and those incurred on or after that date (post-depression debts). The claims of the creditors with regard to the former have been drastically scaled down. All arrears of interest outstanding on 1st October, 1937, are wiped out. When the agriculturist has paid twice the amount of the principal, either by way of interest or of principal or of both the entire debt is wiped out. If the repayments made by the agriculturist debtor, both by way of interest and principal,

10 ibid. p. 290.

11 The provisions of this Act relating to interest have already been seen in § 6.

exceed the amount of the principal but are less than twice the principal, only the balance necessary to bring up the total repayments to twice the principal, or such portion of the principal as is outstanding, whichever is less, need be paid. The Act also gave relief to the indebted tenants with regard to rent debts. It provided that all accumulated arrears of rent up to fasli 1345, were to be wiped out, provided the tenant paid the rents due for fasli 1347 and 1346 before September, 1939. Up to the end of September, 1945, debts amounting to Rs. 955 lakhs were scaled down to Rs. 457 lakhs under the Act, a reduction of 52 per cent.

This principle of the compulsory scaling down of debts has also been embodied in laws enacted for the relief of indebted agriculturists in the Central Provinces and Berar, and Bombay.[12] The main feature of the Central Provinces and Berar Relief of Indebtedness Act, the United Provinces (1939), and Sind (1940) is the scaling down of the principal of the debt by a scheduled percentage on the basis of the estimated fall in the value of land. The Debt Relief Courts which are to be established under the Act have been empowered to re-open all transactions made 12 years before the last transaction or before 1st January 1932, whichever is earlier. The principal amount is to be scaled down by 30 per cent in the case of debts incurred in or before the end of 1925, by 20 per cent in the case of debts incurred after 1925 but before the end of 1929, and by 15 per cent in the case of debts incurred after 1929 but before the end of 1931. As the main aim of the Act is to give relief only to the average and not the rich ryots, it excludes from its scope agriculturists whose debts exceed Rs. 2,000.

The Bombay Agricultural Debtors' Relief Act of 1939 is another attempt at the scaling down of agricultural debts by compulsory methods. It provides for the compulsory scaling down of debts according to the debtors' capacity to repay as ascertained by Debt Adjustment Boards which are to be established under the provisions of the Act. It is in some respects an improvement upon the Madras Act as, simultaneously with an attempt to scale down debts, it has tried to build up sound credit machinery for debt clearance. The Act requires all agricultural debtors whose debts have been adjusted by the Debt Adjustment Boards to become members of the co-operative resource society in the area before the award is made. It also tries to prevent the re-emergence of unproductive debts to private money-lenders, in the future, by preventing the alienation of the standing crops or the produce of the debtors who have secured relief, without the previous permission of the co-operative society.

§ 9. **Miscellaneous measures:** In addition to the above devices for the scaling down of the debts of the agriculturists by

12 For the provision with regard to interest, see § 6.

voluntary or by compulsory methods, various other measures have been adopted to protect the agriculturist debtors.

(a) *The principle of terminable mortgage:* This principle has been introduced in the Punjab, the United Provinces, and Bengal where it has been laid down that the land of a mortgagor should be returned to him free of all encumbrance after a period varying from 15 to 20 years, whether he has repaid the debt in full or not.

(b) *Fixing of a fair price for land:* Some of the provincial enactments have also authorised the courts of law to fix a fair sale price for lands sold in the enforcement of decrees against agricultural debtors, to prevent the creditors from taking over lands at very low prices. This has been done by the United Provinces Agriculturist Debt Redemption Act, 1939, and the Bihar Money-lenders' Act, 1938.

(c) *Amendments to the Insolvency Act:* The Provincial Insolvency Act of 1920 has been amended in some provinces for the benefit of agriculturist debtors. Under the Bengal Agricultural Debtors' Act, 1935, a Conciliation Board can declare insolvent an agriculturist debtor who is unable to pay off his scaled down debts in 20 instalments. Then the lands of the insolvent debtor are sold out leaving for him but a portion of the property including a dwelling house.

§ 10. **Long-term legislation for the regulation of the money-lending business:** Emergency measures of the type discussed above, however useful they may be to save the small agriculturists during periods of crisis and falling land values, cannot be a permanent cure for the problem of rural indebtedness. Unless the root causes of rural indebtedness, such as the insufficiency of the income of the ryot, unproductive borrowing, and the unscrupulous practices adopted by the money-lender are removed, the problem of agricultural debts is likely to crop up again and again, necessitating periodical legislation for the scaling down of debts. Measures for debt relief must, therefore, be supplemented by measures for the prevention of the re-emergence of unproductive debts in the future. Hence, in addition to the various enactments to give immediate relief to the agriculturists, steps have been taken in the various provinces to regulate private money-lending and to protect the person and property of debtors.

Regulation of the money-lending business has been attempted by three types of measures :—

(i) *The registration and licensing of money-lenders:* Usually the money-lender is defined as 'a person who advances loans as a matter of business.' In some provinces, *e.g.*, Madras and Bihar, pawn-brokers are brought within the definition of a money-lender. Every money-lender is required to register himself, and take out a licence, in the Punjab, Bihar, the Central Provinces, Bengal and Sind. Licences to money-lenders are granted on application to the

Registrar of Money-lenders and penalties are provided for carrying on transactions without obtaining the necessary licence. Thus, the Central Provinces Money-lenders' Act, 1934, requires every money-lender to register himself and obtain a registration certificate. The non-obtaining of the registration certificate is treated as an offence punishable by a fine of Rs. 50 for the first offence and Rs. 100 for subsequent offences. The Punjab Registration of Money-lenders' Act, 1938, denies to money-lenders who do not possess a licence the benefit of the legal machinery of the State for the recovery of their dues from their debtors. The Bihar Money-lenders' Act of 1938 was drafted on the model of the Punjab Act. The Bengal Registration of Money-lenders' Act, 1939, provides similarly for the the registration and licensing of money-lenders. The money-lenders who do not take out licences are penalised by a forfeiture of the right to sue in courts of law. The fine for failing to take out a licence is Rs. 15 (thrice the licence fee). The main provisions of the Sind Money-lenders' Act of 1944 again require money-lenders to take out licences, and maintain regular accounts, and also provide for the limitation of the rate of interest. The United Provinces Money-lenders' Bill, 1939, contained similar provisions, and in addition it empowered the individual to lodge a complaint against the evil practices of a money-lender on depositing a given sum in a court of law. The Bombay Money-lenders' Bill, 1938, provides for the registration and licensing of money-lenders. Money lending without a licence has been made an offence.

(ii) *The regulation of accounts*: To check the evil practices of money-lenders, the maintenance of accounts in a prescribed form has been made compulsory in some provinces. The Punjab Regulation of Accounts Act, 1930, made stringent rules for the maintenance by the money-lenders of clear and separate accounts for each debtor, for the sending of a statement of his accounts to each debtor every six months, and for giving receipts for re-payments. In case of non-compliance with these provisions, courts of law were empowered to disallow the costs and interest due on suits brought by the money-lenders.

(iii) *Regulation of interest and measures to check exploitation*: The various provincial enactments have also fixed the maximum rates of interest that can be charged on secured and unsecured loans, and have amended the Usurious Loans Act, defining a usurious rate for the guidance of the courts of law. The Bengal Money-lenders' Act, 1939, made it an offence to enter in the bond an amount larger than the sum actually advanced, the offence being punishable by six months' imprisonment or a fine of Rs. 1,000. The United Provinces Money-lenders' Bill of 1939 contains similar provisions.

The measures adopted to safeguard the property and person of the debtor from exploitation by the creditors are :—(i) Provision.

for the exemption of a given portion of the property of the debtor from attachment and sale ; and (ii) the protection of the debtor from intimidation and molestation. For instance, the Central Provinces Debtors' Protection Act, 1937, the Bombay Money-lenders' Bill, 1939, and the United Provinces Money-lenders' Bill, 1939, punish money-lenders by 3 months' imprisonment or a fine of Rs. 500, if they molest their debtors. The Bengal Money-lenders' Act, 1939, lays down a penalty of one year's imprisonment or a fine of Rs. 1,000 for a similar offence. The Punjab Debtors Protection Act, 1935, the Bengal Debtors' Protection Act 1936, and the Bombay Money-lenders' Bill, 1939, contain provisions for the protection of the debtors' properties.

§ **11. The effects of debt relief legislation on credit machinery**: The various debt relief acts, the moratorium laws staying the initiation of proceedings and the execution of decrees against agriculturist debtors, the executive notifications against the sale of the lands of the agriculturist debtors, and the legislation empowering the Collector to fix a fair price for the land on the basis of the pre-slump prices when land was being sold in execution of a civil court decree against an agriculturist debtor, the exemption of a portion of the produce from attachment—all these have naturally had very important repercussions on the agricultural credit machinery of the country.

The most important effect of these laws was the severe contraction of credit in the rural areas. Money-lenders were now less willing to advance money to the agriculturists. This might have been all to the good if it meant that the ryots could borrow less easily for unproductive expenditure, but there seems to have been a decrease in the supply of credit even for productive expenditure and for cultivation expenses. Measures for debt relief and for the regulation of money-lenders must have been supplemented by an organised development of co-operative societies to advance money to the ryots for productive expenditure. But during the period under review, the co-operative societies were finding themselves in difficulties as a result of the depression, and the co-operative movement was more concerned with re-organisation than with expansion. In the absence of alternative sources of credit, measures to control the money-lenders invariably placed the borrowing ryots in difficulties. There was a contraction of credit not only for unproductive but also for productive expenditure, though the extent to which this happened need not be exaggerated. As pointed out by the Government Review on the working of Debt Conciliation Boards in the Central Provinces, 'For genuine agricultural purposes, financial accommodation, though difficult, is reported to be not totally non-existent. For this reason there has been no fall in the area under cultivation.'

Another significant effect was the decline in the number of unsecured loans. The interference of the Government to protect agriculturist debtors naturally made the creditors extremely cautious. Money-lenders who normally would not have thought of demanding any tangible security now insisted on a mortgage of land or on a conditional sale deed.

If the State attempted in a number of ways to protect the ryot from exploitation, the money-lenders in their turn succeeded in finding out a number of devices to defeat the objects of the law. Very often the farmers with their inelastic demand for credit, abetted the money-lenders in circumventing the law, and the legal safeguards provided for the debtor became a dead letter. Thus, in Madras, as a result of the passing of the Agriculturists' Relief Act, "The small holder or the uneconomic holder now agrees to an inflation of the principal of the loan to compensate for the loss created to the creditor by the legal rate of interest. The agriculturist who has excess lands, mortgages them with possession, thereby evading calculation of interest at the legal rate. Payment of interest in kind has been stipulated in certain cases."[13] To evade the enforcement of the principle of Damdupat according to which interest should not be allowed on a loan in excess of the principal amount lent, bonds were renewed without making any reference to previous documents. Thus, creditor and debtor combined to neutralise the provision of legislation and a demoralisation set in; the scope for falsehood in rural credit transactions increased tremendously as a result of the post-depression debt relief legislation. This proves that the ultimate sanction behind all law is an enlightened public opinion and that legislation to protect the ryot from the exploitation of the money-lenders will not be really effective so long as the ryots continue to remain ignorant and improvident, and alternative sources of credit are lacking.

A vital defect in the recent debt relief legislation is the fact that it has been undertaken piece-meal. Measures to scale down debts and to give relief to debtors in times of crisis should be comprehensive and should be brought into force quickly. In both these respects, all the recent provincial legislation has left much to be desired.

Relief has been given in each province not by a single comprehensive legislative enactment but by a series of Acts. Acts relating to agricultural debtors and to the money-lenders have succeeded each other at frequent intervals and have introduced an element of uncertainty into the business of the money-lenders. "What creditors complain of is about the uncertainty of the laws which are sprung on them from year to year. A comprehensive scheme of debt legislation will be less resented by the creditors, as

13. *K. G. Sivaswamy* Legislative Protection and Relief of Agriculturist Debtors In India, p 320.

they can adjust themselves to the new situation and carry on the business of money-lending."[14] Also, frequent intervention by government to protect the debtor might demoralise him and encourage him to evade his obligations.

Scheme of debt relief to be really effective must be supplemented by schemes of debt clearance. Creditors would have been more willing to accept a scaling down of their debts by the Debt Conciliation Boards if they could have been assured repayment in a lump sum or in a few definite instalments. The best agency to advance a lump amount to the creditors and to recover it in small instalments from the agriculturist debtor would have been the co-operative land mortgage bank, but no systematic attempts was made to develop land mortgage banks and to co-ordinate them with Debt Conciliation Boards.[15] A few land mortgage banks were of course started in the Central Provinces and a number of land mortgage banks were already working in Madras. The provincial Governments (in Madras and in the Central Provinces) also came forward to advance more liberally takkavi loans for the clearance of prior debts and for current cultivation expenses. But all these arrangements were extremely halting and the fact remains that, in most areas, the ryots were unable to take advantage of the debt relief acts, as there were no agencies to advance them credit to pay off their debts (as scaled down by the Debt Conciliation Boards or by compulsory legislation). In the absence of organised agencies for debt clearance, debt relief measures did not bear full fruit.

The future line of advance seems, therefore, to be the development of co-operative credit agencies—land mortgage banks for debt clearance and for the financing of permanent improvements to land, and village credit societies to advance the farmer short-term and medium term credit for current agricultural operations—to free the ryots from the clutches of the private lenders.

All schemes of debt relief and debt clearance are mere palliatives, they do not remove the root causes of the large mass of unproductive debt which weighs down the Indian ryots, *viz.*, insufficiency of income, improvident and unproductive expenditure, ignorance, and the unscrupulous practices of the money-lenders. No amount of legislation to scale down debts and to regulate money-lending, is likely to provide a lasting cure for the chronic disease of rural indebtedness, until the yield from land is increased by the consolidation of holdings and the popularisation of better methods, until the problem of the under-employment of the ryot is solved by the promotion of subsidiary industries, until the income of the ryot is raised by ensuring him a fair price for his produce,

14. ibid p. 315.

15. For a different opinion see *Review of the Co-operative Movement in India. 1939-40*", Bulletin issued by the Reserve Bank of India.

and until the habit of borrowing for unproductive purposes at exorbitant rates is weeded out by the education of the former. Laws cannot protect the farmer who is unwilling to protect himself. Schemes of debt relief must, therefore, form part of an integral programme of agricultural improvement aiming at the promotion of 'better farming, better business and a better living.'

Table X

THE MAXIMUM PERMISSIBLE RATES OF INTEREST UNDER VARIOUS PROVINCIAL ENACTMENTS*

	Secured Loans		Unsecured Loans	
	Simple interest per cent.	Compound interest per cent.	Simple interest per cent.	Compound interest per cent.
Madras Debtors' Protection Act, 1934*	9	...	15	...
Punjab Relief of Indebtedness Act, 1934	12	9 with yearly rests.	$18\frac{3}{4}$	14 with yearly rests.
The Central Provinces Usurious Loans Act, 1934 ...	12	10	18	...
The United Provinces Usurious Loans Act, 1934 ...	12	...	24	...
The Bengal Money-lenders' Act, 1933 ...	15	10	25	10
The Bihar Money-lenders' Act, 1938 ...	9	...	12	...
The Orissa Money-lenders' Bill, 1938 ...	9	...	12	...
The Bombay Money-lenders' Act, 1938 ...	9	...	12	...
The Bengal Money-lenders' Act, 1938 ...				
(cash loans) ...	9	...	25	...
(kind loans) ...	15	...	25	...
The Assam Money-lenders' Act, 1934 ...	$12\frac{1}{2}$	...	$18\frac{3}{4}$	...
The Assam Money-lenders' Act, 1937 ...	$9\frac{1}{2}$	...	$12\frac{1}{2}$	...

* Has since been superseded by the Madras Agriculturists' Relief Act, 1938, according to which the maximum rate permissible on both types of loans is $6\frac{1}{4}$ per cent. simple interest per annum.

CHAPTER IV

AGRICULTURAL CREDIT

§ 1. **Characteristics of agriculture which affect agricultural credit :** Like all other producers, the farmers also require credit. The differences between agricultural and other types of credit are differences rather in degree than in kind, but they are so fundamental as to warrant a special study of agricultural credit. These differences arise mainly from the special characteristics of agricultural production and organization. A brief discussion of these will not, therefore, be out of place.

1. *Agriculture is a complex of many industries:* Agriculture is not a single homogenous industry, 'but an industrial complex of many different types of production and marketing.' Thus, farms vary in size from the large bonanza estates in the United States covering hundreds of acres to the unpretentious small holdings peculiar to India. There are also wide variations in agricultural methods from country to country, these variations being dependent largely npon tradition, general economic needs, and local conditions. The size of the holding, forms of land tenure, and methods of production thus differ a good deal from country to country, and give rise to many different kinds of complex relationships between farmers on the one side, and middlemen, manufacturers, and consumers, on the other. The problems of marketing and finance also are influenced and controlled by the mode of agricultural organization peculiar to each country.

This complex nature of agriculture makes the financing of agriculture relatively more difficult than the financing of industry and trade. It is difficult for the ordinary credit agencies like joint-stock banks to correctly assess the risk and security inherent in financing agriculture. The nature of the rural organization renders the provision of agricultural credit very difficult.

2. *The small size of the farm and its effect on agricultural credit:* Another peculiarity of agriculture which affects agricultural credit is the small size of the business unit in agriculture. The typical agricultural farm tends everywhere to be smaller than the representative factory, from the point of view of the amount of labour employed, the extent of capital invested, and the value of the annual turnover.[1] Credit agencies, such as the commercial banks, will naturally prefer lending to a few big manufacturers in the towns, whose credit can be more easily assessed, to lending to a number of small scattered farmers. Such a course of action will also reduce their cost of marketing credit as it is less expensive to manage a few big loans. Thus, the fact that he is a small-scale

* For reasons see chapter on the Size of the Farm.

producer reduces the bargaining power and credit of the farmer, and makes it difficult for him to secure adequate supplies of credit at reasonable rates of interest in the absence of special agencies to provide agricultural credit.

3. *Difficulties of combinations in agriculture :* The difficulties of the farmer in securing cheap credit are aggravated by the fact that farmers are, as a general rule, individualistic and extremely suspicious of combining with each other. Combinations to secure a common purpose are numerous in industry, but rare in agriculture. As pointed out by Belshaw, 'the nature of the farm economy develops social characteristics and habits of mind that raise a barrier to corporate effort.' Hence, even when combinations are known to be profitable, as in the marketing of agricultural commodities and the obtaining of cheap credit, they have not become common in agriculture. The consolidation of the rural community and its integration have accordingly become difficult to achieve.

4. *The difficulty of safeguarding against risks in agriculture :* (a) *Technical Risks* : In agriculture it is difficult to foresee risks and provide against uncertainty, whether it be in the production of crops or in the storage and marketing of farm produce.

Natural forces such as drought, accidental breakdowns of farm machinery, unsuspected defects in seed and other material, infectious plant diseases, and destructive pests may cause unexpected, but considerable losses to the agriculturist. Hence, unlike the manufacturer, the agriculturist cannot always secure a pre-determined output by regulating the intensity of his effort. Further, agricultural produce tends to perish in storage, and the difficulties of holding back surpluses when supply exceeds demand are accordingly great. These technical risks add to the commercial risks of agriculture.

(b) *Commercial Risks* : Commercial risks in agriculture arise out of the operations of natural forces, the nature of agricultural operations, and the intractability of agricultural production.

The fickle changes of weather make it difficult for the farmer to adjust his output to fluctuations in demand. For instance, a farmer's efforts to reduce output by a reduction in acreage may be foiled by a bumper yield resulting from specially favourable seasonal conditions.

The intractability of production also makes difficult any variation of output in accordance with demand. A greater part of agricultural capital, like land for instance, is so highly specialised that it cannot be easily diverted from one use to another; and often the former finds it difficult to change from one crop to another owing to the play of numerous adverse factors such as the weather, the particular suitability of the soil and climate to one crop, the prevalence of diseases and pests, the difficulties of transportation and the lack of adequate marketing facilities. The farmers are hence unable easily to regulate their supplies in accordance with variations in demand.

Further, in agriculture the economic lag or the time needed for the production of a crop after the initial investment of capital is inordinately long; *i.e.*, there is a long interval during which costs are incurred before a crop is harvested and marketed. During this interval the demand might change, upsetting the calculations of the farmer. The farmer can rarely foresee the conditions which may prevail at the time the crop will be marketed: and even if conditions can be foreseen there is always the possibility that the farmer's judgment might be mistaken. The economic lag in agriculture is long not only in production but also in marketing, and the risks of unforeseen changes in price are increased by the time lag.

Owing to the nature of agricultural organization, its small farms and their remoteness from markets, the complex problems of raising crops etc., the farmer gets little time to study the market. Partly on this account and partly on account of his general ignorance he rarely obtains timely information concerning the relative profitableness of cultivating different crops. When, as in India, the farmer is also heavily indebted, his need for ready money often compels him, 'to dispose of his crops at a time determined not by the state of the market, but by the urgency of his need for cash. Further, the markets are usually at some distance from the farms, demands ordinarily fluctuate, and produce is either perishable or cannot be stored for many reasons; these factors also increase the commercial risks peculiar to agriculture.

The farmer is thus unable to control successfully either his output or his income. This uncertainty regarding the yield from land and the income from the sale of produce, makes the ordinary credit agencies unwilling to lend to agriculture except at higher rates than those charged to the other industries, and thus makes difficult the provision of agricultural credit.

§ 2. **The demand for credit in agriculture:** We have already seen that agriculture is a complex industry. The demand for capital in agriculture is, accordingly, a composite demand made up of demands for different types of capital goods which vary greatly in the degree of their fixity or permanence. The capital goods required in agriculture are :—

(1) land and improvements;

(2) agricultural implements, machines and livestock;

(3) requisites such as seed, fertilizers, oil, etc.; and

(4) stocks of food and clothing to maintain the farmer and his family during the period of production.

The demand for capital is a demand for credit. Generally farmers all over the world have to borrow part at least of the purchase price of their fixed capital—land and machinery. This means that farming resembles other industries in that it requires investment credit for the initiation of production.

Farmers need not only investment credit but also commercial credit, *i.e.*, credit for the purchase of seed, fertilizers, power, food and clothing. We have already seen that in agriculture, 'processes of production and marketing are long and income from the sale of crops is seldom regular.' These combine to make the demand for credit in agriculture inelastic, and this opens the way to the exploitation of the farmers.

§ 3. **Classification of agricultural credit :** We may classify agricultural credit from three points of view, *viz.*, (*a*) the purpose for which credit is needed ; (*b*) the length of the period for which loans are required ; and (*c*) the security against which loans are advanced.

(*a*) *According to purpose* : The farmer often requires credit to purchase land, and to effect permanent improvements. In India, farmers require credit to pay off their prior debts, and to redeem their mortgaged land. Very often permanent improvements, such as the draining of the land, the construction of a well or the construction of farm buildings, add to the income of the farmer and he has to borrow the capital necessary to effect the improvements. This can be called *Settlement and Development Credit.*

As seen above, the interval between the initiation of production and the in-coming of receipts is long in agriculture, and the farmers have often to borrow to start and carry on the work of production. Thus, credit is needed for the purchase of agricultural implements such as ploughs and livestock, and for current expenses incurred on the payment of wages, the purchase of seed and fertilizers, the maintenance of the farmer and his family, etc. This can be called *Production and Equipment Credit.*

Credit is also needed to enable the farmer to wait for a better price, and to enable him to sell in the most profitable market. This can be called *Marketing Credit.* When, as in India, no provision is made for the supply of such credit, the urgency of his need for cash compels the farmer to sell his crop as soon as the harvest is over, when the prices are extremely low.

The above classification should not be regarded as watertight. Very often one type of credit shades into another.

(*b*) *According to the length of the loan period* : From the point of view of the length of the loan period we can classify agricultural credit into the following three types :—

Long-term credit is needed normally for a period of five to thirty years for the purchase of land and standing improvements, and for effecting permanent and durable improvements as, for instance, the construction of wells and embankments. Having regard to their income and obligatory expenditure, farmers can repay the loans raised for these purposes only out of the extra income secured by the investments; repayment has, therefore, to be in instalments spread over a number of years. For instance, the maximum period allowed for repaying such loans is 36½ years in New Zealand, 50 years in Italy and Japan, 60 years in Denmark and 75 years in France.

Medium-term credit is normally required for periods ranging from two to five years for the purchase of stock and machinery, for small or occasional improvements, and for the production of crops involving a long economic lag. The need for special agencies to provide intermediate or medium-term credit to agriculture has been realised only recently, and in most countries special provision has not been made for the supply of this type of credit. There are agencies which provide long-term credit, others which provide short-term credit, and between the two there is a 'barren area' not adequately covered by credit institutions. The term 'intermediate credit' originated in the United States where Federal Intermediate Credit Banks were established in 1923 by the Agricultural Credits Act.

Short-term credit is normally needed for short periods of a few months to meet current expenses and to facilitate production. For instance, the Indian farmer needs credit for short periods for the purchase of manure and seed, for meeting the expenses of transplantation and harvesting, for the payment of land revenue, and for the maintenance of his family till the crops are sold after the harvest. Such short-term loans should normally be repayable after the sale of the harvested crop. Short-term credit which will enable the farmer to store his produce and wait for a better price is also necessary for the efficient marketing of farm products.

(c) *According to Security*: Agricultural credit can also be further classified on the basis of the security offered. From this point of view agricultural credit may again be grouped under three heads:—

(i) *Farm mortgage credit*, secured against land by means of a mortgage of land.

(ii) *Chattel and collateral credit*, the former given on the security of the farmer's livestock, crops or warehouse receipts, and the latter on the security of other kinds of property such as shares, bonds, insurance policies etc.

(iii) *Personal credit*, advanced on the promissory or personal notes of the farmer with or without another's security or guarantee.

Again, the security against loans may be either individual or collective. In the case of a land mortgage bank, for instance, the debentures it issues are secured both against the resources of the bank, and all the mortgages against which it has advanced loans. The individual loans of the bank are secured by means of individual mortgages but the bank's bond-holders or creditors enjoy a collective security. Similarly, in co-operative credit societies of the Raiffeisen type, farmers borrow on their collective security. The principle of mutual guarantee is the characteristic of all co-operative credit societies, and has been adopted by many European credit systems, by the Federal Intermediate Credit Banks of the United States, by New Zealand's Rural Intermediate Credit System and Co-operative Dairy Companies.

The above three classifications are closely inter-related. The length of the loan period depends upon the purpose for which the loan is needed, as repayment has to be made out of the additional income which the loan has made possible. Thus, a loan for a permanent improvement to land can be repaid only over a number of years and has, therefore, to be a long-term loan. The nature of the security demanded by the lender, again, depends upon the length of the period for which the loan is required. As a general rule, the longer the period for which the loan is required, the more tangible is the security needed by the lender. Thus, long-term loans are usually advanced on the security of land while intermediate and short-term loans are made on collateral or personal security.

The relative importance of the different types of agricultural credit varies in accordance with a number of factors such as the country, the land tenure, and the kind of farming practised etc. In countries such as Australia, New Zealand, and the United States, where land is being settled and developed, long-term credit is more important than short or medium-term credit. Again, the cash tenant normally needs only short-term or intermediate credit and the same is true of the share or metayer farmer. The amount and type of credit needed also varies from one type of farming to another. Thus, a smaller amount, but a larger proportion, of long-term credit is needed on dairy farms than on sheep or cereal farms.

§ 4. **Requisites of a good system of credit to agriculture:** A good system of rural credit should satisfy the following three conditions.[2]

A. It should ensure an equalisation of credit terms. Credit must be available to agriculture at rates comparable to those paid by the other industries. If there are any differences, for instance, if the farmer has to pay a higher rate, these differences should be explicable in terms of differences in risk, in inconvenience to the

2. *Belshaw, H.*: The provision of Credit with Special Reference to Agriculture, p, 104.

lender, and in the expenses of marketing credit which cannot be removed. Ordinarily the farmers, especially in countries like India, have to pay interest at rates much higher than are warranted by those factors. If there is to be such an equalisation of credit terms, and if credit is to be available to agriculture at reasonable rates of interest, (i) agencies must be established which will perform the function of collecting funds from the savers and distributing them to the farmer at the lowest possible cost; (ii) the risk to the lenders must be reduced to a minimum, and they should be enabled to keep their investment liquid, *i.e.*, to convert their investment into cash when they urgently need money; and (iii) the emergence of any monopoly in the capital market should be prevented. No lender should be in the position of a monopolist with the power to exploit the farmer.

B. It should satisfy the principle of convenience to the farmer.

C. It should safeguard the equity of the farmer in the event of the farmer being declared an insolvent.

The implications of these three conditions can now be discussed in detail.

A. *Methods of reducing the cost of credit*:—To keep down the cost of marketing credit specialised institutions for financing agriculture are necessary. Generally commercial banks are far removed from farms and they cannot ordinarily assess accurately the value of land and crops offered as security. The remoteness of farms, the variety of farm operations, and the great risks involved in agricultural operations resulting from the dependence of the yield on climatic conditions, all make the ordinary banks reluctant to finance the farmers. Again, on account of the long time lag in agriculture, the farmers require credit for periods longer than those for which the commercial banks can safely lend.

Commercial banks depend largely on short-term deposits, and they cannot accordingly finance agriculture without the risk of freezing their assets. Even short-term credit in agriculture is needed for periods exceeding six months, and commercial banks intent on keeping their resources liquid do not view favourably loans for such long periods nor are the farmers themselves capable of presenting their case clearly before the banks and thus winning their confidence. Special institutions, sufficiently near the farmers to understand their difficulties, specially equipped to assess correctly the value of agricultural property such as crops, livestock and land, lending for periods long enough to fit in with the cycle of production in agriculture, are, therefore, necessary to finance agriculture.

To facilitate the equalisation of credit terms in agriculture, these special institutions must be linked up to the central bank of the country. This will make the rural credit system elastic by enabling the rural credit agencies to borrow from the central bank when there is an increase in the demand for credit. Disparity in rates of interest between one part of the country and another will be eliminated if these special institutions have branches in different parts of the country, and form part of a co-ordinated and integrated banking system.

Again, the farmer can be helped to secure cheap credit by the development of a market for agricultural paper and bills, as for instance, hundis and warehouse receipts. Such credit instruments will also facilitate the easy flow of capital from one area to another according to need.

Another factor in the reduction of the cost of credit to the farmer is the simplification of legal procedure, the provision of standard documents, and the reduction of stamp-duties and other legal charges whether for obtaining credit or for renewing it.

To direct savings to agriculture on reasonable terms, it is essential to increase the degree of confidence engendered by agriculture in the investing public by decreasing the technical and commercial risks which now affect agricultural operations. Lenders find it difficult, under existing conditions, either to estimate the risks involved in loans to agriculturists or to assess the value of the securities offered by farmers; they, therefore, attempt to compensate themselves by charging high rates of interest. If special banks are instituted, they can employ experts to asesss reliably both the value of the security offered and the degree of risks inherent in any loan.

Such institutions can also be expected to judge accurately the integrity of the farmer and his ability to repay. Further, special banking institutions reduce the risk to the lender and safeguard their own position by lending only up to a percentage of the value of the security given. This helps the farmer also in the long run by enabling him to keep solvent.

A credit intermediary like a bank serves to reduce the risk to lenders by spreading the risks over the whole body of lenders. In fact, as pointed out by Belshaw, "The capacity of credit institutions to act as a buffer or to spread risks is one of the important tests of a good system of credit to agriculture." It is the depositors of a bank who ultimately lend to its borrowers, but the risk is transferred from the lenders to the bank. Thus, a money-lender who directly lends to the farmer on the security of land has to bear the whole loss if the farmer fails to repay; but the debenture-holders of a land mortgage bank can secure repayment from the land mortgage bank on the due date even though some of the borrowers might fail to repay their loans to the latter. Even if it comes to the very worst, and the land mortgage bank is unable to honour its obligations fully, the risk is spread over the whole body of the debenture-holders.

Co-operative credit agencies, such as village credit societies and co-operative land mortgage banks, further reduce the risks incurred by the lenders by substituting a collective for individual security. The risks involved in a loan are transferred from the lender to a group of borrowers who assume both an individual security and responsibility for all the loans. In a land mortgage bank the funds are obtained by the sale of standardized debentures, which are backed up by the security of all the mortgages against which loans are issued to farmers.

The linking of these specialised institutions to the central bank of the country will further reduce the risk to the lenders by enabling the institutions to withstand better any sudden shocks or losses.

Any good system of credit to agriculture sbould also ensure the maximum possible convenience to the lender. Lenders will be ready to advance credit to agriculture, and also at lower rates, if they know that they can get back the money they have lent without much difficulty or loss when they unexpectedly need cash. This can be provided for if funds are raised by the sale of standardized securities with a wide market. A special institution such as a land mortgage bank, created with this end in view, can issue for sale long-term bonds suited to cover the needs of the farmer, and secured both against the resources of the institution and against the whole body of the mortgages and liens of borrowers.

A sound system of rural credit should also protect the small farmer needing money, from being exploited by a monopolist lender. When there are no organized credit agencies to provide credit, the small farmers are compelled to borrow from the local money-lender who is in the position of a virtual monopolist. This leads to the exploitation of the small farmer in all possible ways. Thus, the Indian agriculturist is rarely in a position to escape the usurious money-lender. It is, therefore, essential to develop a well organized and co-ordinated system of banking suited to rural needs in order to extend to the farmers cheap credit. The only safeguard against monopoly is the competitive influence of an organized credit market.

B. Convenience to the farmer :—Agricultural credit has also to be considered from the point of view of its convenience to the farmer *viz.*, the borrower.

Firstly, there should be provision for the supply of the three main types of credit needed by the farmer, *viz.*, long-term credit, medium-term credit, and short-term credit. Long-term credit in agriculture may extend from over twenty to thirty years, and provision should be made for gradual repayment through amortisation. Such loans should be repayable out of the additional income secured from the investment. In fixing the instalments due from the farmer, due regard must be paid to the cost of living of the farmer and his family, and to current cultivation expenses. Short-term and intermediate loans provide for the actual productive processes of agriculture, and, therefore, should cover the period of production of the crop and its marketing. Secondly, the loans advanced to the farmer must be adequate for the purpose for which they are needed. When the loan is inadequate the farmer is likely to waste the amount. Thirdly, the loan must be available at short notice. Thus, a loan for the purchase of seed at the beginning of the cultivation season should be given at the proper time, and not three or four months after the farmer has applied for the loan. Lastly, the credit system should be elastic. When the harvested crops are moving to the market for sale, the credit available should expand. If this does not happen, rates of interest rise during the harvest season, the farmer finds it difficult to borrow money, and is hence compelled to sell at an unfavourable time when prices are extremely low. This is what often happens in India at present. Rural credit should, therefore, be capable of expansion during the busy season, and a system should be divised whereby crops in maturity or in transit to the market may be used as security against the issue of loans.

C. Equity to the Farmer :—A good system of rural credit should safeguard the equity of the farmer. If for some reason the farmer is unable to repay his loan and his property has to be sold, provision must be made to secure for him a fair price and to return to him any balance that may be left over, after the claims of his creditors and the costs of liquidation have been met.

We have thus seen the requisites of a good system of credit to agriculture. We shall, in the next few chapters, see how agricultural credit is provided in India.

CHAPTER V

SOME MINOR AGENCIES PROVIDING RURAL FINANCE

§ 1. **The existing agencies for the provision of agricultural credit in India:** Rural finance in India is provided today by the following seven agencies :—

(1) Money-lenders (including sellers on credit), both professional and non-professional.

(2) Co-operative organisations.

(3) Indigenous bankers.

(4) Government.

(5) Commercial banks, including the Reserve Bank of India, the exchange banks and other joint-stock banks.

(6) Loan offices in Bengal.

(7) Nidhis and chit-funds in Madras.

The provision of credit to the farmer has not been systematically organised in India, and the agencies enumerated above act as disjoined units rather than as part of a single, well-organised, and integrated money-market. Thus, there is little connection between the money-lender in the village and the commercial banks, while the links between the indigenous bankers and the commercial banks are extremely loose and ill-defined. Another characteristic feature is the absence of a systematic arrangement for the provision of long-term, medium-term and short-term finance. The money lenders do not make a clear distinction between short-term and long-term finance: the indigenous bankers finance agriculture, for the most part indirectly through local money-lenders, and they provide short-term finance for the marketing of crops. The same is true of the joint-stock banks which play little direct part in the financing of agriculturists. A clear distinction is made between the provision of long-term and short-term credit only by the co-operative organizations and Government. The co-operative credit societies in the villages concentrate on the provision of short-term and medium-term credit, while long-term credit is provided by special institutions known as land mortgage banks, though these are of relatively recent origin and in the early days of the co-operative movement the need for special agencies to lend long-term finance was not clearly realised. The Government advance loans both for short and long periods, though, as we shall see later, the amounts so lent are insignificant. The last two agencies are merely of local interest, but we shall discuss in detail the Nidhis of Madras.

Money-lenders are the most important source of rural credit in India, and deserve a detailed discussion. Co-operative organizations are, as we shall see, ideal agencies for the provision of short-medium-and long-term credit, and the future of rural India lies largely in the development of such co-operative organizations. We shall deal with these agencies separately in the succeeding chapters. We shall here be concerned with the other agencies for the provision of rural finance.

§ 2. **The indigenous bankers**: Indigenous bankers play a prominent part in the financing of the movement of agricultural produce from the producing areas to the markets. Also, the village money-lenders and banias borrow from the indigenous bankers in times of stringency. Thus, the indigenous bankers finance agriculture mainly indirectly. They have been able to maintain a close contact with the small industrialists and traders to whom ordinarily the joint-stock bank are not willing to lend, and thus control more than 90 per cent of the banking business of the country.[1]

Indigenous bankers known as shroffs, belonging to the Marwari, Multani or Sindhi communities are found practically in all the important markets in India. In Madras, in addition to these, there

1 *Sir George Schuster*: Speech in the Indian Legislative Assembly.

are two other classes of indigenous bankers, *viz.*, the Nattukkottai Chettiyars and the Kallidaikkurichi Brahmins. The Chettiyars, though the bulk of their business is outside the Madras Presidency, are still a powerful and influential force in the financing of internal trade in South India. "Some of these indigenous bankers are of very old standing. For example, the famous firm of Gurwalas at Delhi, although recently gone out of business, originally came to the city of Delhi during ths 17th century at the invitation of the Moghul Emperor, Shah Jehan."[2]

The main features which distinguish the indigenous bankers from the money-lenders are their acceptance of deposits and their large business in the discounting of hundis. These differences will be discussed in detail in the chapter on moner-lenders.

The funds of these indigenous bankers come mainly from three sources, (*a*) their own money, (*b*) deposits from the public both on current and fixed accounts, and (*c*) loans from other banking agencies. Thus, during the busy season when the crops are moving to the markets and there is a stringency in the money market, the indigenous bankers usually borrow from other indigenous bankers. The indigenous bankers also borrow from commercial banks such as the Imperial Bank of India, on demand promissory notes drawn by two approved shroffs or by rediscounting hundis they have themselves discounted. Thus, in Madras the Chettiyar bankers and the Kallidaikkurichi Brahmins take both fixed (*thavani*) and current (*nadappu*) deposits from the public, but mostly fixed deposits. The Chettiyars and the Multanis borrow from the joint-stock banks for short terms during the busy season at rates above the bank rate.

The indigenous bankers lend mainly to the mony-lenders, the village baniyas, the arhatiyas and commission agents engaged in the marketing of agricultural produce, and to the smaller artisans and industrialists in towns. Loans are given, (*a*) by discounting internal bills of exchange known as hundis, (*b*) in the form of clean loans against promissory notes, and (*c*) against stocks of agricultural produce. To a small extent the indigenous bankers lend directly to agriculturists on the security of their land and on pro-notes.

The hundis, which are peculiar to India, are internal bills of exchange and "their universality in India may be compared to the cheque in Europe and the West."[3] The seller draws a hundi on the buyer and gets payment at once by discounting the hundi with the indigenous banker. The buyer thus secures short-term credit and the movement of produce is facilitated. There are two main types of hundis, *viz.*, *the muddati hundi* and *the darshani hundi*. The *muddati hundi* is a time bill, drawn upon Government stamped

2 Report on the Marketing of Wheat in India, p. 257.

3 *ibid.*, p. 258.

paper payable by the drawee after a fixed period; it is never drawn in practice for more than one year. The *darshani hundi*, on the other hand, is payable on presentation, though in some places a few days of grace are allowed. The indigenous bankers provide short-term credit to their clients by discounting both types of hundis and their rates differ widely according to the business stability and financial position of the borrower.

The indigenous bankers also help in the transmission of funds from one area to another by themselves issuing hundis to their clients. The hundis sold in this way by the indigenous bankers can be compared to the demand drafts sold by the joint-stock banks.

The practices followed by the indigenous bankers have certain good features. The accounts of the indigenous bankers are kept in a simple and economical way. They do not maintain a costly establishment and are always easily accessible. The absence of the formalities and delays so characteristic of the operations of the joint-stock banks is another important merit. The shroffs usually know intimately the family history, the business standing etc., of their clients and are able to maintain a closer contact with their borrowers than an ordinary joint-stock bank can. The personal touch and knowledge enable the indigenous bankers to lend with less risk on personal security, and the rates of interest charged by the indigenous bankers do not, therefore, compare unfavourably with those charged by the joint-stock banks.

But the majority of indigenous bankers combine banking with some form of trade. As the Central Banking Enquiry Committee point out, there are at present three important types of indigenous bankers, *viz.*. (*a*) those who confine themselves to banking proper, (*b*) those whose principal business is trading, but who employ their surpuls funds in banking, and (*c*) those who are both bankers and traders and cannot be easily classified. When an indigenous banker also undertakes trading, it is often impossible to distinguish the capital employed in banking from that employed in trade.

In many places the indigenous bankers have organized themselves into associations to protect their common interests. Examples of such associations are the Bombay Shroffs' Association, the Ahmedabad Shroffs' Association and the Marwari Chamber of Commerce.

The indigenous bankers are playing an important and useful part in the financing of the internal trade in India, and it is, therefore, of the greatest importance "in the interests of both the general public and the indigenous bankers themselves that steps should be devised to strengthen the position of these bankers."[4] Out of the more than 2372 towns in India, only 130 have commercial banks or their branches, and the indigenous bankers are, therefore,

4 Reports of the Central Banking Enquiry Committee, par. 137.

likely to continue, for a long time to come, to be the main source of credit to the majority of small traders and village money-lenders; they are able to maintain a closer contact with their clients than joint-stock banks and the rates of interest charged by them, as pointed out by the Central Banking Enquiry Committee, compare favourably with those of the joint-stock banks. But at present they suffer from a scarcity of funds during the busy season. If an elastic and cheap supply of credit is to be assured to the Indian farmers, these indigenous bankers should be able to borrow from the Reserve Bank of India by rediscounting the hundis they have themselves discounted. In other words, the indigenous bankers should be linked to the Reserve Bank of India from which they should be in a position to borrow in times of stringency. Such a linking, as pointed out in 1933 by Sir George Schuster, the then Finance Member, is indispensable, if (*a*) the Reserve Bank is to have full control over the currency and credit of India, and (*b*) the masses of the people in the villages of India are to get the full benefits of credit and banking facilities on reasonable terms. The present position is discussed in Chapter XIII.

§ 3. **Government**: The State in India has helped the ryots by the grant of loans from very early times. Loans popularly known as 'Takkavi' loans are at present granted to the ryots for specific purposes under the land Improvement Loans Act of 1883 and the Agriculturist' Loans Act of 1884.

Under the former Act long-term loans are advanced to landholders and cultivators for permanent improvements to land which add to its letting value, such as, the construction of wells, the preparation of lands for irrigation, protection of lands from flood or from erosion etc. Such loans can be advanced for periods extending up to a maximum of 25 years, but in almost all the provinces loans under this Act are restricted to 20 years. The loan is repayable by equal annual instalments discharging both principal and interest.

Under the Agriculturists' Loans Act short-term and medium-term loans are granted for current agricultural needs such as the purchase of seed grain and cattle, for rebuilding house destroyed by floods etc., and for the relief of distress in areas affected by famine. Loans for current cultivation expenses are recovered in some provinces at the next main harvest or at the latest after two main harvests. Loans for the purchase of seed, and for relief of distress, and special loans for the installation of pumping machinery or for the purchase of agricultural machinery are advanced for longer periods.[5]

The advantage of the takkavi loans lies in their long lerm and low rates of interest. In 1931 the rates of interest charged on

5. *The Madras Provincial Banking Enquiry Committee:* Report p. 99.

these loans in the various provinces varied from 6 per cent to $6\frac{3}{4}$ per cent; the rate has since been reduced in Madras to $5\frac{1}{2}$ per cent. Loans for the relief of distress are advanced at a much lower rate, 3 per cent in Madras. The rates are considerably lower than those charged by the money-lenders, and the loans given for the relief of distress have been particularly useful as they are advanced at a time when other credit agencies are less willing to lend to the farmers. But the total amount lent under both the Act is extremely insignificant and amounts to a mere drop in the ocean.[6]

The Royal Commission on Agriculture in India held that both the Acts had worked fairly well, but the Provincial and the Central Banking Enquiry Committees have pointed out various defects. One of the most important complaints against the takkavi loans is the delay in the granting of loans and the levy of illegal gratifications. Months might elapse before a takkavi loan is sanctioned and the purpose for which it was needed might have ceased to exist. Again, it is asserted that almost invariably the borrower has to pay 'commissions' to the official underlings and this adds to the cost of the loan. Thus, according to the United Provinces Banking Enquiry Committee, the effective cost of a takkavi loan is not less than 35 per cent. Another objectionable feature is the insufficiency of the loans. When a loan is insufficient for the purpose for which it required, the borrower is often compelled to borrow from the money-lender at still more onerous rates of interest. The extreme strictness of the Government in realising the loans adds to their unpopularity. Government machinery moves only very slowly and in exceptional circumstances, such as a failure of crops, the Government does not remit its claim quickly. The result is the majority of ryots prefer to borrow from the money-lenders even though they have to pay higher rates of interest. The Government is also said to be often unfair in the realisation of joint bonds. As the Central Banking Enquiry Committee pointed out, when joint bonds are taken, the joint liability should be enforced only after every effort had been made to recover from each individual the amount he has borrowed. Again, the takkavi loans are given only for specific purposes, and the ryots often do not want to estrange the money-lender, who is prepared to lend to them for all purposes, by borrowing from the Government. Lastly, takkavi loans are not given for the clearance of prior debts or for the consolidation of holdings, both of which are essential pre-requisites for agricultural improvements, though in Madras and the United Provinces, amending Acts have been passed recently and loans are now advanced for the clearance of prior debts. The administration of the takkavi loans should be made less rigid, and the delay in the granting of loans and the unfairness in the realisation of joint bonds should be remedied, if they are really to appeal to the ryots. The

6. *Jather and Beri:* Indian Economics, Vol. I, p. 313.

facilities available for borrowing from the Government and the conditions under which loans are advanced should be made more widely known to the public than at present.

But what should be the role of Government in the provision of rural finance ? Is it desirable for the Government to undertake the direct financing of farmers ? Before the advent of the co-operative movement there was a case for the Government lending directly to the ryots to break the monopoly of the money-lender, but now that the co-operative societies are fairly well developed it is best to leave the financing of the farmers, under normal conditions, to the co-operative societies. Direct Government credit is not likely to be as educative as co-operative credit ; nor is it practicable for the Government to undertake the responsibility for fully financing the ryots as this would mean that the Government would have to borrow large amounts in the money market, to maintain a complicated bureaucratic organisation to keep in touch with the borrowers, and undertake the tremendous responsibility of collecting the repayments when they fall due. Hence the provision of agricultural credit should be the business of the co-operative societies : "it is out of the question for Government to provide the whole of the loan requirements of agriculturists and sporadic attempts on the part of Government to supply a fraction of such requirements are bound to meet with failure."

But there are special spheres in which the takkavi loans can be made to play a very useful part. Firstly, the Government can use these loans to popularise agricultural improvements. Much can be achieved if the provincial Governments have a well planned policy of promoting certain improvements and advance loans to ryots who are willing to try these under the guidance and supervision of the local agents of the Agricultural Department. The takkavi loans can thus be made to serve a definite purpose. Secondly, greater use should be made of short-term takkavi loans to mitigate the difficulties of famine. Loans for the relief of distress at low rates are particularly useful as during a period of famine, the alternative sources of credit available to the farmer are likely to get dried up. Thus, short-term takkavi loans should normally be limited to the 'protective purpose,' but they should be given more liberally than has been the case hitherto. Again, such loans, if they are to be really useful, should be advanced at the very beginning of a famine, "as a measure of moral strategy to put heart into the people."! Thirdly, loans under the Agriculturists' Loans Act, should be made freely available in backward tracts where co-operative credit societies canot be successful.

§ 4 **Commercial Banks** : Commercial banks raising their funds mainly by way of short-term deposits, cannot undertake, as seen in Chapter IV, the provision of either long-term or medium-

7. Indian Famine Commission (1901) ; Report, par. 250.

term credit to Agriculture. Even with regard to short-term credit the part which they can play is extremely limited, as the periods for which these loans are required by the farmers are usually longer than those for which the banks can safely lend. Commercial banks in towns do not possess sufficient expert knowledge to assess the value of the security offered by the farmer in the form of growing crops and livestock; these are also precarious forms of security as their value might greatly depreciate on account of factors over which farmers have no control, such as floods, diseases of livestock etc. Nor is it easy for a commercial bank to maintain a close touch with the small farmer in the village. All these make the financing of agriculture a relatively undesirable risk from the point of view of the commercial bank. Thus, even in the Western countries with well developed banking systems, commercial banks do not take any great part in the financing of agriculture. As the Central Banking Enquiry Committee put it so well, "The commercial banking system becomes slower the nearer it comes to the agriculturist and it stops entirely at the outskirts of the agricultural line." But if appropriate credit instruments, like 6 months bills drawn on agricultural produce, which the commercial banks are willing to accept as security, can be developed, the commercial banks can be made to provide considerable amounts of short-term credit to agriculture.

In India, the joint-stock banks play little direct part in the financing of agriculture. Some joint-stock banks in Madras make direct advances to cultivators on the security of gold ornaments, on the mortgage of immovable property, and on produce but the amount so advanced is extremely small. As a general rule, the joint-stock banks finance agriculture only indirectly. They indirectly finance the movement of crops by advancing loans to merchants and commission agents on the security of agricultural produce stored in places approved by them. Stocks so pledged have to be insured against fire and the banks may also require insurance against additional risks such as floods; they are usually kept under the banks' lock and key and are subject to periodical inspection by the banks' officials. These stringent conditions coupled with the fact that in most large centres there are indigenous bankers from whom credit can be obtained at lower rates, makes the merchants, under ordinary circumstances, extremely unwilling to approach the banks for credit.

The joint-stock banks also lend to their approved customers by purchasing and discounting hundis drawn against produce sold and supported by railway receipts and by the purchase and sale of demand drafts. They finance the movement of produce from up-country centres to the exporting ports by the purchase of drafts and telegraphic transfers drawn on ports.

As already seen, the indigenous bankers often suffer from a shortage of funds during the busy season. Indigenous bankers and merchants who provide marketing credit should be able to borrow from the joint-stock banks in times of need without difficulty. The joint-stock banks should, therefore, adopt a more liberal policy in the matter of giving advances on the pledge of agricultural produce stored in godowns and in the discounting of hundies. This will be greatly facilitated by the development of a market in agricultural paper in India, by the provision of storage accommodation in various parts of the country, and by the linking of the Reserve Bank with the indigenous bankers.

§ 5. **Chit Funds and Nidhis** :—*Chit funds*, known as *kuries* in Malabar, are a very old and common system of raising funds in southern Madras and Malabar. The chit system is based upon association, confidence and honest dealing. According to this simple system, a number of men in a village, who usually know each other, unite to subscribe a small sum each, usually a rupee or a multiple of that, at regular intervals to the promoter called 'Karaswan' for a specific period. At each period—generally at the end of every month—when collections are made, the collection so made is given to one of the members of the chit. Different methods are adopted to decide the member who is to be given the amount. The original system is the prize chit. Lots are drawn and the winning lot draws the pool. While the same number subscribe for the next month, the winner drops out from the lot. Here the tail is the less fortunate; it loses by way of interest. Under the second system, to equalise benefit, the winner gets the amount less a deduction for interest and the amount so deducted is divided among the other members who have not won the pool. This is the discount system. A third variant is the auction chit. This seeks to obviate the difficulties of those needy who may not win the pool. Under this sytem the pool is put up to a Dutch auction and the highest bidder of discount receives the amount, while the discount is divided among the remaining contributors as bonus. The person who receives the amount executes a pro-note or mortgage to the foreman and drops out of the next auction. In cases of default penal interest is charged.

Besides these, there are shandy associations in which small traders unite their small subscriptions on the market day. Chits are run on a commodity basis also. In the absence of regular banking institutions to facilitate savings and provide cheap credit, the chit system has been of immense benefit to the people, especially in the rural areas. The system not merely promoted thrift among the subscribers but also enabled them to get lump sums for purchasing land, jewellery etc., for marriages, for trading operations and for settling prior debts.

The Nidhi is a type of mutual loan association which spontaneously grew up in Madras towards the middle of the 19th, century, just when the Schulze Delitzsch and Raiffeisen societies were being organised in Central Europe. The Nidhis partake of the nature of three other institutions. Firstly, in some respects they resemble the co-operative societies in that they regularly pool the savings of their members and use the funds so secured to grant loans to their members. Secondly, in some ways these are similar to the chit funds in that they collect from their members a definite amount at monthly intervals which is, to a greater or lesser extent, advanced to some of the members at each period of subscription. Thirdly, many of the Nidhis to-day partake of the nature of the joint-stock banks also. Unlike pure mutual loan associations they accept deposits from and advance loans to the public in the interests of their members.

The Nidhis have had a chequered career. The objects of the Nidhis are the facilitation of savings, the relief of members from old debts and the accumulation of a fund for loans to members for all purposes. When the Nidhis have surplus funds they also advance loans to outsiders.

Originally the Nidhis were mere mutual loan associations. Every member of the Nidhi had to contribute a monthly subscription of rupee one (or a multiple of one rupee) usually for 84 months. The amounts so collected were used for loans to the members on the strength of their subscriptions at $6\frac{1}{4}$ per cent interest and the balances not so lent were available for loans on other securities to members and non-members. At the end of 84 months the fund was closed, and each member got back Rs. 102-8-0 for every Rs. 84 subscribed by him. These Nidhis were registered under the Indian Companies Act, and the monthly subscriptions paid by the members were shown as the share capital of the Nidhi.

The early Nidhis were designed to act as mere mutual loan associations and neither accepted deposits nor lent much money to non-members. But the Nidhis of to-day accept deposits from non-members also, and have had a definite gravitation to the joint-stock bank, receiving deposits and advancing loans.[8]

This development has led to some difficulties. When a Nidhi accepts deposits from non-members, the security for the depositor is naturally the share capital of the Nidhi. But, as seen above, in a Nidhi the members can borrow on the security of their share subscriptions, and also terminate their membership at the end of the specified period and withdraw their share capital. This greatly weakens the position of the depositor. As pointed out by the Madras Provincial Banking Enquiry Committee the stability of the institution as well as the security for the depositor are endangered by this practice of "allowing members to add to or substract from the share capital at their pleasure."

8 Thus, in 1929, there were in Madras 218 Nidhis with a total paid-up share capital of 2·45 crores and they held deposits from the public amounting to Rs. 1·17 crores. Their total working capital was about Rs. 4 crores.

Another difficulty has been the fact that some of the Nidhis do not conform to the Act under the provisions of which they have been registered, *viz.*, the Indian Companies Act. This Act requires at least 5 per cent of the nominal share amount to be paid on application, but the Nidhis demand only 1 per cent initially, and collect the balance in monthly instalments. Again, this Act prohibits the withdrawal of the share capital of a concern without the permission of a court of law, but as seen above the Nidhis allow members to withdraw their share capital and terminate their membership. The working of the Nidhis was, therefore, upset by a decision of the Madras High Court that even those who had finished their subscriptions and got back their money were still liable for the debts of the Nidhi, on the ground that they had withdrawn their share capital without the sanction of a court of law.

A number of Nidhis have now come into line with the Indian Companies Act. In none of them is the share capital withdrawable; nor is the payment of share capital allowed in monthly instalments.

But some still retain their old features. The Nidhis have several distinctive features which are of considerable value. They encourage thrift, mobilise small savings, promote corporate effort, and inculcate in their members habits of punctuality and planning for future expenditure. Many of the Nidhis are excellently conducted. But if they are to play a considerable part in the provision of credit in the future, the difficulties which they have had to face in the past must be removed by appropriate legislation. As recommended by the Central Banking Enquiry Committee,

(i) The Nidhis and Chit Funds in Madras should be controlled by a special Act of the Madras Legislature called the "Nidhis and Chit Funds Act."

(ii) The Nidhis willing to register themselves under the above Act should be allowed to retain the characteristic features of the Nidhis, such as obtaining their working capital in the shape of monthly subscriptions to the paid up share capital, advancing of loans on the security of subscriptions to the paid-up share capital, and allowing the share capital to be withdrawn at the end of a prescribed period. Such Nidhis, however, should not be allowed to accept deposits from outsiders.

(iii) The Nidhis not willing to come under the provisions of the above Act and desiring to accept deposits from outsiders should conform fully to the provisions of the Indian Companies Act, and prohibit the withdrawal of the share capital or the advance of loans on its security.

CHAPTER VI

MONEY-LENDERS

§ 1. **The money-lenders—their importance:** Money-lenders occupy a dominant position in the provision of credit to agriculture in India. Even in a province like Bombay where co-operation has made fairly rapid progress, co-operative societies, according to unofficial estimates, provide only from 7 to 10 per cent of the credit needs of the farmer. The local money-lender-cum-trader still continues to be, in one form or another, the 'universal provider,' and remains after more than 35 years of co-operation an integral part of Indian rural economy.

Money-lenders are not peculiar to India. In fact, small scale farming by an illiterate peasantry and money-lenders seem to go together. Exploitation of farmers by the money-lenders was as common in Central Europe, before the advent of the co-operative movement, as it is in India to-day. Thus, "in Italy if a poor peasant wanted money, the usurer was delighted to supply it—at from 0 per cent to 1200 per cent often with a Sunday dinner thrown in as a prescriptive condition." [1]

§ 2. **Classification of money-lenders:** Following the Central Banking Enquiry Committee we can divide the money-lenders in India into two broad groups, *viz.*, the professional money-lenders, and the non-professional money-lenders. The professional money-lenders again fall into three distinct classes:—(*a*) the village or rural money-lenders, who often combine trading with money-lending; (*b*) the urban money-lenders, and (*c*) the itinerant money-lenders, *i.e.*, persons whose main business is not money-lending but who nevertheless lend their surplus cash. This class includes, (*a*) landowners who finance their tenants and also lend to other agriculturists. This class of lenders is very important in the Punjab and Madras. (*b*) Persons like lawyers, pensioners and widows who lend to farmers whom they know well and on good security; and (*c*) the village merchants who lend to farmers, mostly on the condition that the latter market their produce through them. We have already seen that the local money-lender like the *Bania* or the *Sowcar* often combines money-lending with trading.

Thus, in India most of the rural credit is provided by rural money-lenders, though non-professional money-lenders also provide a considerable amount in some provinces.

§ 3. **Difference between money-lenders and indigenous bankers:** There are important differences between the money-lenders and indigenous bankers. As pointed out by the Punjab

1. *Wolf:* People's Banks, p. 296.

Provincial Banking Enquiry Committee, the indigenous banker usually accepts deposits and deals in hundis; the money-lender does not accept deposits from the public. The indigenous banker is particular about the objects of the loan, whereas the money-lender is not, provided he is sure of repayment. Again, the indigenous banker lends on security; the money-lender, often without security. The clients of the indigenous banker repay punctually and, as his business is less risky, he usually lends at lower rates, varying from 6 per cent to 9 per cent; the money-lender has to take more trouble to recover his loans and usually charges higher rates, varying usually between 9 per cent and 18 per cent to insure himself against the greater risk. Lastly, while the indigenous banker finances primarily trade and industry, the money-lender more often finances consumption.

§ 4. **The methods, funds and the interest rates of the money-lenders**: The methods of the money-lenders are exceedingly diverse; they vary according to the idiosyncracies of the particular money-lender and the urgency of the need of the borrower. But their essential characteristic is their extreme flexibility, elasticity and absence of routine. The methods are very simple and the farmers understand them. On account of the close proximity between the lender and the borrower credit is given more quickly than in a co-operative credit society, and there is no scrutiny by neighbours. All these combine to make borrowing from the local money-lender more attractive to the farmer, than borrowing from a co-operative society.

But the money-lender makes no distinction between short-term and long-term loans and there is no provision for repayment in instalments. The money-lender may be willing enough to grant an extension when there is a failure of crops or to renew the loan when the farmer offers adequate security, but all this depends on the idiosyncracy of the lender; the farmer is usually at his mercy whenever a loan has to be renewed.

The money-lenders generally own all their working capital. But sometimes the village money-lenders borrow from the urban money-lenders and indigenous bankers; money-lenders who are also traders, borrow from the joint-stock banks on the security of hundis.

The cost of the money-lender's credit, *i.e.*, the rate of interest is high.[2] But the money-lenders are not wholly to blame for the higher interest rates charged by them. For, (*a*) the assets of the farmer are extremely flimsy and money-lenders often accept risks which no other credit agency is willing to shoulder; the higher

2 It varies from 12 per cent to 75 per cent in Assam, 12 per cent to 25 per cent in Bombay, 12 per cent to 24 per cent in the Central Provinces and Madras, and 18¾ to 37½ per cent in Bengal.

rates charged by them are in the nature of an insurance against risk. (*b*) The money-lenders are not linked to the money-market, and thus often suffer from a shortage of capital. (*c*) As the money-lenders advance small sums of money to innumerable small borrowers, their expenses of collection and management are much higher than those of the organized credit agencies.

But in actual practice the rates are much higher than are justified by the above factors. The local money-lender is in the position of a monopolist, as there are few other agencies which are willing to lend to the farmer and the farmers are usually illiterate and conservative. The higher rates charged by the money-lenders are, therefore, in the nature of a tax on the illiteracy of the people.'[3]

§ 5. **General objections to financing by money-lenders:** The financing of the farmers by money-lenders is open to some grave objections.

(i) The most important of these is the money-lenders' system. Unlike a co-operative society, (*a*) the money-lender does not think of the advantage of the borrower; (*b*) he does not enquire into the object of the loans, and is prepared to lend even for unproductive purposes if the ryot offers good security; (*c*) he does not insist on punctual repayment; (*d*) he charges high rates of interest, which have little relation either to the prevailing rate for other industries (thus ensuring an equalisation of credit terms) or the yield from agriculture. Compound interest is not unusual and a farmer, once caught in the meshes of debt, finds it very difficult to free himself. The money-lenders' credit is not '*controlled*' credit and the improvident farmer, instead of being educated in thrift and the productive use of credit, is tempted to borrow and ruin himself.

(ii) It is easier to control and regulate the credit advanced by a few semi-public agencies like joint-stock banks and co-operative societies, than to control a number of money-lenders. When agricultural credit is advanced by private lenders 'it is much easier for exploitation to escape the searchlight of public opinion.'[4]

(iii) As the money-lenders are not an integral part of the general money-market, and as there is no co-ordination between the innumerable small lenders, there is no sensitive movement of funds to where they are required most. Credit is not evenly distributed according to requirements.

(iv) All the risks involved are concentrated on two persons—the borrower and the lender. There is no intermediary between the lender and the borrower like a co-operative credit society or a land mortgage bank, which will act as a shock-absorber and spread

3 *The Madras Committee on Co-operation*. Report, par. 88.
4 *Belshaw:* The Provision of Credit to Agriculture. p. 110.

the risks widely. The money-lender must "recoup himself for heavy risks by heavy compensation. Dealing with unorganized individuals, he is not concerned with lessening risks but heaping up compensation."

(v) The canon of convenience to the borrower is not satisfied. Loans are for too short a period and there is no provision for amortization, *i.e.*, gradual repayment in instalments out of the profits of agriculture. There is, therefore, no incentive to thrift, and replacement and renewal charges add materially to the cost of credit. Especially during a depression the farmer, if he wants to renew the loan, will be at the mercy of the money-lender.

(vi) "The canon of convenience to the lender is not adequately safeguarded, since his asset cannot so readily be turned into cash as standardised securities marketable in small units." [5] Thus, a money-lender, with land in some out-of-the way village on his hands, will find it more difficult to secure a purchaser for the land than will the debenture-holder of a land mortgage bank for his debentures.

§ 6. **The case for the elimination of money-lenders:** Hence credit provided by private individuals can 'scarcely be considered to be the ideal form of credit for agriculture.' We want a credit agency which will not only lend at low rates, but will keep down borrowing and educate the borrower in the productive use of credit. As Sir Frederick Nicholson has put it, "the substitution of organized credit for that of the money-lender is a necessary development of civilisation."

In India, where the majority of the peasants are illiterate and have very little bargaining power, the money-lender is virtually a monopolist and is able to enforce his terms. The case for the elimination of the money-lenders is strengthened by the malpractises in which they usually indulge. Some of these, pointed out by the Central Banking Enquiry Committee, are (i) demand for regular advance interest; (ii) demand for regular presents; (iii) taking of thumb impression on blank pieces of paper, with a view to inserting any arbitrary amount at a later date; (iv) general manipulation of accounts to the disadvantage of the debtor; (v) charging of compound interest; and (vi) the taking of conditional sale deeds. Also, when the money-lender finances the farmer, the latter loses his liberty with regard to the sale of the crop. As pointed out by the Madras Committee on Co-operation, "repayment is forced at the harvest and crops are taken over in payment at a low price. The weighment or measurement is often in the hands of the creditor, so that, though much grain changes hands, the debt is not reduced as it should be."

When farmers are exploited in this way, they have little incentive to improve agriculture. "In an industry which leaves a

5. *Belshaw:* The Provision of Credit to Agriculture, p. 112.

small margin of profit and which is, therefore, in need of a reduction in the cost of production, these practices have a demoralising effect on the agriculturist debtor; there is no inducement for him to make serious attempts to improve his holding or to grow a bigger crop as another person will get the lion's share of the produce."

Our ideal, therefore, should be to replace the money-lender's credit by co-operative credit. But co-operation has not yet made much headway in India, and any attempt at eliminating the money-lenders before alternative sources of credit are well developed is likely to end in a disastrous contraction of rural credit. The money-lender cannot, therefore, be eliminated in the near future and will continue to be a necessary evil in the rural economy of India, until he can be replaced by an efficient and wide-spread co-operative credit system. The best solution, therefore, seems to be to curtail the money-lenders' powers for evil by appropriate legislation for the control of money-lenders.

§ 7. **Attempts to control money-lenders by legislation:** Money-lending has always existed in India, but exploitation by the money-lender seems to be of comparatively recent origin. During the pre-British days the power of the money-lenders was curtailed by (*a*) the existence of a vigorous village community, and (*b*) the comparative apathy of the State towards recovery. The existence of a vigorous village community made it impossible for the money-lender to drive hard and unconscionable bargains with the borrowers, and he had to depend in most cases on the village panchayat for help in the recovery of loans. But the establishment of the British rule changed the whole situation. The village community declined and the law-courts enforced all contracts to the letter and allowed the sale of mortgaged lands for the repayment of debt. The peace and security that followed the establishment of the British Raj led to a rise in the value of land and the money-lenders found it very profitable to lend on the security of land. They took advantage of the illiteracy and improvidence of the ryot, got all kinds of unconscionable contracts enforced by the law courts, and land began to pass on an alarming scale from the farmers to sahukars, especially in Bombay and the Punjab. As Sir H. Darling put it, "once the munsif and the lawyer were enthroned in the courts, legality and chicanery were constantly forced into an unholy embrace to the confusion of justice and equity . . . . With the establishment of civil courts and the decline of the village community the reign of the money-lender began." The rise in the value of land and the agricultural prosperity due to increasing trade and the opening up of means of communication, instead of benefiting the farmer actually ruined him by tempting him to borrow recklessly; "as some one said *apropos* the wealth that was pouring into the country, the money-lender got the oyster, while the Government and the cultivator each got a shell."

The situation soon became alarming, and agrarian discontent caused by the expropriation of the cultivators by the money-lenders, led to a series of risings of the peasants mainly against the money-lenders, such as the Sonthal rebellion (1855), the Deccan riots (1874) and those of Ajmer. The Government was, therefore, forced to realise that the system of enforcement of all contracts, based upon ideas of *laissez faire,* led to disastrous results, because the farmers had neither the bargaining power nor the ability to protect their own interests effectively. The Government have therefore tried, by a series of enactment to prevent the exploitation of the farmers by shrewd and unscrupulous money-lenders. These measures are mainly of four types, *viz.,* (*a*) measures for the improvement of the civil law ; (*b*) restrictions on the transfer of land ; (*c*) measures to prevent unnecessary borrowing by the ryot ; and (*d*) the provision of alternative sources of credit.

Measures for the improvement of the civil law: (*i*) *Alterations in the Code of Civil Procedure*:—These measures were intended "to substitute for the blind and ruthless operation of legal machinery the intelligent dispensation of justice between man and man." Originally the civil law regarding debts was defective in the following respects :—(*a*) It made no provision for a consideration of the history of the debts under litigation. (*b*) The rate of interest fixed in the bond, however usurious it might have been, was enforced. (*c*) No attempt was made to control the transfer of land from the ryots to the creditors in enforcement of decrees for debts. This opened the way to the exploitation of the ignorant and improvident ryots. While the law should help the money-lender to recover his reasonable claims if there should be no contraction of agricultural credit, it should also prevent the exploitation of ignorant ryots by shrewd money-lenders. With this object in view several alterations were made in the Code of Civil Procedure. The agriculturist's tools and implements, the cattle necessary for tillage, and the utensils of the agriculturist's house could not be attached in execution of a decree against him. The agriculturist was given the concession of repayment of his debt in instalments ; nor could he be arrested on a decree of the court.

(*ii*) *The Deccan Agriculturists' Relief Act,* 1879:—This Act allowed the courts to go behind the contract and modify it when the stipulated rate of interest was oppressive. It also forbade the sale of land where it was not specifically pledged. It required all future mortgages of land by agriculturists to be in writing and obliged money-lenders to furnish accounts and grant receipts. The Act, though well-intentioned, "has on the whole been found ineffective and even positively injurious,"[6] because it has restricted credit, and its concessions have been abused by dishonest

6. *Jathar and Beri*: Indian Economics, Vol. I, 296.

ryots. The Usurious Loans Act of 1911 has made this Act superfluous.

(*iii*) *The Usurious Loans Act*, 1918 :—Before 1918 the courts were obliged to decree interest at the rate fixed between the parties, and the only remedy was for the debtor to plead 'undue influence'. But this Act empowered the courts to reopen and examine all loan transactions if, in their opinion, the interest was excessive or the transaction unfair. The Royal Commission on Agriculture in India held that the Act was practically a dead letter, but this seems to be an extreme view. As pointed out by the Madras Provincial Banking Enquiry Committee, the courts have cut down interest in many cases, and because of the existence of the Act, plaintiffs also cut down their interest claims voluntarily to make their claims appear reasonable in the eyes of the court.

But, as pointed out by the Madras Committee on Co-operation, the Act "has been applied by the civil courts with a considerable degree of disparity." The practical utility of the Act was greatly reduced by two vital defects, *viz.*, it did not make it obligatory for the court to reopen and examine all loan transactions which were substantially unfair; and it did not define a 'usurious rate.' But during the past few years these defects have been remedied by suitable amendments to the Act in Bengal, the Central Provinces, the Punjab, the United Provinces, Bihar, Assam and the North-West Frontier Province, and the courts are now obliged to re-examine all unfair transactions. In Madras, as far as agricultural debts are concerned, the rates of interest are now regulated by the provisions of the Agriculturists' Relief Act of 1938.

(*iv*) *Provincial enactments compelling the money-lenders to keep regular accounts* :—These try to prevent dishonest manipulations of accounts to the disadvantage of the borrower by unscrupulous money-lenders. Here the Punjab led the way with the Punjab Regulation of Accounts Act of 1931. We can take this Act as typical. It imposes certain obligations on creditors. These are (*a*) the regular record and maintenance of the account of each debtor separately in a manner prescribed by the local Government; (*b*) furnishing each debtor, every six months, with a legible statement of accounts signed by the money-lender or his agent; (*c*) the interest and the principal have to be shown separately in the accounts. When the creditor has not regularly recorded or maintained accounts, the court is empowered to disallow the whole, or a portion of the interest found due.

Restrictions on the transfer of land:—These aim at preventing the passing of land from the hands of the agriculturists into the hands of non-agriculturist money-lenders. The Punjab, where the evil was greatest, led the way with the Punjab Land Alienation Act of 1901. Under this Act non-agricultural classes are not allowed to buy land from a member of an agriculture tribe, nor to take in mortgage for more than 20 years. Thus, the non-agricultural money-lender is prevented from taking over the land of the cultivator in lieu of repayment of debt. The Agency Tracts Interest and Land Transfer Act of Madras applies to the hill tribes in the Agency Tracts of the Vizagapatam and Godavari Districts. It prohibits the transfer of immovable property, unless it be to another member of the hill tribes, without the assent of the Agent to the Governor. Land Alienation Acts with a restricted scope have also been enacted in the United Provinces and the Central Provinces.

Non-agriculturist creditors have of course sometimes contrived to evade the provisions of the law by the use of benami transactions. Thus, "sometimes a non-agriculturist creditor gets the land of his agriculturist debtor mutated in favour of another agriculturist in his confidence and receives the rent or the produce of the land from his agricultural nominee." Nevertheless, Land Alienation Acts have undoubtedly achieved their main object. They have prevented the passing of land into hands of absentee landlords and have helped to keep it in the hands of the cultivating classes. But they have led to the following evil consequences: (*a*) The money-lender is unwilling to lend as he cannot take over the land when the farmer fails to repay. This has led to a serious contraction of credit which hampers genuine agricultural operations. (*b*) The Acts have helped to create a class of agricultural money-lenders who are even more rapacious than the non-agricultural money-lenders. Thus, as the Punjab Land Alienation Act did not prevent the taking over of the land of one agriculturist by another, the bigger landlords began to take to money-lending. As far as the farmer is concerned "there is nothing to choose between the agriculturist money-lender and his professional rival. The one is as harsh as the other is astute and both are demoralised by the system under which they work." A recent amendment to the Punjab Land Alienation Act seeks to remedy this defect, but its success in preventing exploitation of the poor ryots by the agriculturist money-lender is yet to be seen. (*c*) The Punjab Land Alienation Act has, according to Sir M. Darling, created an undesirable divorce between the town and the country by making it difficult for enterprising people from towns to invest in land.

Land Alienation Acts, therefore, while they prevent the expropriation of cultivators by non-cultivating money-lenders, lead to a serious contraction of agricultural credit and the rise of a class of agricultural money-lenders.

The Madras Committee on Co-operation (1940) are not in favour of legislation restricting the alienation of agricultural land. As they have pointed out, the same object, *viz.*, the prevention of the expropriation of cultivating farmers by creditors can be achieved by legislation providing that (1) existing mortgages of agricultural land in which the mortgagee has enjoyed the fruits of the land for not less than 27 years, should be deemed to be extinguished; and (2) no usufructuary mortgage of agricultural land should, in the future, be permitted unless provision is made for automatic redemption within a fixed period of years, 20 years being the maximum. After the period the land must be redelivered to the mortgagor free from all encumbrances. Legislation on the above lines seems to be the best way of ensuring the retention of land in the hands of cultivators without unduly contracting credit.

The attempts of the Government to increase the income of the ryots and to educate them to take a more business-like view of borrowing, the direct advance by the Government of takkavi loans to the ryots and the introduction of the co-operative movement mainly to provide cheap credit to the farmers, have all further reduced the hold of the money-lender on the ryot. As the Central Banking Enquiry Committee have pointed out, the money-lenders are not as powerful today as they were some years back, because of (*a*) the legal protection given to the borrower by legislation; (*b*) the effects of the economic depression after 1929; (*c*) the spread of the co-operative movement; (*d*) the courts' delays in enforcing the recovery of loans, and (*e*) the general unpopularity of the business.

§ 8. **The Licensing of Money-lenders**:—The measures indicated above have not been able to prevent completely the exploitation of the farmers by unscrupulous money-lenders. If the latter are to be controlled effectively, all these measures should be supplemented by the compulsory registration and licensing of money-lenders.

All money-lenders should be compelled to register themselves and take out licenses, and money-lending without a licence should be made penal. Money-lenders requiring a licence should be compelled to submit to certain conditions:—(1) They should agree not to charge above a prescribed maximum rate of interest: compound interest should be prohibited. (2) They should keep accounts in a standard form and allow these accounts to be inspected by government auditors once or twice a year. (3) They should give receipts for all payments received. (4) The account of each individual borrower should be separately kept and a copy of it should be furnished to the borrower once every six months.

Such legislation is in the interest of the large mass of the agricultural population, and is sure to stamp out the dishonest practices of the money-lenders. Compulsory registration is likely, in actual practice, to benefit the honest money-lender, by removing the unpopularity at present attaching to the business and by ensuring for him a definite role in the scheme of rural finance.

But, any scheme of registration and licensing of money-lenders has to face certain difficulties. The first is the definition of the term 'money-lender.' As we have already seen, there is a large class of non-professional money-lenders, such as land-owners, and it will be difficult to bring them within the scheme. Secondly, there is some truth in the view that in a country like India, with its illiterate borrowers, the more the restraints placed on the money-lender the worse will become the position of the borrower, as long as there are no alternative sources of credit.

The Central Banking Enquiry Committee held that by a fuller utilisation of the Usurious Loans Act and provincial enactments on the lines of the Punjab Regulation of Accounts Act, money-lenders could be adequately controlled; they were not, therefore, in favour of a system of licensing. But experience has proved that this is not enough. The difficulties in the way of compulsory registration of money-lenders have somehow to be overcome. Under the present circumstances there seems to be no alternative to the scheme of compulsory licensing of money-lenders. Acts providing for such licensing have been passed in the Punjab, Bihar, the Central Provinces, Bengal and Sind. In the Punjab and Bihar money-lenders who do not take out licenses are not helped by the courts in the recovery of their loans.

But such measures can really benefit the farmers only when the farmers have the will to help themselves. As long as the farmers are improvident and reckless no legislative enactment can protect them and they may even collude with the money-lender to evade the law. We are, therefore, once again driven back to the fundamental fact, that no progress is possible without the education of the farmer. "A real and lasting solution can only be found by the spread of education, the extension of co-operative and joint-stock banking and by the training of the borrower in the habits of thrift and saving."

CHAPTER VII

HISTORY OF THE INDIAN CO-OPERATIVE MOVEMENT

§ 1. **What is Co-operation? The difference between co-operation and socialism and between co-operation and capitalism:** Co-operation as a special mode of doing business is a term rather difficult to define, though it has certain easily distinguishable characteristics. To the threat of domination and exploitation by large business, the products of the Industrial Revolution, co-operation was the reply of the small-scale farmer and the isolated and powerless individual, possessed of little bargaining power and left helpless by the *laissez faire* policy of the State. Thus the flannel weavers of Rochdale combined together in the Rochdale Society of Equitable Pioneers to secure their household requisites at wholesale prices and escape exploitation by the retailers; thus was initiated the consumer's co-operative movement. The poor farmers of Germany under the guidance of Raiffeisen combined into co-operative societies to obtain cheap credit; thus originated the co-operative credit movement. When, with the spread of industrialism and the growth of big cities, a wide gulf grew up between the farmer and his markets, and the farmers found themselves more and more at the mercy of an increasingly long chain of middlemen, they were forced by the logic of circumstances to combine together for self-preservation; this led to the emergence in Europe of agricultural co-operation in its various forms, such as societies for the purchase of raw materials and implements required for cultivation, societies such as the Co-operative Creameries in Denmark to undertake the processing of agricultural products, co-operative associations for leasing and cultivating land, for the improvement of livestock, for mutual insurance against agricultural risks, etc.

Co-operation, therefore, like socialism, is a protest against the destructive competition and the acquisitiveness of capitalism. To the prophets of co-operation, such as Robert Owen in England, and Fourier in France, co-operation is an alternative to competition as a principle of social organization, substituting for the latter concerted action by a number of isolated individuals. It tempers the profit motive by the spirit of mutual service. But co-operative societies, as seen in the previous paragraph, grew up almost unconsciously as "practical solutions of obvious difficulties rather than as embodiments of a distinct theory of economic organization." There is, therefore, an intensely practical strain in the co-operative movement. Unlike socialism, co-operation does not seek to do away with private property. Again, while socialism centralises control in the hands of the State, co-operation is voluntary and retains local initiative, and emphasises self-help and collective responsibility. While socialism implies a radical transformation of the existing society, co-operation seeks to improve the economic condition of the weaker strata of society without disturbing the frame-work of the existing system. Again, from the moral point of view, co-operation is superior to socialism as, instead of focussing attention on the defects of the capitalistic system and stirring up class consciousness, it insists on self-help and thrift by the poorer classes and thus places on their shoulders the responsibility for their own uplift. Thus, in common with socialism it has a strain of a lofty idealism; but its innate shrewdness has helped it to avoid some of the drawbacks of the latter.

The differences between a co-operative society and a capitalistic organization like a joint-stock company are fundamental. The aim of the co-operative society is to provide a service to its members, as, for instance, the provision of cheap credit or the provision of reliable goods at fair prices, and not to make a profit for its share-holders. The co-operative societies often confine their transactions to their members. The principle in a co-operative society is "one man, one vote" and not "one share, one vote" as in a joint-stock company. In fact, in most societies there is a maximum limit to the number of shares an individual may hold. This prevents the control of the society from passing into the hands of the richer members. Again, profits in a co-operative society are divided not according to the number of shares held, but on the basis of the volume of business transacted with the society. The profits are often spent on the provision of common amenities like education, reading rooms, etc., from which the poorer members derive a greater benefit.

A co-operative society seeks to combine in an association a number of individuals who have got a common economic end but are too weak to achieve it individually. It promotes the ideal of "each for all and all for each", and tries to strengthen the economic position of its members by insisting on self-help, thrift and mutual support. The theory of co-operation cannot be stated better than in the words of the Maclagan Committee. "The theory of co-operation is, very briefly, that an isolated and powerless individual can, by association with others and by moral development and mutual support, obtain, in his own degree, the material advantages available to wealthy or powerful persons, and thereby develop himself to the fullest extent of his natural abilities. By the union of forces material advancement is secured, and by united action self-reliance is fostered and it is from the inter-action of these influences that it is hoped to attain the effective realisation of the higher and more prosperous standard of life which has been characterised as 'better business, better farming, better living.'" Thus, a number of small farmers can improve their economic condition by joining together into a co-operative society which will encourage them to save regularly, pool their savings and lend to each other; to purchase and operate machinery which they are too poor to buy individually; and to purchase their supplies and sell their produce jointly, thus eliminating middlemen. Thus, the essence of co-operation is self-help, avoidance of competition in distribution and production and the elimination of middlemen of all kinds. It also elevates business to a moral plane by emphasising the relation between business and ethics. As Sir Horace Plunkett has put it, co-operation is "self-help rendered effective by organization."

There is no sphere of economic activity to which the principles of co-operation cannot be applied. Co-operation has almost always been the child of necessity, and has developed in different countries along different lines. Thus Great Britain, whose labourers were exploited by the truck system, led the way in consumer's co-operation; Germany, where exploitation of the poorer farmers and artisans by money-lenders was rampant, developed credit co-operation; Denmark, whose peasant farmers were forced to give up the production of grain by the competition of cheap imports from the New World, has specialised in the co-operative production of dairy products for the British market; and the new countries such as Canada, with their immense distances and production for a foreign market, have tended to concentrate on co-operative marketing.

The main spirit of co-operation underlies many characteristic Indian institutions, *e.g.*, the joint family, the caste organization, the chit funds in Madras, and many village undertakings. But the application of this spirit to the organization of business is an essentially Western development, and in similar application of the spirit to agriculture lies the salvation of the Indian farmer. Co-operation can help the farmer in India to consolidate his holding, to purchase his supplies cheap, to sell his produce for a remunerative price, to secure cheap credit, and to improve his agricultural methods. But more important than all these, it can educate the farmers, induce self-help and create in them that desire to improve their economic condition which is the spur to all economic and social progress. As the Royal Commission on Agriculture in India remark, "If co-operation fails, there will fail the best hope of rural India."

§ 2. **The Raiffeisen and Schulze-Delitzsch Societies:** The Government in India initiated the co-operative movement as a method of rescuing the small and illiterate farmers from the clutches of the money-lenders by the provision of cheap credit. It has, therefore, been essentially a credit movement and it has been largely influenced by the example of Germany—the home of credit co-operation. As the great majority of the co-operative societies in India are credit societies, based with small modifications on the Raiffeisen and Schulze-Delitzsch types, a brief study of their characteristic features is necessary.

Exploitation of the farmers and lower middle classes and artisans by private money-lenders was as rampant in Germany in the middle of the last century as it is in India today. The Raiffeisen type of credit society was evolved by von Raiffeisen, the Burgomaster of Weyerbusch, in 1862 to protect the small farmers, while Schulze-Delitzsch organized co-operative societies on a different model to protect the artisan and the small industrialist from such exploitation by the provision of cheap credit. In either case the aim was to raise funds cheaply by the substitution of individual by collective security, and to advance loans on personal or chattel security for short or intermediate terms. The Raiffeisen banks are mainly agricultural, while those of the Schulze-Delitzsch type are mainly urban.

The Raiffeisen banks have four characteristic features, *viz.*, (*a*) unlimited liability, (*b*) a restricted area of operation, (*c*) gratuitous management, and (*d*) little emphasis on share capital, most of the profits being carried to an indivisible reserve fund. A co-operative society consisting of small peasants cannot raise enough funds for loans to members except on the basis of unlimited liability. A limitation of the area of operation is essential in order to ensure the mutual knowledge and mutual supervision so necessary to minimise the risk from unlimited liability, and to ensure efficient management. The value of each share is kept at as low a figure as possible in order to enable even the poorest peasant to join the society, and the profits are all carried to a reserve fund to which all bad debts can be debited. A strong reserve fund is in effect an insurance against the risk of unlimited liability. Gratuitous management keeps down the cost of the credit advanced by the society. Such a society is expected to foster among members the spirit of "each for all and all for each"; in the Raiffeisen societies perhaps even greater emphasis is laid on the moral advancement of the members than on improvement in their economic condition.

The management of the Raiffeisen societies is democratic. The routine business is conducted by a committee of management controlled and supervised by a committee of supervision, both of which are elected by the general meeting of members. Only the secretary-treasurer is paid.

One characteristic feature of the Raiffeisen society is the great emphasis which it lays on thrift. Thus, savings deposits accounted for 78.0% of the funds of such societies in Germany in 1910.[1] Thrift is encouraged by three main systems: (*a*) school savings banks, (*b*) monthly house to house collections, and (*c*) domestic savings in small locked boxes.

Frequently the Raiffeisen societies combine with the provision of credit other objects like the co-operative supply of agricultural requisites and the co-operative sale of produce. The written orders given by members are pooled and the supplies are purchased collectively at low prices, often through a central agency, to which we shall refer later. They thus do not incur the risks of price changes by carrying stocks.

Three types of central organizations have been evolved by the German Raiffeisen societies, *viz.*, Federations, Central Banking Institutions and Central Co-operative Supply Societies. The

1. The position had altered radically in the thirties, as a result of the great German post-war inflation and the advent to power in Germany of the Nazis.

federations of co-operative societies are unions set up for propaganda, education, defence, and inspection, and these, in their turn, have formed themselves into a central body known as the National Federation which deals with all questions of legislation, administration, and publicity. To raise funds cheaply from external bank. The central co-operative supply associations are another type of federation of co-operative societies. These pool the orders of a number of small societies and purchase supplies in bulk. They are able to safeguard quality by expert selection and testing, and to utilise their superior knowledge of market fluctuations to buy at the right time.

Societies of the Schulze-Delitzsch type, started to finance the smaller artisans and the lower middle classes in towns had to work in a totally different environment and they developed characteristic methods appropriate to the conditions under which they worked. (*a*) There is no rigid adherence to unlimited liability in the banks of this type, though Schulz himself favoured unlimited liability. (*b*) Share capital is insisted on and a larger proportion of the profits is distributed as dividends. (*c*) The area of operations is wider than with the Raiffeisen societies. (*d*) The management is in the hands of paid servants. In the towns people are not likely to possess intimate mutual knowledge and unlimited liability under these conditions would have been extremely risky. Lack of personal knowledge among members leads naturally to greater emphasis on the share capital and the accumulated reserves as security, and the big size of the society necessitates a paid management. In general, the activities of the Schulze-Delitzsch banks correspond more closely to those of the commercial banks and in them there is a greater emphasis on business than on normal uplift.

The agricultural credit societies in India have conformed to the Raiffeisen pattern, while the non-agricultural credit societies in towns, popularly known as urban banks, conform more closely to the Schulze-Delitzsch type. This takes us to the co-operative movement in India.

§ 3. **History of the co-operative movement in India**: Though co-operation in India officially began only with the passing of the Co-operative Credit Societies Act of 1904, stray attempts to start and work co-operative credit societies can be traced to a much earlier date. As early as in the eighties of the last century attempts were made to start an Agricultural Bank in the Purandhar Taluk of the Poona district, and the Nidhis which were then developing in Madras embodied some of the principles of co-operative societies. Some co-operative credit societies were organised in the United Provinces but their working was hindered in many ways by the fact that they had to be registered under the

Indian Companies Act. But the idea that co-operation was the main solution of the rural credit and debt problems in India was essentially the contribution of Sir Frederick Nicholson, a Madras Civilian, who in 1897 submitted to the Government of Madras a "*Report on Land and Agricultural Banks*" and summed up his conclusion in the words "Find Raiffeisen." He deprecated all attempts of the State directly to finance the farmer, as such direct financing, even assuming that Government could raise the necessary funds, would involve a large and cumbrous official organization, kill all self-help and would make the Government incur the odium of the bailiff in addition to that of the tax-collector. According to him "small locally worked institutions on the lines of the European village institutions" were the ideal agencies for the supply of rural credit "because they would satisfy the postulates of proximity, security, facility, excite local confidence and consequently draw in local capital, work cheaply, almost gratuitously and thus provide cheap credit, influence borrowers towards the true use of credit and watch the utilisation of loans in accordance with contract, exercise educative influence in matters of thrift, association and self-help and develop high forms both of individual capacity, of public life and of national character." Mr. Dupernex, a civilian officer of the United Provinces, followed Sir F. Nicholson with a work on the '*People's Banks for Northern India*' and the Famine Commission of 1901 strongly recommended the starting in India of village banks of the Raiffeisen type. This was followed by the passing of the Co-operative Credit Societies Act of 1904 which formally inaugurated the co-operative movement in India.

The Co-operative Credit Societies Act of 1904 provided for the starting of credit societies only. Any ten persons who had attained their majority, living in the same village or town, or belonging to the same tribe or caste, could get themselves registered as a co-operative society. The Act made a distinction between 'rural' and 'urban' societies. A society was to be classed as rural or urban according as four-fifths of its members were agriculturists or non-agriculturists. Rural societies were to have unlimited liability and were to carry over their profits to an inalienable reserve fund. In urban societies the nature of the liability was left to the option of the society. The urban societies were to carry one-fourth of their net profits to the reserve fund. Registrars were to be appointed in all the provinces to organize, supervise, and control the co-operative societies, and the Government, through the Registrar, reserved to themselves considerable powers in the matter of the registration, compulsory inspection and audit, and dissolution of societies.

The Act was framed with a view to simplicity and elasticity. The object was to create small and simple credit societies for simple folk with simple needs. The All-India Act merely laid down the general outlines and the provinces were left free, as they aquired experience, to fill in the details according to local conditions and needs. To encourage the movement the Government made certain concessions, such as exemption from income-tax, registration fees, stamp duties, etc.[2]

There was a steady though slow increase in the number of credit societies, but the years that followed 1904 brought to light certain grave omissions and defects in the Act of 1904. Firstly, that Act gave no legal protection to co-operative societies for purposes other than credit, *viz.*, marketing, supply, etc. Secondly, it did not provide for the registration of central organizations such as central banks and unions, which were increasingly needed for financing the primary societies in the villages and for supervision. Thirdly, in some provinces like Madras and the Punjab, the rural societies had raised a substantial amount of share capital and the total prohibition of the distribution of profits in rural societies with unlimited liability was found to cause some hardship to their members. Lastly, the classification of societies into rural and urban was found to be extremely unscientific and inconvenient. The Government had therefore to come forward with a new Co-operative Societies Act in 1912.

The Co-operative Societies Act, 1912, gave legal recognition to non-credit co-operative societies, such as societies for the purchase of supplies for the sale of produce, insurance and housing. It also recognised three kinds of central societies, as distinct from primary societies, *viz.*, unions of primary societies for mutual control and audit, central banks and provincial banks. It also substituted for the old distinction between rural and urban societies the more scientific one between limited and unlimited liability societies. All central societies were to have limited liability, all societies of which the majority of members were agriculturists, unlimited liability, and in all other cases the nature of the liability was to be optional. The Act also permitted societies with unlimited liability to declare dividends on shares, after 25% of the profits had been carried to the reserve fund, with the permission of the Provincial Government concerned. It also allowed them to set apart a portion of the profits not exceeding 10% for educational and charitable purposes.

After 1912 there was a rapid growth in the number of co-operative societies and their membership. Unions for supervision, and central banks, all began to develop rapidly and co-operation began to strike root in the big cities also, where a number of non-agricultural credit societies were rapidly developing. The development, of course, was not even in all the provinces, being more rapid in areas like the Punjab, Bombay and Madras, where

[2] See below Ch. XI § 2

the agriculturist has mortgage rights in his land, than in the zamindari areas like Bengal, where the cultivator has little to offer except his personal security. Meanwhile, non-credit types of co-operation were also being gradually developed. Societies for milk supply, cattle insurance, the sale of produce, the purchase of manure, improved implements and common necessaries were all being gradually organized.

In 1914 the Government considered that the time had come for a general stock-taking and appointed a committee under Sir Edward Maclagan "to examine whether the movement especially in its higher stages and its financial aspects was progressing on sound lines and to suggest measures for improvement which seemed to be required." The report of the Maclagan Committee appeared in 1915, and though it contained no novel recommendations, it still remains one of the authoritative reports on the working of co-operation in India.

The work of financing the primary societies, as we have already seen, was gradually taken up by the central co-operative banks, but propaganda still remained the function of the Registrar. This function also was gradually taken over from the Registrar by the Provincial Co-operative Institutes which were started in the various provinces. These enlisted in the service of the co-operative movement an increasing number of non-officials and introduced into the movement a tendency towards de-officialisation.

Under the constitution of 1919, co-operation became a provincial subject in the charge of a popular minister and this gave a further impetus to the movement. The economic prosperity between 1920 and 1929 facilitated expansion and there was a rapid increase in the number of societies. But side by side with this expansion there were also some disquieting features as, for example, a steady increase in overdues. These led to the institution by various provinces of Co-operative Committees of Enquiry to enquire into the working of the movement. The Central Provinces led the way with such an enquiry in 1922; the Oakden Committee in the United Provinces, the Calvert Committee in Burma and the Townsend Committee in Madras made similar enquiries. But the period between 1920 and 1929, taken as a whole, was characterised by a rapid expansion of the co-operative movement. This period also saw the birth of the co-operative land mortgage banks in India, first in the Punjab and subsequently in Madras and Bombay.

Some provinces like Bombay and Madras have replaced the All-India Act by provincial enactments.[3] The co-operative movement in Madras is at present governed by the Madras Co-operative

3. Other provinces which have enacted their own Co-operative Societies Acts are Bihar and Orissa (1935) and Bengal (1940).

Societies Act of 1932 and the Madras Co-operative Land Mortgage Banks Act of 1934.

Following the Committee on Co-operation in Madras we may distinguish four main phases in the evolution of the co-operative movement in Madras. The first phase, from 1904 to 1917–18, was a period of slow growth. The second phase, from 1918–19 to 1919–33, was a period of rapid, in fact too rapid, expansion. This coincided with a period of agricultural prosperity in the wake of the Great European War of 1914–18. Societies of all types increased from 3,676 in 1918–19 to 15,238 in the latter year and there was a corresponding increase in the membership and the working capital of the movement which rose from about Rs. 30 lakhs to more than Rs. 1,799 lakhs. With the advent of the depression and the crash of agricultural prices, the movement entered on its third phase. Many depressing features, such as an increase in the amount of overdue loans, an increase in the number of liquidations and of moribund societies, became prominent in the working of co-operative societies. The number of societies fell from 15,238 in 1929–36 to 12,927 in 1936–37 and the membership declined from 974,919 to 897,128 during the same period. The co-operative movement passed through a wholesome period of introspection and reform and the period has aptly been described by the Madras Committee as "a period of consolidation and reconstruction." But even during this period there were two bright features, *viz.*, the rapid development of land mortgage banks, and co-operative sale societies which increased from 3 in 1924 to 111 in 1937.

The fourth phase, *viz.*, period after 1937, has been characterised by a gradual recovery. "It would appear as though we have turned the corner and signs of improvement have begun to manifest themselves both in the number of societies and membership."

These four distinct phases characterise not only co-operation in Madras but co-operation in India as a whole, as general economic trends affect in the same way all parts of the country.

Before we conclude this study of the history of the Indian co-operative movement we may refer to certain characteristic features. Firstly, the co-operative movement in India has not sprung up from the people. It was initiated by the Government as solution to the problem of indebtedness and is even today based not on the voluntary effort of a people determined to help themselves but on Government support. Secondly, started originally to provide the farmer with cheap credit, it has continued to this day a predominantly credit movement. The progress of non-credit co-operation has been extremely slow and agricultural credit societies dominate the picture. Thirdly, though there are inter-provincial differences, the structure of the co-operative organization is uniform in almost

Table No. XI

PROGRESS OF CO-OPERATION IN INDIA (INCLUDES INDIAN STATES)

	Number of Societies, (in thousands)	Number of Members (in lakhs)	Working Capital (in Rs. Crores)
Average for 4 years from 1906—07 to 1909—10 ...	2	1.6	0.68
,, ,, 5 ,, ,, 1910—11 to 1914—15 ...	12	5.5	5.48
,, ,, 5 ,, ,, 1915—16 to 1919—20 ...	28	11.3	15.18
,, ,, 5 ,, ,, 1920—21 to 1924—25 ...	51	21.5	33.36
,, ,, 5 ,, ,, 1925—26 to 1929—30 ...	94	36.9	74.89
,, ,, 5 ,, ,, 1930—31 to 1934—35 ...	106	43.2	94.61
,, ,, 5 ,, ,, 1935—36 to 1939—40 ...	117	50.8	104.68
1940—41 ...	142	64.0	109.33

Figures after 1934—35 exclude Burma

Table No. XII

GENERAL POSITION IN 1940—41 ACCORDING TO TYPES OF SOCIETIES

	British India		Indian States		Total	
	No.	Working Capital Rs. (Crores.)	No.	Working Capital Rs. (Crores)	No.	Working Capital Rs. (Crores)
Provincial Banks ...	8	13.13	2	0.75	10	13.39
Central Banks and Banking Unions ...	489	26.88	112	2.44	601	29.32
Supervising and Guaranteeing Unions ...	433	...	33	...	466	...
Agricultural Societies ...	108,778	29.94	14,945	3.59	123,723	30.53
Agricultural Insurance Societies ...	1	...	...	...	1	...
Land Mortgage Banks ...	196	6.49	56	0.56	252	7·05
Other Insurance Societies ...	12	25.03	3,122	3.50	17,442	28.53
Non-Agricultural Societies ...	14,320	...	3	...	15	...

all the major provinces. Broadly speaking, in each province, at the head of the movement there are three authorities, *viz.*, the Registrar of Co-operative Societies in charge of control and direction of the movement, the Provincial or apex Bank in charge of finance, and the Provincial Co-operative Institute or Union in charge of education and propaganda.

Non-agricultural co-operative societies, such as the co-operative urban banks, thrift and life insurance societies, societies for factory workers, credit societies for government employees, consumers co-operative societies and artisans' societies for purchase and sale, are beyond the scope of this book. The co-operative movement in India with particular reference to agriculture will be discussed in the following chapters.

CHAPTER VIII

THE VILLAGE CREDIT SOCIETY

§ 1. **Its importance in the Indian co-operative structure:** The co-operative moment in India, as we have already seen, was started mainly with the object of providing the farmer with cheap credit and freeing him from the clutches of the money-lender. The movement, therefore, has been essentially a credit movement, and agricultural credit societies dominate the picture. In number as well as membership they far exceed all other types of co-operative organizations put together. In 1940–41 out of a total of 1,42,512 co-operative organizations of all kinds in India, 1,04,084 were agricultural credit societies. On the 30th June 1941, there were 14,409 co-operative societies of all kinds in Madras, and of these 10,993 were agricultural credit societies. The primary societies are the raison d'etre of the provincial and central banks, and as the Townsend Committee put it "the agricultural primary credit society is the foundation stone on which the whole co-operative edifice is built." It will not be too much to say that the co-operative movement in India will stand or fall with the soundness of the credit society in the village, which is usually referred to as the primary agricultural credit society.

§ 2. **Its objects:** The main object of the village credit society (we shall use this term instead of the more cumbrous term the primary agricultural credit society) is, of course, the provision of credit to its members. But the bye-laws of the societies often include other objects also. In Madras the bye-laws of these societies provide not only for borrowing funds for loans to members but also for the joint purchase of the requisites of members and the joint sale of their produce. They are also intended to act as agencies for propagating knowledge of the latest agricultural improvements and promoting village handicrafts, and generally to act as centers of educative and moral influence. But in actual practice the societies have remained mere dispensers of credit and have scarcely attended to the other objects.

§ 3. **Membership and the area of operations:** The minimum initial membership for such a society is ten. As the liability is unlimited and members are expected to evaluate each other's credit, enquire into the objects of the loan and keep watch on the employment of funds obtained through the society, the members have to know each other and membership has to be compact.[1] The area of operation is restricted, as in the case of the Raiffeisen societies in Germany, to ensure the co-operative safeguards of mutual watchfulness and supervision, and the aim till now has been one society for each village.

§ 4. **Liability:** As a rule the village credit societies, like the Raiffeisen societies, have unlimited liability. "Unlimited liability has been one of the basic principles of rural co-operative credit ornanization of India." It was felt that the village credit societies whose members are mostly poor ryots would be unable to raise sufficient funds in the money market for loans to their members, unless they were buttressed by unlimited liability. In the words of the Maclagan Committee, unlimited liability "constitutes an important factor in the confidence reposed on societies both by central institutions inside the movement and by the joint-stock banks outside it." The members of the village credit society are, therefore, liable for the debts incurred by the society to the full extent of their property. Details regarding the property possessed by each member are collected together in the 'Property Statement' of the society which forms the basis of all its borrowing transactions. But unlimited liability in the case of a co-operative society means only 'contributory' liability. The creditors of a society cannot try to recover their loans from individual members; only "the ultimate deficit could be secured by a series of levies *per capita* on members."

But the dangers from unlimited liability are reduced to a minimum by the following divices: (1) The maximum amount which such a society can borrow, has been fixed by law at a definite fraction of the net assets, *i.e.*, the property of all its members, varying usually between one-fourth and one-eighth. In Madras the maximum borrowing power of an agricultural credit society with unlimited liability is one-eighth of the total value of the net assets of the members as disclosed in the property statement. (2) The maximum sum the society may borrow from outsiders, the maximum

1 But in actual practice, as pointed out by Dr. Hough, there seems to be no definite co-relationship between the size of the society and its efficiency. Thus in the United Provinces, where the movement is weak, the average membership was 24 in 1931, while in Bombay where the movement is relatively prosperous it was 72.

sum that can be lent to each member, are both fixed once or twice a year by the general body at its meeting. (3) The members of the society have the right to refuse admission to individuals whose solvency and honesty are doubtful. (4) The societies have built up strong reserve funds. When most of the profits are carried to a reserve fund, unforeseen losses can be met therefrom. "An indivisible reserve is a fundamental feature of the Raiffeisen system, to serve as a buffer between the members and the rigours of a possible enforcement of unlimited liability."

Therefore, when a society is well-managed and members exercise mutual supervision and are alert and watchful, unlimited liability is likely to be a source of strength rather than of weakness. How far these conditions have been fulfilled in India, we shall discuss later, when we deal with proposals for the reorganization of the village credit society.

§ 5. **Sources of Capital:** To grant loans to its members at low rates of interest, the village credit society needs funds. These funds it raises from sources internal and external. The internal sources refer to the funds raised from the society's members, and consists of the share capital, the entrance fees, the reserve fund (these three together constitute the 'owned capital' of the society), and deposits from members. The external sources consist of deposits from non-members, loans from co-operative central financing organizations like the district, central and provincial co-operative banks, and loans from Government which now provide only a very small part of the working capital of the village credit societies.

Theoretically, in a co-operative society of the Raiffeisen type, emphasis should be on the character and honesty of the members rather than on share capital. Insistence on share capital may mean the denial of the benefits of co-operation for the poorer classes. But societies in India have not conformed to the orthodox pattern as regards share capital. Share capital provides an important part of the working capital of the village credit societies in the Punjab and Madras and is becoming increasingly important in the other provinces. In some societies there is provision for the purchase of shares in instalments. The possession for a substantial amount of share capital is said to increase the society's financial stability, reduce dependence on outside capital and also to reduce the danger from unlimited liability.

Entrance fees charged on the admission of members, provide only a small proportion of the working capital and serve merely to cover the preliminary expenses.

The village credit societies in India have built up strong reserve funds. The Co-operative Societies Act of 1912 compels all societies to carry over at least 25% of their net profits to the reserve fund, and the actual percentage so carried over differs from province to province. The importance of the reserve funds is shown by the fact that in 1940-41, the reserve and other funds of the agricultural societies provided almost 28% of their working capital.

Deposits from members which are the real test of co-operation are very small in India. Attempts have of course been made to foster such deposits. Obligatory deposits are found in Bihar and Orissa; in Bombay, in most societies members are compelled to deposit for 5 to 10 years, 5 to 10% of the loan advanced. Some societies have tried to encourage saving by members by the provision of home savings boxes, *e.g.*, in Bengal, while others by their bye-laws require each member to deposit a specified portion of the annual produce.[2] But the results have been disappointing. Thus, in 1940-41 member deposits provided only about 4·0% of the total working capital of agricultural societies in India.

Village credit societies can accept deposits from non-members and the amount of non-member deposits a society is able to secure can be taken as a fair measure of its success in inculcating thrift and in winning the confidence of the local public. But local deposits form only a small part of the total working capital of the village credit societies in India. This might be due partly to the poverty of the rural areas, partly to the greater profitability of money-lending, and partly to the recent tendency to discourage the acceptance of non-member deposits by the village credit societies in order to centralise all their borrowing in the district central bank and thus facilitate supervision.

But the major portion of the funds the village credit societies lend to their members, they secure from central financing institutions known as co-operative central banks. Theoretically a co-operative credit society, by inculcating thrift and self-help among its members, must be able to raise locally all the funds that it needs and in the forcible language of Mr. H. W. Wolff, a society in debt to the central bank should be regarded as 'a society in hospital.' Judged by this test almost all the village credit societies in India have been chronically bed-ridden. In 1940-41 out of a total working capital of Rs. 30,53 lakhs possessed by the agricultural societies more than Rs. 15,31 lakhs was provided by the provincial and central banks.

To sum up, the main features are the increasing importance of share capital, the strong reserve funds, the almost complete absence of member deposits and the extreme dependence of the village credit societies on funds provided by the central and provincial banks. The village credit societies can almost be said to be mere agencies for the transfer of funds raised in the money-markets in towns to the farmers in the village. The share capital and reserve funds may of course be regarded as some form of collective saving belonging to the members, but these are not

2. *E. M. Hough*: The Co-operative Movement in India, p. 70.

savings voluntarily made. The real message of co-operation, *viz.*, emphasis on thrift and self-help, seems to have made little headway in rural India.

§ 6. **Credit Policy:** The main point regarding co-operative credit is that it should educate the borrower in the productive use of credit, by giving loans mainly for productive purposes and insistence on punctual repayments out of the increased returns resulting from such productive use.

1 (*a*) *Purposes of loans*:—From the ideal point of view the village credit society should give loans only for productive purposes. But in India under the existing social conditions farmers find it almost impossible to avoid a certain amount of expenditure on marriages and other social ceremonies; if the co-operative societies refuse loans for these purposes, the members are certain to borrow from outside sources. "In India" says Mr. Calvert "the distinction has to be, not between productive and non-productive so much, as between necessary and unnecessary purposes." The village credit societies, therefore, lend for current cultivation and living expenses as well as for occasional social expenditure. Thus, in Madras in 1940-41, 86·8% of the loans given by the agricultural societies was for productive purposes; 12·48% for the payment of prior debts and only 0·72 for non-productive purposes.[3] These figures however do not reveal the true position. We have it on the authority of the recent Madras Committee on Co-operation, that the village credit societies have done hardly anything to restrict unproductive expenditure on ceremonial occasions. As members lack the co-operative spirit, they not only fail to scrutinize the way in which the loans advanced by the society are spent, but often collude to deceive the society and the benami loan is not rare. Loans taken ostensibly for a productive purpose are often spent on unproductive purposes. Failure to keep down unproductive borrowing, which does not create its own means of repayment, to a minimum, is usually the first step on the down-ward path, as it gradually leads to default by members, default by the society to the central bank and the ultimate liquidation of the society and enforcement of unlimited liability.

2 (*b*) *The amount of loans*:—If the credit given by the village credit society is to be really useful to its members it should be adequate. But even after 35 years and more of co-operation no serious attempt has yet been made in India to ascertain the normal credit requirements of the cultivator for maintenance and expenses of cultivation. In 1930 the Bengal Banking Enquiry Committee estimated the average annual short-term and medium-term credit requirements of an agricultural family in Bengal at Rs. 160. But

3. Report on the Working of Co-operative Societies in the Madras Province, 1940-41, p. 70.

even during the prosperous years before 1929 the village credit societies never lent as much as this, and in 1928-30 the average annual loan per member of an agricultural primary society was Rs. 36.6 for Madras and Rs. 38.6 for all India. After the great depression of the thirties, societies now lend much less, and in Madras during the period between 1934-35 and 1937-38 the average loan disbursed varied from Rs. 19 to Rs. 21.[4]

The credit provided by the village credit societies has been extremely inadequate. According to the Bihar and Orissa Banking Enquiry Committee, the primary agricultural credit societies provide not more than three-fourths of the actual credit requirements of their members, and even in Bombay, it has been estimated that half the members have to borrow from outside sources for current needs. As the credit societies do not satisfy *all* their credit needs, the members have often been driven into the clutches of the local money-lenders. Such disloyalty to the society is one of the main reasons for the present sad plight of our village credit societies.

As pointed out by Dr. Hough, the average loan per member in the agricultural societies has actually declined during recent years.

3 (c) *The length of the loan period:*—Principles of sound finance require that the village credit societies and the central banks which get most of their funds from deposits should not invest them in long-term loans to their members. But the need to separate short-term from long-term finance was not clearly realised in the early days of the co-operative movement in India. The village credit societies tried to liquidate the prior debts of their members with the result "that a good deal of accumulated debt was passed on to village societies and converted into co-operative debt." But with the advent of the land mortgage banks, the primary credit societies are rightly concentrating on the provision of short-term and medium-term finance.

The period of repayment of the loans, as pointed out by the Madras Committee on Co-operation, 'should correspond with the period of reproduction of the loan given.' In agriculture the period of production varies from a minimum of six months in the case of some crops to eighteen months in the case of others. Again, medium-term loans for the purchase of cattle and implements can be repaid only in small instalments out of the extra income got from such investments. The societies, therefore, advance short-term loans for cultivation expenses for periods up to twelve months and medium term loans for periods varying from two to five years with particular reference to the annual income of the farmer and his obligatory expenditure. In Madras, in 1937-38, 41·6% of the loans outstanding against members of all agricultural societies (exclusive of land mortgage banks) was for a period

4. *The Committee on Co-operation in Madras*: Report, par 189.

exceeding two but not five years, and 13·4%, for periods exceeding five years.[5]

The village credit societies, therefore, provide mainly short-term and medium-term finance.

4 (d) *Security*:—The main asset of a co-operative society is said to be 'the funded honesty of its members'. The emphasis should be on the honesty and thrift of the members rather than on material security, and credit must be *personal*. But in India the emphasis on character has been ignored and there has been a tendency to rely more and more on the tangible socurity provided by the members in the form of land and crops. Loans are given on the personal security of one or two members, on mortgages of immovable property and on the pledge of standing and harvested crops. But, as the Madras Committee on Co-operation have pointed out, "Loans have been made to rest more and more on the security of immovable property......in recent years the proportion of mortgage loans in village societies has shown a steady rise."[6]

Though insistence on material security may be necessary under the circumstances now prevailing in India, unless such material security is considered as strictly secondary the fundamental co-operative principle that credit must be based on the character of the borrower is likely to be neglected. This is in fact, what has actually happened in India. When loans are advanced on the security of movable or immovable property, members are less likely to supervise each other and insist on the punctual repayment of the loan, as there is always the security of the property to make good any loss to the society. The central financing institutions, like central banks, again, are likely to be lulled into a false sense of security and to advance loans without adequate insistence on the fundamental principles of self-help and thrift.

5 (e) *Enforcement of repayment*.—"Unless loans are repaid punctually" wrote the Maclagan Committee, "co-operation is both financially and educationally an illusion." The main merit of the co-operative credit society is that it insists upon the punctual repayment of loans, and thus prevents the accumulation of arrears and the ultimate insolvency of the borrower. As there is

5 *The Committee on Co-operation in Madras:* Report, par. 177.

6 The following figures relating to Madras given by the Committee on Co-operation are very illuminating:

Percentage of the loans outstanding against members of all agricultural societies advanced on—

	(1) the joint personal security of one or more members	(2) the mortgage of immovable property.
30th June, 1925	33	14
30th June, 1239	44	56

unlimited liability, every member stands to lose when any particular member fails to repay; hence it may be expected members are likely in their own interest to enforce the prompt repayment of loans by mutual watchfulness and supervision.

But in practice the village credit societies in India have failed to achieve this ideal. Book adjustments, giving new loans again immediately after the previous loans have been discharged etc., have been common. Usually default has started with one or two influential members, and in the absence of prompt measures against defaulters, has spread to the others. Overdues were assuming serious proportions even before 1929, and the economic depression and the severe fall in agricultural prices combined to make the situation worse after 1930. In 1936-37 in almost all the British Indian provinces more than 50% of the loans due to the agricultural societies was overdue.

6 (*f*) *Interest rates*:—One of the primary objectives of the village credit societies is to secure an equalisation of credit terms as between agriculture and industry and to provide the farmer with cheap credit.

The village credit societies in India have been fairly successtul in achieving this ideal. The Maclagan Committee held that it was a mistake to reduce interest rates unnecessarily till a substantial reserve fund had been built up. A premature reduction of rates to levels below the current market rates might tempt the members to borrow too much and make it difficult for the central banks to finance the primary societies. Moderately high rates are held to be desirable (1) to prevent reckless borrowing, (2) to prevent borrowing for reloaning, (3) to cover management expenses, and (4) to build up a strong reserve fund. But in India, where agriculture is almost a deficit economy, cheap credit is a desideratum.

The interest rates charged by the village credit societies are much lower than those of the money-lenders, and their competitive influence has also led to a reduction in the money-lenders' rates. In Madras they now borrow from central banks at rates varying from 5% to 6% and lend to their members at rates varying from $6\frac{1}{4}\%$ to $7\frac{1}{2}\%$. The rates in Madras compare very favourably with the rates prevailing in the other provinces as may be seen from the following statement[7]:—

Province		Rate	Province		Rate
Bihar	...	$12\frac{1}{2}\%$	Central Provinces	...	9%
Bengal	...	$12\frac{1}{2}\%$	United Provinces	...	9%
The Punjab	...	$9^{3}/_{5}\%$	Sind		$10^{15}/_{16}\%$

7 (*g*) *Disposition of Profits*:—As the liability is unlimited a strong reserve fund has to be built up to provide for unforseen

7 Statistical Statements relating to the Co-operative Movement in India, 1940-41.

losses. The reserve fund may almost be called the second line of defence against the enforcement of unlimited liability, the first being sound management.

The Co-operative Societies Act of 1912 requires all societies to carry at least one-fourth of their annual net profits every year to a reserve fund. It also permits any society, with the permission of the Registrar, to contribute 10% of the remaining profits to any charitable purpose. But co-operation is now a 'provincial subject,' and the proportion of the profits which has to be taken to the reserve fund varies from province to province. In Madras, societies have to take 50% of their net profits to the reserve fund of the society until it equals one-half of the society's total liability, and $33\frac{1}{3}$% thereafter.

In addition to this, to prevent dividend hunting, the maximum dividends which societies can declare has been fixed by law in many provinces, *e.g.*, $6\frac{1}{4}$% in the case of the village credit societies Madras.

8 (*h*) *Management* :—The management of the village credit society like of that the Raiffeisen society, is democratic. It is based on the principle of 'one member, one vote.' The general body is the ultimate authority on all matters concerning the society; executive administration of the society is vested in the hands of a 'Panchayat' or committee elected by the general body. From among the panchayatdars, a president and a secretary are elected, and the secretary carries on the executive work of the society subject to the control of the president. The fundamental Raiffeisen principle of 'honorary management' has been adopted, and only the secretary is paid a small remuneration for clerical work.

But in actual practice, whether the management is really democratic and co-operative depends on the interest the members take in the society. In many cases members are not only illiterate but also indifferent and the panchayatdars have things their own way. This opens the way to mismanagement. The co-operative ideal of collective responsibility is hardly realised. The apathy of the members may be said to be the bane of the Indian co-operative movement.

9 (*i*) *Arbitration* :—In the event of a dispute between a co-operative society and a defaulting member, the society should be spared the trouble and expense of protracted litigation in civil courts. The Registrars of Co-operative Societies, therefore, have been empowered to arbitrate in such cases either directly or through honorary arbitrators appointed by them.

10 (*j*) *Audit* :—The audit of the co-operative societies is a statutory function of the Registrar in all provinces. But though the ultimate responsibility for audit rests with the Registrar, the actual audit is done in different provinces by different agencies. Thus, in the Punjab it is carried on by the Provincial Co-operative

Union through its own inspectors.[8] In the other provinces the audit of the village credit societies is done directly by the staff of the Co-operative Department. In some areas a number of big societies have voluntarily formed themselves into audit unions for arranging their audit. The actual audit helps the Registrar in each province, by providing him with a correct picture of the working of each society, to exercise an effective control over the movement.

With regard to the cost of audit, in some provinces the societies audited have to pay an audit fee ; in Madras and Bombay the audit of village societies is practically free.

11 (*k*) *Supervision and Inspection* :—Supervision lays emphasis on administration, and inspection on finance. Theoretically the best method will be to make the societies in a restricted area responsible for their own supervision, and the higher financing bank responsible for inspection. But in India there is much overlapping and the practice differs from province to province. Thus, in Madras and Bombay the primary credit societies have federated themselves into local supervising unions for supervision, though of late there has been a tendency to bring the supervising union itself under the control of the central bank in the area. In the Punjab and Bihar the staff of the Provincial Institutes who do the audit also do the supervising. In other provinces supervision is done by the Registrar's staff and the central bank to which the societies are affiliated.[9]

12 (*l*) *Liquidation* :—When a society is mismanaged and is likely to bring the whole co-operative movement into disrepute, the Registrar has the power to cancel the registration of the society and to enforce its liquidation, *i.e.*, to realise the assets of the society by sale or otherwise, and pay off its liabilities. As this is too drastic a step, the Madras Co-operative Societies Act of 1932 has empowered the Registrar to supersede the Board of Management and appoint a nominee of his own to manage the affair of a society, if in his opinion the society is not working properly and is mismanaged. This provision enables the Registrar to intervene before things have become too bad. Sometimes, where the society is financially sound but does not have a proper panchayat, provision has been made in Madras for it voluntarily to entrust its management to an agent for setting right its affairs. On the 30th June 1939, there were 961 societies under the management of such agents in Madras.

§ 7. **The need for a reorganization of the village credit societies :** The above discussion of the working of the rural credit

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8 Kaji, Ed : Co-operation in India—Article on 'The Agricultural Credit Society' by Mr. V. Ramadas Pantulu, p. 316.

9 Ibid., p. 321.

societies shows that, in practice, they have failed to conform to the co-operative ideal in many respects. Emphasis upon thrift and self-help, upon mutual supervision and mutual watchfulness and upon the productive use of credit, which are the distinctive features of co-operative credit, has been wholly lacking and the primary society in the village has become a mere intermediary between the central bank seeking investment and the borrowers in the primary society who are in no particular hurry regarding re-payment and understand very little regarding the principles of co-operation. This ignorance and apathy of the members and their failure to appreciate the implication of unlimited liability led, even before 1929, to the emergence of radical defects in the working of the primary credit societies, *viz.*, the indifference of the panchayatdars, factions in the society, advancing loans without proper consideration of their purpose and the repaying capacity of the borrower, benami transactions, failure to take prompt and effective action for the recovery of overdue loans, etc.

The situation, thus, was already serious before the economic depression. But the economic depression, and the crash of agricultural prices after 1929, which converted agriculture into an almost deficit economy, greatly aggravated the troubles of the rural credit societies. The majority of their members had borrowed heavily during the boom period which preceded the depression, and the disastrous fall of agricultural prices greatly reduced both their income and repaying capacity.

The impact of the world economic depression thus brought about the crisis of the Indian Co-operative movement, and brought to a head the vital defects in the working of the village credit societies. As the Madras Committee on Co-operation have summed up so well, "The large number of liquidations in recent years, the increasing number of societies which have not borrowed for years, the marked rise in the arrears from members to societies and from societies to financing banks, the increasing number of arbitration references and decrees, the forced purchase of lands of members by societies in execution of decrees, the voluntary supersession of the panchayats and the appointment of agents for the management of societies, these are all the elements of a situation which cannot be viewed with equanimity and which indicate a general lack of vitality on the part of many agricultural credit co-operatives." The following figures regarding agricultural credit societies (unlimited) given by them, give a comparative idea of the position of overdues in some of the British Indian provinces in 1936. When the members of the primary societies fail to repay the loans punctually, the societies have to default to the central banks and are, therefore, unable to approach them for fresh loans. The funds of the societies thus get frozen up with a few defaulters and the members who have promptly repaid their loans fail to get new ones. Thus a large proportion of the rural credit societies have ceased to be active suppliers of credit. When the society is not in a position to sanction a loan, members are naturally driven to borrow from outside sources; this leads to a further deterioration in the financial position of the society.

Province.	Amount of loans	Amount overdue.	Percentage of overdues to outstandings.
Madras ...	351·99	162.07	46.1
Bombay ...	247·36	128.24	51.8
Bengal ...	396·39	345.80	87.4
United Provinces ...	75·91	36.21	47.7
Bihar ...	104.18	96.40	92.5

The majority of societies have thus ceased to be living organisms and active suppliers of credit. They are, in the apt words of the Madras Committee on Co-operation, " in a state of suspended animation." The problem now is " to unfreeze the movement and to reopen the stream of credit wisely."

If the village credit societies are to be, as they should be, an effective agency for the economic betterment of the agriculturists, they must be radically reorganized. The Madras Committee on Co-operation (1940) have recommended radical changes in (*a*) the area of operation, (*b*) the functions, and (*c*) the nature of the liability, of our primary agricultural credit societies.

As we have already seen, our village credit societies have adopted the three fundamental Raiffeisen principles of a restricted area of operations, unlimited liability, and honorary management. They have also specialised in one function, the mere provision of credit. The Committee hold that these principles should be given up, and advocate (*a*) a reorganization of the village credit societies on the basis of one society for a group of neighbouring villages, (*b*) the gradual evolution of the rural credit societies into multi-purpose societies, (*c*) the substitution of unlimited by limited liability, and (*d*) the employment of paid clerical staff. We shall now discuss the first three proposals in detail.

§ 8. Which is preferable, one society for each village or one society for a group of villages? In our discussion of the present working of the village credit societies in India, we saw that the principle followed at present is " one village, one society." But the Madras Committee advance the following very strong reasons in favour of an enlargement of the area of operation of our village credit societies :—

10 *G. R. Fay*. Co-operation at Home and Abroad, Vol. II, p. 379.

(a) During recent years there has been a decentralisation of co-operative activities and departmentalisation of credit, sale and production. The provision of long-term finance has been taken over by land mortgage banks and special sale societies have emerged to facilitate the co-operative sale of produce. Societies for special crops, like the sugarcane growers societies have also been started. All these developments have led to a narrowing down of the sphere of activity open to the village credit society. This decentralisation of functions combined with the deterioration in the agricultural economy has greatly reduced the volume of business of the village credit societies and converted them into 'uneconomic units.' The reduction in the lending rates of societies forced by the economic depression has further reduced their income and many agricultural societies have been working at a loss, while others are moribund. If such small societies, which are unable to pay their way individually, are amalgamated on the basis of one society for a group of neighbouring villages, their volume of business will increase. This will enable them to secure a fair margin of profit and facilitate the employment of an efficient paid staff and the building up of strong reserve funds.

(b) When a single society serves a group of villages there is wider scope for the selection of proper men to carry on the business of the society. When a society serves only one village, on account of the paucity of literate men, the same persons may have to be elected office-bearers year after year.

(c) It will be easier to audit and supervise a few, strong, centrally situated societies than a number of small, scattered societies.

(d) When the jurisdiction of a society is extended to more than one village, it may be possible to check and overcome the bitter village factions which mar the working of the societies at present.

But there is still a powerful body of opinion which demands the retention of 'the one village, one society' principle, and the Officer in charge of the Agricultural Credit Department of the Reserve Bank of India has opposed the enlargement of the area of operation of the village credit societies on the following grounds:

(a) When one society serves a group of villages the fundamental co-operative principle of mutual knowledge and mutual trust will be lost.

(b) Factions instead of decreasing might actually increase when one society serves a group of villages, as inter-village jealousy might be added to the already existing village factions.

(c) A small society serving one village is likely to offer greater training in business methods of its members than a big society serving a number of villages.

(*d*) The 'one village, one society' principle is in accordance with the Indian tradition. The village has been the unit of corporate activity in India from time immemorial.

But we have to take facts as they are, and the 'one village, one society' principle which we have followed so far, seems to have ensured neither the mutual knowledge and trust nor the training in business methods that are claimed in its favour; as we have already seen, the existing societies have become uneconomic units on account of a progressive decline in the volume of their business and are, therefore, unable to pay their way. The Officer-in-charge of the Agricultural Credit Department of the Reserve Bank of India holds that the existing credit societies can increase their volume of business as well as profits by becoming multi-purpose societies, *i.e.*, by undertaking more functions. According to him therefore, an enlargement in the area of their operations is unnecessary. But as the Madras Committee on Co-operation put it, "we must not count the rupees the multipurpose chicken are going to earn for us, even before eggs are hatched." Therefore the first three arguments which have been advanced in favour of amalgamation of existing societies on the basis of one society for a group of villages, are decisive. Of course, if co-operation is to be real, the members of a society must know each other and must have an identity of interest. But villages close to each other "have an intimate identity of agricultural and economic interests, social bonds too throw them together." Therefore when a society serves a group of neighbouring villages, the fundamental principles of co-operation are not violated. A reorganization of societies on the basis of one society for a group of villages within a radius of three to five miles as recommended by the Madras Committee is thus highly desirable. Such an enlargement of the area of operation of the village credit societies will also facilitate an extensive development of the co-operative movement, as all the villages in the country can be brought within its sphere more rapidly.

§ 9. **Conversion of the village credit societies into multi-purpose societies:** The village credit societies have so far been concentrating mainly on the provision of cheap credit. But, as the Madras Committee on Co-operation have rightly pointed out, the village credit society, if it is to be of real benfit to the farmer, should provide the farmer not only cheap credit, but also with the means of repayment by increasing his income. The agricultural problem cannot be tackled and solved piecemeal. The village credit society "must take up each aspect of the problem and try to find out in what manner it can assist the farmer by limiting his expenditure and increasing his income.[11]. This means that the society should undertake a number of subsidiary

11: *The Reserve Bank of India:* Bulletin on Co-operative Village Banks, p. 41.

functions besides the mere provision of credit and help its members to achieve the triple ideal of 'better farming, better business and better living.' As suggested by the Reserve Bank of India and the Madras Committee on Co-operation, the village credit societies can undertake the following subsidiary functions :—

(*a*) *Promotion of better farming* :—To enable its members to secure better yield of crops with less expenditure, the society should encourage improved and intensive methods of cultivation. It can take up the responsibility of suppling seed and manure of good quality, and improved implements. It can be empowered to acquire common seed beds and to attempt joint co-operative farming, and thus get over the evils of subdivision and fragmentation. It can help its members to improve the quality of their livestock, negotiate with the Government for the reservation of proper pasture lands and arrange for their grazing in rotation. It can also undertake the supply of electrical and other mechanical power on a collective basis.

(*b*) *Promotion of better business* :—The society can increase the income of its members by encouraging the co-operative sale of produce. It need not engage in marketing activities, like the storing of produce and the holding of produce for better prices, which require expert knowledge and are speculative. But where there is no co-operative sale society near by, the village credit society can profitably undertake selling in the village itself on a commission basis, and thus ensure the farmer a fair bargain, or it can negotiate with big merchants for sale in bulk of the produce of its members. Such types of activity are not risky, as the society does not hold the produce and does not advance loans. When there is a co-operative sale society near by, the village credit society can arrange with it for the sale of its members' produce.

When the credit society thus arranges for the sale of its members' produce, besides ensuring a better price to its members it can secure a control over the sale proceeds and also a sufficient volume of business for the marketing society, thus facilitating co-operative marketing.

(*c*) *Encouragement of subsidiary industries*:—Without some subsidiary industry to keep the farmer employed during his spare time, small-scale farming is hardly economical, and if our agricultural credit societies have failed so far to raise the income and the purchasing power of the rural population, one of the reasons for their failure is their total indifference to this aspect of the problem. "The village societies should, therefore, be utilised to a greater extent in the organization, under proper direction and suitable safeguards, of subsidiary or cottage industries." Either the old cottage industries like hand-spinning will have to be revived or new ones will have to be found out. The village credit society can encourage cottage industries like the processing of crops at home, *e.g.*, the hand-pounding of rice, hand-spinning, and the production and sale of milk, ghee, and butter. It can arrange for the sale of these products on a co-operative basis.

(*d*) *Promotion of better living*:—The village credit society should in the future make determined attempts to eliminate extravagant expenditure by a member on social functions like marriage, etc., by fixing a maximum limit for each member on each occasions. It must be given the powers necessary to control the unproductive expenditure of its members, and 'controlled credit' for productive purposes must become a reality rather than a theoretical fiction.

(*e*) *Joint purchase of supplies*:—The societies can do some supply work on an indent system. The requirements from members for such things as cloth, domestic requirements, etc., can be pooled and purchased in bulk at cheaper prices.

There are, thus, many subsidiary functions which the village credit society can profitably undertake without increasing its risks. The village credit societies can take up all these functions one by one and thus emerge as 'full-fledged multi-purpose societies.' Such an enlargement of the functions of our village credit societies, so as to bring within their ambit the whole life of the farmer, has the following decisive advantages:—

(*a*) It is likely in actual practice to increase the financial stability of the societies by increasing the incomes of their members and thus ensuring the prompt repayment of loans.

(*b*) The variety of services which the recognized society would provide would attract into the society the large body of people who are at present outside the co-operative movement. Different people in the village need different services and "there should be people in the village credit society for all sections of the community, each of which has definite economic and social needs." When the village credit society provides a variety of services, the big landholders, who require merely co-operative marketing and the joint purchase of supplies, and the poor farmer, who needs cheap credit, can combine in the same society, for their mutual benefit.

If outside-borrowing by members of the village credit societies is to be prevented, every eligible family of the right type of character in their area of operation must be brought within their fold. The richer agricultural classes do not at present interest themselves in co-operative effort, as they either do not need credit or can raise it elsewhere. This has meant that the village credit societies have become mere associations of partially solvent borrowers, and they are, therefore, unable to command much credit. It has been suggested that the only solution is 'compulsory co-operation' ; the richer classes should be compelled by law to become members of the village credit societies and thus help to raise the credit of their poorer brethren. But, as the Madras Committee on Co-operation have rightly pointed out, the essence of co-operation is voluntary effort and 'compulsory co-operation' is a contradiction in terms. When the village credit societies perform a variety of useful functions and are well-managed, the richer class of agriculturists can be expected to join them voluntarily, and with the conversion of the existing village credit societies into multi-purpose societies the need for 'compulsory co-operation' is likely to disappear.

(*c*) A village credit society providing a number of services is likely to be in more continuous touch with its members than a mere credit society to which members resort only occasionally when they need loans. Such continuous contact is likely to create in members a more lively interest in the working of the society. As the Bulletin on Village Banks issued by the Reserve Bank of India points out, "The bank must never lose touch with the member. He must come to the bank for something or other throughout the year. Absence of such touch leads to indifference, default and disloyalty. The bank should never be allowed to degenerate into a loan office."

But even granting that the whole life of the farmer must be brought within the sphere of co-operation, why, it is argued, should the village credit society undertake a number of functions ? Cannot the same end be achieved by having, as in Denmark, one society for each purpose! In Denmark it is not unusual for a farmer to be a member of three or four co-operative societies, each of which renders a distinct service. It is suggested by some that the village credit society, with its unlimited liability, should have a simple organization and should not go on adding to its risks by undertaking new functions. They, therefore, suggest there should be a separate society for each purpose, for instance, one for credit, another for sale, and a third for the encouragement of cottage industries.

But the farmer in India has been accustomed to borrowing from and selling to the same person, *viz.*, the village baniya, and he is too illiterate to join and take an active part in the management of a number of co-operative societies. In fact, in India co-operation is likely to make a greater appeal to the farmer when the credit society provides him most of the services he needs. The "one purpose one society' principle, therefore, does not appear to be suited to India.

There is nothing revolutionary in the village credit society undertaking a few subsidiary functions. In fact such an integration of the provision of credit with supply and sale, as pointed out by Dr. C. R. Fay, has been forced upon the agricultural co-operative movements of countries in Europe and the New World also. "The new emphasis is everywhere on co-ordination, not indeed on the undifferentiated society, but on the association of finance with trade supplies and marketing, on a *credit central which has the whole position of the borrower under review*...This development is fast reaching down the old time-honoured barriers and is making the example of pre-war Denmark less and less relevant to the co-operative world of to-day." [12]

An enlargement of the functions of the village credit society is, therefore, an essential line of development in India. It does not go against co-operative theory; in fact, it will make the Indian village credit society conform more closely to the Raiffeisen pattern. But, as Dr. C. R. Fay has suggested, "the term multi-purpose is misleading; a better term would be integrated co-operation."

§ 10. **Should the liability of the village credit society be limited or unlimited?** The severe agricultural depression of the thirties, which brought along with it the liquidation of a number of societies, has led people to question methods which have been till now regarded the very fundamentals of co-operation. Unlimited liability is the bedrock of the Raiffeisen type of co-operative society and has been till now regarded as one of the basic principles of rural co-operative credit organization in India. But the majority of the Madras Committee on Co-operation are of opinion that the principle of unlimited liability has outlived its utility, and recommend its substitution by limited liability on the following grounds :—

(1) The majority of our ryots do not understand the principle of unlimited liability. When the members of a society fail to understand its implications, unlimited liability, instead of being a source of help, becomes a dangerous sham.

(2) The economic depression of the thirties led to the liquidation of a number of societies, and the enforcement of unlimited liability. This has caused hardship to members who are either non-borrowers, or non-defaulters, and has brought the whole movement into disrepute. When unlimited liability is enforced, it is the honest members, who have punctually repaid their loans, who suffer most.

(3) The better class of agriculturists who are really solvent, have not joined the agricultural credit societies as the liability in such societies is unlimited. The movement has, thus, been deprived of their sympathies and material help. They would have contributed much to the efficient management of societies.

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12. *G. R. Fay*: Co-operation at Home and Abroad, Vol. II. p. 390 (italics ours).

(4) The practical utility of unlimited liability is open to doubt. Though every member is liable to the creditors of the society to the full extent of his property, membership in a society does not bar the right to alienate property. The dishonest and cleverer members can, therefore, successfully evade the enforcement of unlimited liability by alienating all their property before such enforcement. Again, unlimited liability in the case of a co-operative society, as we have already seen, means only contributory liability and it can be enforced only when a society is liquidated. "So long as unlimited liability does not bar the alienation of the property of members during the period of their membership, its practical utility is open to doubt." This is a very important consideration.

(5) "It is efficient management rather than unlimited liability that induces confidence among financing banks and depositors." The confidence of the depositors is also partly due to the belief that the Government is behind the movement through supervision, audit and other forms of statutory control.

(6) Unlimited liability assumes that the members of a society possess mutual knowledge, exercise mutual supervision and control with regard to borrowing, and insist on punctual repayment. But these assumptions are not true of village life in India today.

(7) It is also pointed out that unlimited liability is essential, only when credit is advanced merely on the security of personal character. But, as we have already seen, loans in India have been made to rest more and more upon material security in the shape of immovable property, crops, etc.; unlimited liability, therefore has become superfluous.

But there is still a large volume of opinion which favours the retention of unlimited liability. "We feel" says the Officer-in-charge of the Agricultural Credit Department of the Reserve Bank of India, "that unlimited liability is a matter of necessity and not a matter of choice. If the funds are to be attracted at cheap rates there seems to be no escape from this form of liability." The minority of the Madras Committee on Co-operation want unlimited liability to be retained on the following grounds:—

(1) Unlimited liability has an educative and moral value, and reinforces the basic co-operative principle of 'each for all and all for each.' It creates a sense of collective responsibility and fosters mutual watchfulness, mutual trust and mutual supervision. In actual practice the risks arising from unlimited liability are reduced to a minimum by the careful selection of members, grant of loans on good security, provision of share capital and the building up of strong reserve funds.

(2) If the liability of the members of the village credit societies is limited, the local panchayatdars will cease to examine loan applications carefully and the central banks will have to scrutinise all

individual loan applications. This will lead to an undesirable centralisation of co-operative financing and transform the village credit societies into mere agencies of a centralised banking system.

(3) Though unlimited liability has long been in force, its rigour is softened by the rules issued by the Department and very little is recovered by its actual enforcement.

(4) A sudden change all at once from unlimited to limited liability might shake the confidence of the despositors and affect the flow of money into the movement.

(5) If unlimited liability is given up the emphasis on character might be neglected and the deserving poor might be deprived of the help they need.

According to the advocates of unlimited liability, if solvent people have not hitherto joined the rural credit societies, the reason is not the unlimited liability of the rural credit society but its inefficient management.

These arguments are of course strong in theory, but in actual practice few of the moral advantages claimed for unlimited liability seem to have been realised in India. Though unlimited liability has been the basis of the Indian village credit societies since 1904, the mutual knowledge and mutual supervision which are claimed to result from it are conspicuous by their absence. In fact unlimited liability seems actually to have led to a certain amount of demoralisation and over-financing of the rural credit societies by the central banks relying on their unlimited liability. Corporate life and effort are very weak in our villages today and the mere adoption of unlimited liability is not likely to work a miracle and achieve the ideal of 'each for all.' The nature of the liability is not after all the real test of co-operation and the argument that the substitution of unlimited by limited liability would mean the virtual enthronement of the principle of 'each for each' seems weak; the urban credit societies have limited liability and their co-operative character has never been questioned.

Recent world opinion also is in favour of the abolition of this 'ideal' of joint and several liability.[13] As Dr. Westsrate of Holland writes in the Year Book of Agricultural Co-operation for 1938, "use of this liability impairs the support of the members and the feeling that co-operation is valuable to them. We have realised that a sound economic purpose, good organization and good management are much more essential to the well being of co-operation, than the most complete liability of members."

We can, therefore, agree with the recommendation of the Madras Committee on Co-operation that "the liability of a village

13 Report on Co-operative Enterprise in Europe by an American Committee, 1937.

credit society should normally be limited, but if, in the opinion of the Registrar, having regard to local opinion and other circumstances, unlimited liability is more suitable for any society, its liability may be unlimited. An additional reason for the change over to limited liability is the fact that when the jurisdiction of a society is extended to a group of villages and the society undertakes a few subsidiary functions besides the provision of credit, limited liability seems to be the more appropriate form. We have already seen that such an enlargement of the area of operations as well as of functions is essential in India.

§ 11. **The financial policy of the reorganized village credit societies:** To make the village credit societies useful agencies in the supply of agricultural credit, the above changes in the structure of the societies should be supplemented by radical changes in their financial policy. They have so far failed in their objective of substituting controlled productive credit for the unregulated credit of the money-lender because of (*a*) the outside borrowing by members, (*b*) the delay in the sanctioning of loans, and (*c*) their failure to insist on the proper use of credit.

A. Measures to prevent outside borrowing by members: We have seen that loans advanced by the village credit societies are often inadequate for the purpose for which they are advanced, and members, therefore, are driven to borrow from outside sources, usually money-lenders. As the rate of interest charged by the money-lenders is usually higher, the member usually discharges first his obligations to the money-lender and becomes a defaulter to the society. The society in turn has to default to the central bank. Outside borrowing, thus, leads to a division of the members' loyalties, and should be completely eliminated if the co-operative movement is to succeed.

This outside borrowing by members can be prevented by (*a*) the adoption of a policy of 'full finance' by the credit societies, (*b*) the immediate expulsion from the society of any member who is found to have borrowed from outside sources, (*c*) the control of money-lenders, and (*d*) the creation of a first charge on the produce of members' holdings (up to the extent of the loans advanced by them) in favour of the agricultural credit societies.

Inadequate financing is worse than no financing at all, as it leads to outside borrowing, and the chances are that an inadequate loan will be dissipated in unproductive expenditure. The village credit societies should, therefore, undertake to finance *all* the legitimate credit needs of their members as prescribed in the bye-laws. If sometimes a member wants a loan for productive purposes over and above the maximum limit of credit fixed for him, the central bank to which his society is affilitated should be allowed to relax the maximum credit limit. The village credit societies should develop a system of 'produce loans' against standing crops and produce, particularly small loans for the smaller ryots. Again, under the conditions prevailing in India, loans for consumption purposes and for expenditure on social ceremonies like marriage, etc., cannot altogether be ruled out, but the societies should lend with more circumspection than has been the case in the past and should fix a maximum limit for each member, on each occasion. When members are provided such 'full finance,' the need for outside borrowing will be eliminated.

Prohibition of outside borrowing by members:—When societies provide "full finance" members ought to be prohibited from borrowing from outside sources. Such members as violate this rule should be immediately expelled from the societies and all their dues recovered at once.

Creation of first charge on agricultural produce.:—The village credit society should have the first claim on the produce raised on the holdings of members whom it has financed, up to the extent of the loan advanced, subject of course to the overriding claims of the State with regard to land revenue. When a member sells his produce to any other agency, he should be required to pay out of the sale proceeds, first the dues to the society, and a breach of this rule should be made an offence. When the village credit societies are thus given a first charge on the produce, money-lenders will be less willing to lend to members of village credit societies, and there will be a partial sterilization of credit from private sources.

The regulation and control of money-lenders on the lines suggested in Chapter VI will also tend to reduce outside borrowing.

If, by the devices outlined above, outside borrowing by members of co-operative societies is brought under 'control, we would have advanced a long way in achieving our ideal of controlled co-operative credit'.

B. *Measures for the quick supply of credit*:—Credit to farmers, especially short-term credit for cultivation expenses, must be given promptly as soon as the need arises. But the delay in the sanctioning of loans by the village credit societies and by the central banks has become proverbial and, when there is an urgent need for credit, (as for instance, when an early monsoon necessitates an early starting of agricultural operations) the members of a co-operative credit society have usually to resort to some outside agency. Hence the credit given by a co-operative credit society must not only be adequate but prompt, if it is to be useful. The supply of credit by the village credit societies can be quickened by the following methods:—(*a*) the adoption of the system of forecast loans; (*b*) the introduction of cultivation cash-credits: and (*c*) the prompt disposal of loan applications by the central banks and by the provincial bank.

The system of forecast loans :—The essence of this system is, that the panchayat of the society, instead of waiting for the members to apply for loans, prepares fairly in advance of the cultivation season a forecast of the amount of short-term credit each member is likely to need during the season, and gets the loan application of the society sanctioned by its central bank well ahead of the actual demand. This enables the society to draw funds from the central bank and advance it to the members with the least delay. Though the initial preparation of such a forecast might be difficult, once the system has been adopted, the estimates will merely have to be revised year after year.

The initial difficulty in the preparation of such a forecast, the ignorance of the panchayatdars and the fact that some of them are often defaulters not interested in approaching the central bank for a fresh loan, the indifference of the supervising unions and of the central banks, the economic depression and the consequent preoccupation of the Co-operative Department with the work of rectification and consolidation of societies, have all led in Madras to the comparative neglect of the system in the past. But the system of forecast loans is one of the best ways of ensuring the quick supply of loans and efforts should be made in the future to popularise the system. The Madras Committeee on Co-operation recommend that, in the future, the central banks should insist that all applications for cultivation loans should be made only on the forecast system. The staff of the Co-operative and Agricultural Departments might in the early stages help the village credit societies to prepare such forecasts.

Introduction of cultivation cash-credits :—Another method of quickening the supply of credit is to give cash-credits, or credits on current account, with central banks to the village credit societies. The societies can draw on such cash-credits as and when they need funds and they can give the same facilities to their members. The Madras Committee on Co-operation suggest that such cash-credit facilities should be given by the central bank to select A and B class societies, so that the other societies may try to emulate them and earn the same privilege. The societies which enjoy such cash-credit facilities can split up the maximum credit allowed to each member and allow him to use a part of it designated 'cultivation cash-credit' for short period agricultural operations. This system will enable the members of the well-managed societies to secure cash quickly without applying for a loan and at the same time educate them in the economic use of money.

Prompt disposal of loan applications of central banks by the provincial bank :—At present whenever the central bank applies for a loan to the provincial bank, the latter consults the Registrar regarding the financial standing of the central bank, and requires the central bank to forward, with its loan application, statements of loans required by constituent societies. The provincial bank, by virtue of its position as apex bank, must know well the financial standing of the central banks concerned, and as suggested by the Madras Committee on Co-operation, these formalities might be dropped. This will mean a great saving of time and the quick supply of loans to members by the primary societies.

C. Controlled Credit :—In actual practice most of the principles which make co-operative credit 'controlled credit' are either not observed or not enforced. Much of the borrowing is misused and to prevent such mis-application the Thirteenth Conference of the Registrars of Co-operative Societies (December 1939) has suggested, "that loans should be advanced in the form of seed fertilisers and implements where practical......and that the possibility of encouraging and extending repayment in kind should be explored."

In order to ensure the productive and judicious use of credit, the Co-operative Department in Madras has introduced in select areas in Salem, Coimbatore, Tanjore, and Tinnevelly, districts a scheme known as the scheme of controlled credit.[14] Under this scheme, (i) the loan sanctioned is disbursed to members in instalments as the need for the purpose for which the loan is given arises; (ii) the member is asked to execute an agreement to sell the produce either through the co-operative credit society, or through the sale society to which the village co-operative society is affiliated; (iii) the sale society deducts from the sale proceeds both the amounts due from the member to the village co-operative society and to the land mortgage bank, and remits to the member only the balance.

By such procedure, which involves the co-ordination of the village credit society, the sale society, the central bank, and the land mortgage bank, the possibility of the loan being wasted and of default are both reduced to a minimum. "Credit is linked up with marketing and every stage of the application of the loan, *i.e.*, from the stage of cultivation to the stage of the sale of produce is supervised and controlled.

But the scheme of controlled credit, as it works, has some serious drawbacks; the co-ordination between the various agencies concerned is often cumbrous and impracticable, and the centralised administration and supervision involve a greater expense to the central bank. Again, under the scheme, the co-operative principles of mutual watchfulness and mutual supervision are rejected; members and panchayatdars are not made to feel the responsibility of their transactions. "Village societies, instead of being live organic wholes, will become mere agents of the central bank."

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14. In 1941-42, the scheme of controlled credit was in operation in all the districts of Madras except Anantapur (Report on the Working of Co-operative Societies in the Madras Province, 1941-42.)

Table No. XIII

PROGRESS OF AGRICULTURAL CO-OPERATION IN INDIA (INCLUDES INDIAN STATES)

Number of Societies.

Year	No. of members (in lakhs).	Credit.	Purchase and Purchase and Sale.	Production and Sale.	Others.	Total.	Working Capital (Rs. Crores).	Value of goods sold to members (Rs. Lakhs).	Value of members products purchased (Rs. Lakhs).
1915-16	6	15,005 (99.5)	25 (0.2)	12 (0.1)	40 (0.2)	15,082	4	Na	Na
1920-21	13	37,488 (97.8)	377 (1.0)	36 (0.3)	366 (0.9)	38,337	10	24	10
1925-26	22	64,778 (97.2)	328 (0.5)	266 (0.4)	1,240 (1.9)	66,612	21	46	67
1930-31	31	87,535 (95.8)	366 (0.4)	1,416 (1.5)	2,103 (2.3)	91,420	34	53	52
1934-36	30	87,564 (94.5)	347 (0.4)	2,248 (2.4)	2,539 (2.7)	92,698	33	36	33
1936-37	31	88,498 (93.7)	401 (0.4)	2,780 (3.0)	2,732 (2.9)	94,411	34	42	49
1937-38	32	89,293 (93.3)	423 (0.4)	3,066 (3.2)	2,924 (3.1)	95,706	32	72	79
1938-39	36	96,676 (91.8)	459 (0.4)	4,118 (4.0)	4,018 (3.8)	105,271	32	92	101
1939-40	41	101,401 (86.0)	504 (0.4)	1,217 (4.3)	11.662 (9.3)	118,744	30.5	262	321
1940-41	42	104,084 (84.1)	547 (0.4)	6,493 (5.3)	12,599 (10.2)	123,723	30.5	200	212

Figures in brackets show the percentage of each type in the total number of societies. Note the very large proportion of credit societies. Na represents 'figures not available.'

Table No. XIV

OPERATIONS OF AGRICULTURE SOCIETIES, 1940-41

Number of Societies 123,723			Number of Members 43,41,119	
	Rs. Lakhs.	Percentage of total working capital.		Rs. Lakhs.
Share Capital paid-up ...	415.4	13. 6	Loans made during the year to :	
Loans and deposits held at the end of the year from :			Individuals ...	752.0
Members ...	122.9	4.0	Banks and Societies ...	71.6
Non-members ...	115.3	3.77	Loans and deposits repaid during the year by :—	
Societies ...	9.8	0.32		
Provincial or Central Banks ...	1531.4	50.16	Individuals ...	719.2
Government ...	7.8	0.25	Banks and Societies ...	86.7
Reserve Fund ...	727.0	23.80	Loans due by individuals ...	2250.2
Other Funds ...	123.3	4.10	Of the above overdue ...	1041.4
Total ...	3052.9	100.00		

The scheme of controlled credit thus violates to a certain extent co-operative principles. But the Indian village credit societies as they are at present, need a certain amount of guidance and control. The scheme, therefore, as suggested by the Madras Committee on Co-operation may be given a fair trial in suitable localities and may be modified in the light of local experience.

CHAPTER IX

CO-OPERATIVE HIGHER FINANCING AGENCIES AND UNIONS

§ 1. The need for and types of higher financing agencies: Isolated primary societies in the villages have been unable to raise sufficient funds to meet the credit needs of their members. Unlike the co-operative credit societies in Europe, the village credit societies in India have failed to attract sufficient local deposits. Neither the joint-stock banks nor the depositors in towns can be expected to lend money for fairly long terms to small societies in out of the way villages, managed mostly by borrowers, on the security of agricultural produce, the value of which it is extremely difficult to assess. In the early days of the co-operative movement, the Registrars of Co-operative Societies in several provinces arranged for financial assistance for the societies from the provincial Governments as well as from a number of individual sympathisers of the movement. But soon the need was felt for the formation in urban areas of higher financing agencies organized on co-operative principles to tap the funds of the money market for loans to primary societies. This has led to the emergence of central financing agencies.

The structure of the co-operative movement in all the major Indian provinces can be compared to a pyramid. At the top is the provincial co-operative or apex bank; below the apex bank are a number of central banks, and below them are the primary societies like the village credit societies, the urban banks and the various types of non-credit co-operative societies. This organization is also mainly federal. The shares of the central bank in a given area are mainly held by the primary societies affiliated to it, and the shares of the provincial bank, by the central banks of the province. We can almost define the higher financing agencies as federations of co-perative societies. The working of the primary agricultural credit societies has already been discussed in detail. We shall now discuss in turn the working of the central banks and the provincial co-operative banks.

§ 2. The central banks—their present working: The primary object of the central bank is to raise funds for loans to the primary societies in the area of its jurisdiction. The central banks may belong to one of three types:

(*a*) *Banks of which the membership is confined to individuals, or to societies admitted on exactly the same footing as individuals:*—In such banks the share capital is subscribed almost wholly by individuals and the banks are hardly different from joint-stock banks. They are more likely to aim at profits for the shareholders than at the provision of cheap credit to the primary societies and, therefore to violate the co-operative ideal. In 1915 there were many banks of this type in India, but the Maclagan Committee looked upon them with disapproval and they have now practically disappeared.

(*b*) *Banks of which the membership is confined to societies*:— Such purely federal banking unions are ideal from the co-operative point of view, as they merely carry one step further the principle of the substitution of collective for individual responsibility (*viz.*, from individuals to co-operative societies).[1]

(*c*) *Mixed banks whose shares are owned partly by individuals and partly by societies*:—Conditions in India at present make banks of the purely federal type almost impossible, as it is feared that a central bank constituted solely by borrowing societies will be unable to induce confidence and attract a sufficient volume of deposits. The majority of the central banks in India, therefore, are now of the mixed type. The individual shareholders are generally public-spirited and influential local men, who supply the much needed business ability and enhance the credit of the central banks. The societies which want to borrow have usually to take shares in the central bank in proportion to their borrowing. The usual requirement is a ratio of 1·20.

But even in such mixed banks the representatives of the affiliated societies are in a majority in the board of directors and thus have a dominating voice in the management. A purely federal central bank whose membership is confined to societies, must remain for some time to come merely an ideal, at least until the village credit societies become sound from the point of view of finance as well as membership.

The *liability* of the central banks is limited. This is limited ordinarily to the face value of the share, but in some provinces to a multiple thereof as in German societies.

The extent of the area and the number of societies served by each central bank varies in different parts of the country. In the Central, Southern and Western parts of India, the usual rule is one central bank for each revenue district, while in the Punjab and Bengal the central bank usually serves a smaller area. No universal rule can be laid down with regard to the proper area of operations of a central bank, but when the area is too large the central bank is likely to lose touch with the primary societies and supervision is likely to become inefficient, while if it is too small, its volume of

1. Federal central banks have increased recently in the Punjab and Bengal, where they are reported to work well when they are confined to a small area and a small group of well-established societies.

business will fall and the cost of management tend to rise. Much will depend on the conditions prevailing on the area. But the Reserve Bank of India considers that where there is only one central bank for each revenue district, the work of the latter has become unwieldy. Therefore, the Reserve Bank has in recent years become an ardent advocate of central banks serving a smaller area, known popularly as Taluk Banking Unions.

Functions :—The central banks have three important functions:

(*a*) They finance the primary societies in the area of their jurisdiction.

(*b*) They act as balancing centres for the primary societies. They make available the surplus funds of some societies to others which need credit and thus equalise the flow of credit.

(*c*) They also undertake the supervision of their constituent primary societies.

The central banks have also undertaken many merely commercial functions. They issue and purchase, sell and discount demand bills of exchange or hundis. In Bombay some central banks have built their own godowns where agriculturists can store their produce while waiting for a favourabe market.[2]

Source of working capital :—The working capital of the central banks consists of (*a*) share capital, (*b*) reserve funds, (*c*) deposits from members and non-members, and (*d*) loans from the provincial co-operative bank, the other central banks, and the joint-stock banks. The relative importance of the different sources of working capital is well illustrated by Table No. XVI and the following figures showing the position in Madras at the end of 1940-41.[3]

Total number of central banks (on the 30th June 1941)		30
		Rupees in Lakhs.
1.	Share Capital	49·71
2.	Deposits from individuals (members and non-members)	228·37
3.	Loans and overdrafts from—	
	(*a*) Provincial and Central Banks	106·22
	(*b*) Societies	143·75
4.	Reserve Fund	35·51
5.	Other Funds	31·53
	Total ...	595·09

2. E M. Hough : The Co-operative Movement in India, p. 130.

3. Report on the Working of Co-operative Societies in the Madras Province, 1940-41.

The central banks depend only to a small extent on advances from the provincial bank. By sound management on purely business lines they have been able to win the confidence of the investing public and they derive the bulk of their deposits from individuals. Deposits in central banks are mainly of two kinds, savings and fixed; current deposits are accepted by the central banks only in some provinces such as Bombay and Madras, as they are expensive to maintain and difficult to manage.[4] Part of the funds of the central banks comes also from the Government. In Madras, the local bodies were authorised in 1919—20 to deposit their surplus funds in central banks, and to these were added railway cess and deposits with the Forest, Abkari, Jail, Hospital, and other Government Departments. But subsequent to 1930—31, there has been a rapid fall in the deposits of local bodies as a result of the restrictions imposed by the Government to prevent the glut of funds caused in the central banks by the depression. But, as the Madras Committee on Co-operation point out, in the future with the reorganization and spread of the co-operative movement, there is likely to be an increasing demand for funds; they have, therefore, recommended that the present restrictions imposed on the local bodies in this matter should be withdrawn.

In order to safeguard the interests of the depositors and ensure the solvency of the central banks, the maximum amount which they can-borrow by way of deposits and loans, has generally been fixed at eight times their owned capital, *viz.*, the paid-up capital plus reserve fund. In 1926 this limit was raised in Madras to ten times their owned capital in the case of the central banks, and twelve times its owned capital in the case of the provincial co-operative bank.

As the central banks raise the major portion of their funds by way of deposits, they are also required by the Registrars to maintain a certain portion of their deposits in liquid form to meet their deposit liabilities on the due dates.

Loan business :—The central banks originally advanced loans to the primary societies both for short and long periods. But with the development of land mortgage banks to provide long-term finance, the central banks concentrate more and more on providing the primary societies with short-term and medium-term finance. The nature of a bank's deposits must govern the nature of its loan policy, and it is dangerous for central banks, which raise their funds mainly by way of deposits for short periods extending to two years, to advance long-term loans. The central banks have, therefore, wisely concentrated on the provision of short-term finance. But in agriculture, on account of the uncertainty of output and length of the production period, medium-term credit for periods extending up

4. H. L. Kaji, Ed.; Co-operation in India, p. 83.

to five years is necessary for purposes like the purchase of livestock, and if the central banks do not provide this type of finance a gap is likely to arise in the co-operative credit system. But if the central banks are to provide medium-term credit, they will have to raise the funds by deposits of appropriate duration. The Madras Committee on Co-operation have, therefore, suggested that in the future the central banks should encourage deposits from one to three years to raise sufficient medium-term funds for this purpose.

As there are individual shareholders and non-member depositors, the central banks also lend to them on the security of the deposits made by them. But the main function of the central banks is to finance the primary societies and the major portion of the advances made by central banks is to village credit societies. For instance, in Madras, on June 30th, 1941, loans due from individuals to the central banks amounted to Rs. 5·64 lakhs while the loans due from societies amounted to Rs. 421·81 lakhs.[5]

The central banks usually keep the margin between their borrowing and lending rates at a minimum. Thus, in Madras they usually pay $3\frac{1}{2}\%$ on their deposits and lend to societies at $5\frac{1}{2}\%$.[6]

Profits :—The central banks are compelled by the Co-operative Societies Act of 1912 to carry at least 25% of their net profits to a reserve fund, and they have, therefore, built up strong reserve funds. The rule has recently been amended in Madras, and the central banks in Madras have now to carry one-third of their net profits to the reserve fund, until the reserve fund and other reserves equal the paid-up share capital. In adition to this, with the advent of the depression, they have been making adequate provision for bad debts by building up 'bad debt reserves.'[7] The maximum dividend which the central banks can declare, has generally been fixed by statute to prevent dividend-hunting, and is now in Madras only 5%.

The administration of the central bank is carried on by a board of management and an executive committee, to which the board delegates many of its powers. The societies as well as individual shareholders are represented on the board of management, but always the representatives of societies are in a majority. They generelly provide twice as many directors as individual shareholders. Some central banks co-opt to their board of management

5. Statistical Statements relating to the Co-operative Movements in India, 1940-41.

6. ibid.

7. In Madras, on the 30th June, 1939, in addition to the statutory reserves which amounted to Rs. 33·80 lakhs, the central banks had debt reserves amounting to Rs. 20·03 lakhs—Report of the Committee on Co-operation in Madras, 1939-40, par. 35.

persons who have local knowledge, or have served the co-operative movement. Unlike the village credit societies, the central banks employ paid and trained staff.

The central banks also undertake the supervision of the primary societies in the area of their jurisdiction. They are helped in this work in Bombay and Madras by the local supervising unions. Some central banks in Madras have created separate committees to be in charge of the work of supervision.

Estimate:—The central banks have on the whole worked well and have achieved the main object with which they were started, *viz.*, to tap the funds of the money market and to make them available to the primary societies. The achievements of the central banks have been well summed up by the Madras Committee on Co-operation. "The central banks have served their purpose of financing rural and urban societies and balancing their funds admirably well, they have mobilised local deposits and made them available to primary societies at reasonable rates of interest and have rendered great service in the organization of agricultural finance on co-operative lines; they have drawn into the movement a number of honorary men whose services have been invaluable to the progress of the co-operative movement; they have taken a genuine interest in the growth of the movement in their respective areas and in schemes of co-operative education and rural development generally; they have enlisted the sympathy of an increasing body of depositors, and as a rule, have justified the confidence which the depositors have reposed in them." In the words of the Central Banking Enquiry Committee, they are today a factor to be reckoned with in the Indian money-market.

But the central banks cannot be wholly absolved from blame for the present bad plight of the village credit societies. If co-operative credit in India has not been controlled credit, and if the rural credit societies have failed to keep down borrowing during the boom that preceded the economic depression, the central banks are also partly to blame. The central banks found themselves with a plethora of funds and initiated a policy of hasty expansion of primary societies to provide a profitable outlet for their surplus funds. "Not only money-lenders but also central banks made reckless advances during the last boom period."[8] The central banks are as responsible for seeing to it that credit is controlled as the village credit societies, and their object should be not so much to thrust money on societies and make a profit, but promote the ultimate economic interests of the borrowers. The success of the central bank should ultimately be judged by the success of the primary societies, especially the village credit societies, in the area of their jurisdiction: while they have been fairly successful as

8. The Committee on Co-operation in Madras: Report, par. 196.

business propositions, the central banks have not been as successful either in spreading the message of co-operation or in promoting rural uplift.

§ 3. **The case for converting the central banks into branches of the provincial co-operative bank examined:** Recently there has been much discussion regarding the proper area of operation of central banks. On the one hand, it has been suggested that in the interests of economy the existing central banks should be converted into branches of the provincial co-operative banks; on the other hand, some have proposed the splitting up of the district central banks into smaller banking unions, on the ground that when there is only one central bank for each revenue district the work of the central bank becomes unwieldy.

Both those proposals have rightly been turned down by the Madras Committee on Co-operation, who are af opinion that, "the present federal structure should on no account be disturbed." As they have pointed out, the arguments advanced in favour of converting the existing central banks into mere branches of the provincial co-operative bank do not bear critical examination; there are so many serious disadvantages involved in the proposal.

In favour of the scheme, it is argued, firstly, that the central banks are mere intermediaries in the co-operative structures connecting the provincial co-operative bank with the primary societies, and that they can be eliminated with advantage to the ultimate borrower in the village, who could then be provided with cheaper credit. This assumes that the central banks borrow most of their funds from the provincial co-operative bank and make a profit by lending at higher rates to the primary societies. But as shown above, the central banks are almost self-sufficient with regard to finance, and in Madras on June 30th, 1939, the provincial co-operative bank provided 11·3% of the working capital of the central banks.

Secondly, it is argued that the conversion of the central banks into branches of the provincial co-operative banks, will effect a saving in the expenses of management. All banking experience, skill, and funds will be concentrated in the provincial bank, which will thus be enabled to secure the economics of a 'large scale.' But the little saving effected in this way might be eaten up by the extra expenditure which the provincial banks will have to incur in organizing an adequate staff to supervise the branches.

Thirdly, it is maintained that the provincial banks will find it easier to ensure uniformity of control and co-ordinate action when the existing central banks become their branches. But as the Madras Committee point out, the provincial banks are already securing such uniformity of banking policy by convening annual conferences of their respective central banks and this machinery can, if necessary, be improved.

On the other hand, such a conversion of the central banks into mere branches of the provincial bank will create serious difficulties :—

(*a*) The boards of directors of the existing central banks will become mere advisory committees of the branches of the provincial bank. This will destroy all local enthusiasm and local voluntary enterprise, which are the very basis of co-operation and might even lead to a falling off in local deposits.

(*b*) The methods adopted by the central banks at present, are flexible and have been evolved to suit the needs of each locality. There is an intimate contact between the central banks and the primary societies. This valuable contact and mutual adjustment will be lost and everything reduced to a rigid routine.

(*c*) The central banks are at present responsible, along with the supervising unions, in provinces where they exist, for the supervision of the primary societies. The provincial bank will have to take up this responsibility if the central banks are abolished, and as the Madras Committee on Co-operation forcibly put it, "To devise a satisfactory scheme of supervision of village societies on a provincial scale seems......to be beyond the range of practical politics."

(*d*) The central banks act as shock-absorbers and serve to distribute risks widely, and insulate the provincial bank to a certain extent from the consequences of wide-spread economic depression. For instance, the old Central Provincial Co-operative Bank and the Burma Provincial Bank, both of which advanced directly to primary societies, were ruined by the agricultural depression which led to a freezing of the assets of the village credit societies, while Madras, where the central banks act as intermediaries, weathered the storm fairly well. This proves that the central banks really serve to reduce the impact of financial crises on the provincial banks.

(*e*) This is a great need for a rapid expansion of the co-operative movement in India, and only independent central banks can evoke the necessary local enthusiasm and secure the services of local honorary workers.

(*f*) Also, from the theoretical point of view the case for the abolition of the central banks is very weak, as even European experience and practice are in favour of two storeys in the co-operative structure —local associations at the base, regional federal associations above them, and one central organization at the head of the whole movement in the country.

Theory as well as practical wisdom, therefore, require the retention of the existing central banks as independent units in the co-operative pyramid. As the Madras Committee on Co-operation point out, the central banks which have helped the co-operative movement in provinces like Madras to tide over one of the severest economic depressions, " must have some intrinsic vitality."

§ 4. **District Central Banks versus Taluk Banking Unions (small central banks):** Banking unions have been a success in the Punjab and Kodinar (Baroda State). The Reserve Bank of India holds that, on account of the increase in the number of co-operative societies, there is less and less contact between the central banks and their constituent societies, and their co-operative character has become extremely slender. It therefore suggests the creation of banking unions which will serve the primary societies in a more restricted area like a taluk. This means that instead of there being one central bank for each revenue district, there will be a large number of small central banks, each serving a small area.

But the existence of many central banks in a district is more an inconvenience than an advantage. As the Madras Committee on Co-operation have pointed out, a central bank operating over a district ensures economy of overhead charges, secures the money required at reasonable rates of interest, provides a large field for selection of men for management and tends to reduce opportunities for concentration of power in a few hands. The banking union, operating over a more restricted area, will have a smaller turnover and cannot, therefore, maintain an efficient staff for supervising and educating the societies in the area of its jurisdiction. It is again doubtful, whether a small banking union will be as sucoessful in attracting deposits from the public as the central banks have been. When the operations of the higher financing agencies are confined to a small area like a taluk, directors will be drawn from a very restricted area and local consideration are likely to play a larger part in the conduct of business than would be the case if the field of operation were wider.

As far as Madras is concerned, the central banks have worked well, and there is no need for the creation of taluk banking unions simply because they have been successful in the Punjab. "We deprecate tampering with a sound system " say the Madras Committee on Co-operation, " just because a different system is reported to have worked well elsewhere. .

§ 5. **Should individual shareholders be eliminated from the constitution of the central banks?** The central banks in India, as seen before, are generally of the mixed type and it was necessary, at the beginning, to admit individual shareholders in order to secure for the movement the services of able men with business experience, and the confidence of the depositing public. But society members predominate in the constitution of the central banks, and the essential co-operative character is preserved by the fact that (*a*) the directors representing the individual shareholders are elected by the full general body of the societies and the individual members, and (*b*) the directors representing the individual shareholders are always in a minority, usually of one-third, on the boards of management of central banks.

But the Madras Committee on Co-operation hold that "the time has come when individual shareholders should be eliminated", the central banks should in the future become pure federations of affiliated societies. They argue that there are, even among the representatives of rural and urban societies, men of shrewd commonsense and capacity who can undertake the management of central banks. There is, therefore, no need to retain the individual shareholders to secure the necessary business ability for efficient management. In fact, according to them, individual directors have been merely amateur bankers, and the central banks are being actually managed by a paid staff. The representatives of societies can, therefore, according to them, be entrusted with the management of central banks. Again, even at present, the individual directors are only in a minority on the boards of management of central banks and do not much affect the management. The elimination of the individual shareholders and the directors representing them will not, therefore, adversely affect the management of the central banks, while it will certainly make them more co-operative by making them pure federal banking unions.

But when the village credit societies are, as they are in India today, mere associations of borrowers, will a central bank purely made up of borrowers be able to earn the confidence of the investing public? If the support and influence of the individual shareholders were necessary in the beginning to ensure efficient management and attract sufficient deposits, have conditions altered so much, at present, as to make their presence wholly unnecessary? Unless these questions can be definitely answered in the affirmative, there is no case for the elimination of the individual shareholders. The Committee seem to have evaded these problems. The individual shareholders have not so far hindered the progress of the movement; they have provided a wholesome corrective in the constitution of the central banks to the borrowing element represented by the societies. The fact that the individual directors are in a minority in the boards of management actually strengthens the case for their retention, as they supply a steadying influence in the central banks without detracting from their co-operative character. The Committee, who usually prefer practical advantages to theoretical considerations, seem suddenly to develop a fondness for co-operative theory when they recommended the elimination of individual shareholders from the constitution of the central banks. Until there is a decided improvement in the personnel as well as the management of the primary credit societies the individual shareholders will have to be retained.

§ 6. **Provincial or Apex Banks:** All the major provinces of British India except the United Provinces, and the States of Mysore and Hyderabad have at the head of their co-operative structure Provincial Co-operative Banks.

" The provincial bank is the final link in the chain between the small scattered primary societies and the money market." Just as the small primary societies in the villages need a central bank to finance and supervise them, the different central banks scattered throughout the province have felt the need for some central agency which will be to them 'lender of the last resort,' advancing loans in times of need on the security of their co-operative paper. There is also need for a central institution, situated in the main city of the province and linking the co-operative movement to the money market, which will make available the surplus funds of the central banks in one area to central banks in another. The Maclagan Committee recommended such a provincialisation of finance in 1915, and soon after this, provincial banks emerged all over India.

Constitution :—The relations between the central banks and the provincial banks are of a loose federal type. The constitutions of the provincial banks vary from province to province, but the majority of provincial banks, like the central banks, have a mixed constitution, *i.e.*, both in the general body and in the directorate there are individual shareholders as well as representatives of co-operative societies and central banks. But the general tendency at present is to eliminate the individual shareholders and make the apex banks conform to the pure federal type. In Bengal and the Punjab there are no individual shareholders in the apex bank. In other provinces the primary societies are allowed to hold shares in the provincial co-operative bank, while in Madras, only the central banks hold shares in the provincial co-operative bank.

With regard to the relationship between the central banks and the apex banks also, there are provincial differences. Thus, central banks in Madras, Bengal and the Punjab have direct relations with the Imperial Bank of India, while in Bombay the central banks have dealings only with the provincial bank.[9] The central banks in Madras borrow directly from the Imperial Bank of India on the security of Government or commercial paper; some central banks have also direct financial dealings with the commercial banks.[10] Again, in some provinces apex banks deal only with the central banks and have no direct dealings with primary societies; while in Bombay, Bihar and Mysore the provincial banks still continue to finance primary societies in areas where central banks have not yet

9 H. L. Kaji, Ed. : Co-operation in India, p. 67.

10 The Committee on Co-operation in Madras: Report, par. 267.

been established. But from the point of view both of co-operative theory and of sound finance, the central banks should deal only with the provincial co-operative banks, and these, in turn, should deal only with the central banks and not directly with the primary societies.

Functions :—The functions of the provincial co-operative banks are fourfold : (*a*) They act as bankers' banks to the central banks in the districts. They thus finance the central banks in times of need, and, by acting as balancing centres serve to distribute the available funds evenly throughout the province. (*b*) They form the connecting link between the money market and the co-operative movement. (*c*) By virtue of their position as apex banks in the co-operative structure they ensure co-ordination of effort and uniformity of banking policy as between the different central banks in the area of their jurisdiction. As we have already seen, the central banks are, normally, almost independent in the matter of finance, but the provincial banks by convening annual conferences of the representatives of central banks try to secure a uniform banking policy and practice throughout each province. (*d*) They promote the cause of co-operation in general by periodical grant of subsidies to central banks for the development of co-operative activities. Thus the Madras Provincial Co-operative Bank has given subsidies to the central banks to enable them to support sale societies and thus encourage co-operative marketing ; it has contributed liberally to the common good fund of the Madras Provincial Co-operative Union to further the co-operative movement in the districts.[11]

Funds :—The funds of the provincial banks are mainly (*a*) share capital, (*b*) reserve fund, and (*c*) deposits from the affiliated co-operative societies and the public. Of these, deposits are the most important source of working capital. The provincial banks handle all types of deposits. In 1940-41 out of a total working capital of Rs 13,89 lakhs, deposits held from the individual members and the public provided Rs. 6·53 lakhs. (*See* Table No. XV). Provincial banks lend to one another with the consent of the Registrar and to facilitate this interlending they exchange information every quarter on their financial requirements.[12] The apex banks in all the provinces have cash-credit facilities with the Imerial Bank of India. Originally the Imperial Bank was prepared to give such facilities against the security of co-operative paper but now the loans are given only on the security of Government of India promissory notes. In an agricultural country like India the demand for credit is seasonal and unless the co-operative organizations are in a position to expand credit when the crops are marketed, there is likely to be a seasonal stringency. An elastic supply of credit can be

11 The Committee on Co-operation in Madras : Report, par. 271.

12 E. M. Hough : The Co-operative Movement in India, p. 137.

assured if the co-operative central and the apex banks are in a position to lend on the security of agricultural paper (*viz.*, bills of exchange drawn on the security of produce moving to the market), and they have facilities to get such paper rediscounted (*i.e.*, they can reborrow on the security of such bills) when they need cash. How far the need for such rediscounting facilities has been met by the Reserve Bank of India we shall consider in a later chapter.[13]

Matters of common interest to the apex banks are discussed by the All-India Provincial Co-operative Banks Association which meets once in two years. It has a standing committee and functions by correspondence.

Except in some provinces like the Central Provinces, the provincial banks have served their functions admirably.

§ 7. **Unions** : Just as small societies scattered in the villages have combined together in central banks in order to raise funds, they have also combined together in unions for purposes of mutual supervision. In the early days of the co-operative movement the Provincial Registrars personally undertook the supervision of primary societies but with the rapid increase in the number of societies the need was felt for a local supervising agency responsible to, and representative of, the constituent societies.

Two types of unions have been evolved in India—the guarantee union and the supervising union. The guarantee union first sprang up in Burma. The guarantee union, in addition to ensuring the supervision of the affiliated societies, guarantees the loans given by outside agencies to any member society. If that society defaults and there is a loss, the other societies in the union will have to make contributions in proportion to their own maximum borrowings during the twelve months immediately preceding the enforcement of the guarantee. Such guaranteeing, it is held, facilitates financing from the point of view of the central banks and reinforces the co-operative principle of "each for all and all for each." The Maclagan Committee regarded the guarantee system "as feasible and full of promise" and recommended its adoption by all provinces. Bombay, Bengal, the United Provinces, Bihar and Orissa and the Central Provinces all experimented with guaranteeing unions, but almost everywhere the guarantee system has proved a failure and has had to be abandoned. The guarantee given by

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13 There was till a few years back a demand for an All-India Co-operative Bank, which would be to the provincial banks what they are to the central banks. Such a completion of the co-operative structure was regarded as a logical development. "But financial machinery does not necessarily develop on logical lines." The cheaper as well as more convenient way of making financial accommodation available to the provincial banks, will be to give them direct discounting facilities with the Reserve Bank of India, instead of through an All-India Co-operative Bank.

the union has been found to be ineffective because (*a*) the liability of an affiliated society could be enforced only on the liquidation of the society, and the proceeds of a forced sale often did not suffice to meet the society's own liabilities;[14] (*b*) the sliding scale of responsibility based on the extent of borrowing put the greatest liability on the weakest members of the union, who naturally had to borrow most;[15] (*c*) as the Burma Committee on Co-operation point out, the guarantee union failed even in its main function of assessing the credit of affiliated societies.

The supervising union "is of the present and the future."[16] Unions merely for the purposes of supervision were started in Madras as early as 1910 and have gradually spread to other provinces. Supervising unions have attained their fullest development in Madras and Bombay. As the main function of the union is to supervise the working of the affiliated primary societies, it has to operate over a smaller area than a district, usually over a taluk. The ideal union consists of about 25 affiliated primary societies, all within a radius of about seven miles, to ensure mutual knowledge. The main duties of the union are generally, (*a*) to supervise the working of affiliated societies, (*b*) to help in the preparation of credit statements, the maintenance of accounts and the recovery of loans, and (*c*) to promote the spread of co-operative education and to help in organizing co-operative activities for purposes other than credit.[17]

Each affiliated society is represented in the union. The executive management of the union is vested in a governing body, the members of which hold office for a term of three years. Each union employs one or more supervisors to supervise the societies affiliated to it; the members of the governing body also pay occasional visits to the member-societies.

At one time it seemed a natural development for the supervising unions in a district in turn to combine together into a higher agency to co-ordinate their activities. For instance, in Madras after 1918-19 there emerged district co-operative federations to supervise and co-ordinate the work of the unions. The Townsend Committee on Co-operation (1927) regarded these federations as a desirable development and recommended greater powers for them. But in less than four years after the report of the Townsend Committee there was a complete change in the attitude towards federations, which were considered as a fifth wheel to the coach. The district federations were therefore gradually liquidated one after another after 1930.

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14 Report of the Committee on Co-operation in Burma, 1928-29, p. 44.

15 *E. W: Ewbank*: Indian Co-operative Studies, p. 56.

16 *E. M. Hough*: The Co-operative Movement in India, p. 110.

17 *H. L. Kaji Ed.*: Co-operation in India, p. 47.

The present position in Madras, therefore, is the local supervising unions (in areas where they exist) are in charge of the immediate supervision of the primary societies, and the district central banks control and co-ordinate the working of the unions in the area of their jurisdiction. The central bank is thus a supervising as well as a financing agency.

The funds of the supervising union generally consist of "affiliation fees, fees for registration of delegates, contributions by the central bank and affiliated societies towards supervision fund, and the grants and subsidies by central banks.

The defects which have paralysed the working of the primary societies have also manifested themselves in the working of the supervising unions. In Madras there has been a progressive decline in the number of supervising unions from about 400 in 1930-31 to 263 at the end of 1940-41. The Madras Committee advance the following reasons for the defective working of the unions: (i) the general dearth of enthusiastic and disinterested workers; (ii) the difficulty of getting such people, when they are available, elected to the governing body of the union; (iii) the dormancy of the affiliated societies; (iv) the presence of the representatives of bad societies on the governing body of the unions; (v) dual control over supervision by both the unions and the central banks; (vi) prevalence of local factions or party politics; and (vii) inadequacy of supervision fund etc. With the increasing inefficiency of the supervising unions the central banks have practically taken over the functions of supervision and the control of the supervising staff.

The Madras Committee on Co-operation have recommended that the question of the retention or abolition of the supervising unions in the future should be left to the discretion of the central banks concerned. But complete centralisation of both finance and control in the district central bank seems to be undesirable from the theoretical as well as the practical point of view. The supervising union, by making the societies responsible for mutual supervision, has an educative value; it satisfies the fundamental co-operative principle that co-operation should come from within; and gives the members of societies a wider co-operative outlook. With a rapid increase in the number of co-operative societies there is likely to be a greater need for some decentralisation of the work of supervision and the supervising union is likely to be a useful link between the central bank and the primary society in the village. The remedy, therefore, lies not in the abolition of the unions but in strengthening and revitalising them. The unions can be made not only useful agencies for supervision but also centres of co-operative education and enlightenment. Their working can be improved if the representatives of bad societies are eliminated from the governing body of the unions, and provision is made for the co-operation

Table No. XV

OPERATIONS OF PROVINCIAL CO-OPERATIVE BANKS, 1940-41

No. of Banks:			
9 British India: 8 } Indian States: 2 }	...		
		(Rs. Lakhs),	Percentage of total working capital.
Share Capital paid-up	...	79.56	5.7
Loans and deposits held at the end of the year from:—			
Societies ..	...	124.89	9.0
Provincial or Central Banks	...	314.20	22.6
Government ...	...	59.25	4.3
Individuals and other sources	...	653.36	47.0
Reserve Fund ...	...	51.02	3.7
Other Funds ...	...	106.94	7.7
Total	...	1389.22	100.0

Members.	Individuals:	4.537*
	Societies:	18.838
...		
		(Rs. Lakhs.)
...		
Loans made during the year to:—		
Individuals ...	...	194.49
Banks and Societies ...	...	498.57
Loans due at the end of the year by:—		
Individuals ...	...	34.76
Banks and Societies ...	...	665.07

* The provincial co-operative banks in the Punjab and Bengal have no individual shareholders.

Table No. XVI

OPERATIONS OF PROVINCIAL CENTRAL BANKS, 1941

	(Rs. Lakhs,)	Percentage of total working capital.
No. of Banks :		
British India : 489		
Indian States : 112		
Share Capital paid-up ...	267.44	9.0
Loans and deposits held at the end of the year from :—		
Societies ...	327.20	11.2
Provincial or Central Banks	450.86	15.4
Government ...	57.69	2.0
Individuals and other sources ...	1392.02	47.5
Reserve Fund ...	203.12	6.9
Other Funds ...	234.16	8.0
Total ...	2932.48	100.0

No. of Members — Individuals :	79.834
No. of Members — Societies :	121.292
	(Rs. Lakhs.)
Loans made during the year to :—	
Individuals ...	99.62
Banks and Societies ...	1005.11
Loans due at the end of the year by :—	
Individuals ...	66.75
Banks and Societies ...	1831.32

Table No. XVII

OPERATIONS OF UNIONS, 1940-41

Province	Number of Unions	Number of Societies affiliated to Unions.	Number of supervising staff maintained by Unions.
Madras — — —	263	9,177	433
Bombay — — —	127	3,608	150
Sind — — —	1	953	45
Bengal — — —	1	1	—
Bihar — — —	6	68	17
Orissa — — —	9	432	18
United Provinces — — —	3	135	483
Central Provinces and Berar — — —	6	9,041	197
Ajmer—Merwara — — —	3	58	1
Coorg — — —	13	260	15
Hyderabad Administered Areas — — —	1	19	1
Indian States — — —	33	4,817	173
Grand Total —	466	28,569	1,543

of one or two public spirited local men with leisure; if the supervisors are entrusted with only a manageable number of societies and the morale and the conditions of service of the supervising staff are improved, and if the central banks give adequate financial support to good unions. The unions should be retained and made not only useful agencies for supervision but also centres of co-operative education and enlightenment in the rural areas.

CHAPTER X

LAND MORTGAGE BANKS

§ 1. **The need for and the main types of land mortgage banks:** Long-term credit is needed by farmers for undertaking permanent and standing improvements to land. In India such credit is needed also for the clearance of prior debts which bear heavy rates of interest and eat into the small income of the farmer. It may be said that there are two main ways of curing the chronic disease of agricultural indebtedness, the surgeon's cure and the physician's cure. The former, *viz.*, the compulsory scaling down of agricultural debts, has already been dealt with.[1] The latter is the provision of long-term credit facilities for the discharge of prior debts. In virtue of the fact that the debt of a farmer is often the accumulated load of many previous years' arrears, its easy discharge would be facilitated, if it were permitted to be repaid in instalments spread over a number of years. To this the individual creditors might not agree; the need, therefore arises for an organization which will provide funds for fairly long periods and receive repayment in instalments. This method of solving the problem has been referred to as the physician's cure, as the disease of indebtedness is wiped out by the provision of medicine in small doses in the form of facilities for the repayment of loans in instalments.

Both remedies are needed at present in India. The fact that most of the rural debts have been incurred for unproductive purposes at a time when prices were higher, as well as the fact that most of them began as modest amounts and have swollen to their present size by the unscrupulous practices of the money-lenders and the unconscionable rates of interest charged by them, the urgency of the need to set agriculture on its legs and make it a paying industry, all justify some drastic and surgical remedy such as a compulsory scaling down of agricultural debts.

But, as experience in Madras has shown, a mere scaling down of debts is not likely to be of benefit to the farmers unless side by side arrangements are made to help the farmers to repay the scaled down debts and to prevent the re-emergence of unproductive

1 See Chapter III, § § 6 and 8.

borrowing. It is here that agencies lending for long periods on the security of land can be of help to the agriculturists.

The agencies already providing credit to agriculture such as the money-lenders, the indigenous bankers, the co-operative societies and the joint-stock banks are neither willing nor able to help the agriculturists by the provision of long-term finance. The limited funds of the money-lenders and the practices that govern the banking habits of the indigenous bankers stand in the way of any help being rendered by the first two agencies mentioned above. Their constitution, their limited financial resources, and the fact that the major portion of their funds comes from short-term deposits, all prevents the ordinary co-operative credit institutions from undertaking the provisions of long-term finance. Neither are the joint-stock banks in a position to help the agriculturist. The nature of a bank's deposit liabilities and its loan policy mutually govern each other, and the commercial banks raising funds mainly by way of short-term deposits cannot afford to lock up their money in long-term loans to agriculture. Moreover, the extremely uncertain nature of the yield from land, and the fact that the types of security offered by the farmers, such as growing crops, and livestock, are precarious and likely to depreciate in value, make the provision of credit to farmers a relatively undesirable risk from the banker's point of view. The need, therefore, for a special type of organization to undertake the provision of long-term credit to agriculture is obvious. All over the world such special organizations have taken the form of land mortgage banks.

Land Mortgage banks find it possible to advance long-term loans to agriculture, because they raise their funds mainly by the sale of debentures. These debentures bear a fixed rate of interest, and unlike current deposits are repayable only after a specified period. Thus the debentures sold by the Central Land Mortgage Bank in Madras are repayable only after 20 years. This enables it to lend to the primary land mortgage banks and through them to the farmers for periods up to 20 years. Land mortgage banks help both the farmers and the lenders. They assist the farmer by providing him with long-term credit on the security of his land at reasonable rates of interest. At the same time they help the creditors by providing them with more sound and liquid security than land in some remote village. The debentures of the land mortgage bank are backed up by all its assets and all the lands mortgaged to it as security for loans. The debenture-holder of a land mortgage bank is, thus, in a safer position than a private money-lender who has lent on the security of land, as the farmer has shifted on part of the risks to the land mortgage bank and has also greater security. Debentures, again, satisfy admirably the canon of convenience to the lender; when the debenture-holder needs cash, he can sell them in the stock market. Land mortgage banks are, therefore, ideal agencies for attracting long-term funds at low rates of interest.

The land mortgage banks can be broadly classified under three heads, *viz.*, co-operative, quasi-co-operative and commercial, according to the nature of their organization. Land mortgage banks of the first type do not aim at profit and try to keep the rate of interest low. They are primarily associations of the borrowing farmers. Such are the Landschaften of Germany and the Federal Farm Loan Banks of the U. S. A. The non-co-operative or the commercial type of Land Banks works mainly for a profit to their shareholders and are owned by private investors. Often the State controls them to ensure that no hardship is caused either to the borrower or to the debenture-holder. Under this category come the commercial and joint-stock land banks working all over Europe and in the United States. The most outsanding of such organizations is the Credit Foncier de France. In between these two types come the quasi-co-operative types of land mortgage banks. The organization of these banks differs from country to country. According to the Central Banking Enquiry Committee these are "Associations with a membership of borrowers and non-borrowers, operating over fairly large areas and formed with share capital and on a limited liability basis, but in which each member has a single vote irrespective of his share capital and the dividend on the share capital is fixed at a low figure". Examples of the quasi-co-operative type are the Hungarian Land Mortgage Institutions for large landowners, and National Small Holding Land Mortgage Institutions for small owners.

The land mortgage banks working in India today are of the quasi-co-operative type. They are not purely association of borrowers alone, but have on their rolls a few non-borrowing individuals for attracting capital and providing the business talent and the organizing capacity needed. But restrictions are placed on the number of shares that individual members may hold. The co-operative principle of 'one man one vote' is accepted and dividends are kept at a low figure to prevent dividend hunting. Thus the land mortgage banks in India combine the ideals of co-operative institutions and the practices of a private concern.

§ 2. **Land mortgage banking in India.** The earliest attempt at land mortgage banking in India came in 1863 out of European initiative. A company called 'The Land Mortgage Bank of India Limited or the Credit Foncier Indien' was started with its head office in London. It was modelled after the French Credit Foncier. Its main aim was to earn a profit for its shareholders: it lent for seven-year periods at rates varying from 7 to 8 per cent through its agents and sub-agents at Calcutta, Bombay, Madras and the other principal cities in India. The bank however was shortlived and failed within 20 years after its inauguration. It had made large advances against tea, the value of which began to decline, and its expectation that the permanent settlement would be extended to the rest of India, thus leading to a rise in land values, was not fulfilled. It had also to face the increasing competition of indigenous credit institutions such as the Loan Offices of Bengal.

The real history of land mortgage banking in India begins only from 1920. The need to keep clear the distinction between short-term and long-term credit and the necessity for some kind of long-term credit to wipe out the standing debts of the Indian farmers were not clearly realised during the early days of the co-operative movement in India. But experience soon showed that the village credit societies could not work well unless the past debts of their members were cleared, and they began to advance long-term credit also. Thus primary societies in the Tamil districts used to advance long-term loans for ten years for the clearance of prior debts. Such a freezing of the funds of the co-operative societies was however extremely unsound from the financial point of view as these funds were secured mainly from short-term deposits. The need for a separate institution to raise long-term funds by appropriate devices, thus became gradually clear. Experience also showed that co-operative credit, to be successful, should increase the income of the farmer and for this purpose, long-term credit for permanent improvement to land was essential.

To the Punjab goes the honour of having started the first co-operative land mortgage bank in India in 1920 at Jhang. During the first few years, there was a steady increase in the number of land mortgage banks, but soon a rot set in and the economic depression of the thirties aggravated the troubles of the banks. Most of the banks ceased working, their assets became frozen, and they began to concentrate upon recoveries. The reasons advanced for this failure of the land mortgage banks in the Punjab are the lack of loyalty on the part of directors, grant of loans without proper enquiry, and favouritism in the grant of loans. But the most significant reason is the fact that land mortgage banks were started in the Punjab at a time when land values were inflated. The depression which set in in 1929 led to a severe fall in land values, greatly reduced the repaying capacity of the borrowers, and thus created great difficulties for the land mortgage banks.

The lead given by the Punjab was soon followed by Madras and Bombay. Two mortgage banks were registered in Madras in 1925 and in Bombay in 1926. In both these provinces, the movement has made rapid progress and the structure of the land mortgage banking system has become complete, with a central land mortgage bank for the centralised issue of debentures and with local or primary land mortgage banks in the districts to assess the value of the security offered, to advance and recover the loans advanced on the security of land and to supervise the mortgaged property. A number of factors have, during recent years, combined to focus attention more and more on the need for organizing land mortgage banks. The working of the debt relief measures recently adopted in almost all the provinces has shown that schemes for debt relief can be successful only when institutions such as land mortgage banks come forward to advance money to the small ryots on the security of their land, and thus help them to repay their scaled down debts to their creditors. In other words, land mortgage banks and Debt Conciliation Boards have to work side by side on a scheme of debt clearance. Another factor which till recently focussed attention on land mortgage banking was the depression which led to a plethora of funds in the money-market. The time was thus opportune for starting land mortgage banks which would attract the idle funds at relatively low rates and make them available for the clearance of the prior debts of the farmers. A third factor working in favour of land mortgage banks was the growing realisation of the need for increasing the income of the ryots by facilitating permanent improvements to land. A beginning in land mortgage banking has been made in Bengal, Assam, the United Provinces and the Central Provinces. Table XVIII shows the operations of the land mortgage banks and societies in India in 1940-41.

§ 3. **Land mortgage banking in Madras:**[2] Both in the number of land mortgage banks and in the amount of working capital at their command, Madras leads the other Indian provinces. The land mortgage banking system in Madras has been extremely well organized, and the working of the system in Madras can be taken as typical. No apology, therefore, need be tendered for dealing at length with the system of land mortgage banking in the Madras Presidency.

A scheme to raise funds for the co-operative banks in Madras by the sale of debentures backed up by mortgages of immovable property was mooted as early as 1919 by Mr. F. R. Hemingway, the then Registrar of Co-operative Societies. In the absence of special institutions to lend long-term finance, the co-operative primary societies in Madras were at the time in the habit of advancing long-term loans to agriculturists for periods up to ten years for the discharge of prior debts. This was considered from a banking point of view extremely unsound, and Mr. Hemingway formulated a scheme of raising money on the security of immovable properties mortgaged by members of primary societies who wanted long-term finance. This scheme was modelled on the experiments

2. Of the 15 land mortgage banks in Bombay in June 1939, only 3 had been started before 1935. The land mortgage banks in Bombay have in fact been modelled on those working in Madras. We, therefore, discuss in detail only the Madras system.

Table No. XVIII

OPERATIONS OF LAND MORTGAGE BANKS AND SOCIETIES IN INDIA, 1940-41.

Province	Number Banks or Societies.	Number of Members	Deposits. Rs.	Debentures. Public Rs.	Debentures. Govt. Rs.	Working Capital Rs.	Most usual rate of interest on Borrowings Per cent	Most usual rate of interest on Lendings Per cent
Madras ...	120	65,712	11,43,499	?	?	?	?	?
Bombay ...	18	10,523	...	26,77,048	3,23,800	68,67,529	...	...
Bengal ...	5	2,624	75	...	...	6,83,153	5	8½
Orissa ...	1	442	...	...	75,000	1,36,339	3½	7
United Provinces ...	5	775	74,884	...	...	2,00,581	5	9½
Punjab ...	10	3,943	13,161	...	...	12,13,002	4½	7
Central Provinces and Bihar ...	21	6,300	...	...	...	15,92,894	4½	6½
Assam ...	4	1,779	...	...	37,200	4,09,628	4 to 6½	10½
Ajmer— ...				...	...	91,606	5½	8
Total (British India) ...	196	93,327	12,70,237	2,72,04,848	4,36,000	6,48,84,192	...	...
Mysore ...	53	7,335	...	12,79,900	19,800	29,56,861	4¾	6½
Baroda ...	2	2,193	2,50,190	2,69,440	1,30,750	8,48,770	2¾	6
Cochin ...	1	2,425	...	15,00,000	76,022	17,83,212	4	6
Total (Indian States) ...	56	11,953	2,53,190	30,49,340	2,26,572	55,88,843	...	...
Grand Total ...	252	105,280	15,20,427	3,02,54,188	6,62,572	7,04,73,035	...	...

conducted in the Central Provinces with minor differences in the method of issuing debentures. However, the Government did not favour the scheme 'as they presumably felt that it would be dangerous to link up long-term mortgage loans with existing co-operative banks and that land mortgage banks should be separate concerns'. The land mortgage banking movement in this Province was initiated in 1922 when the Government called for proposals for organizing land mortgage banks on the model of the Jhang Co-operative Land Mortgage Bank of the Punjab. The Registrar of Co-operative Societies stressed the necessity for starting separate institutions to provide long-term credit, and the need for Government help in the beginning for popularising the debentures of the banks. Proposals to start land mortgage banks in select areas were sanctioned by the Government and the first land mortgage bank was started in 1925. By June 1927, 10 land mortgage banks had been registered. The liability of these banks was limited, and they were expected to confine their operations to a compact group of villages. This was considered necessary to enable the banks to keep in close touch with the borrowers and to keep a watch over the mortgaged land. The borrowing power of the banks was limited to 8 to 10 times their paid-up share capital. The maximum amount which a land mortgage bank could lend to any one of its members was fixed at Rs. 1,000 and no loan was to exceed fifty per cent of the value of the mortgaged land. The land mortgage banks were to raise their funds mainly by the sale of debentures for 20 years terms and were to advance loans for periods not exceeding 17 years. To encourage the public to invest in the debentures of these banks, the Government undertook to purchase an amount equal to that taken up by the public, subject to a maximum of Rs. 50,000 per bank and Rs. 2½ lakhs for the whole Presidency.

But few people came forward to purchase the debentures of small land mortgage banks scattered here and there. To remedy this, the Townsend Committee on Co-operation (1927) recommended the formation of a Central Land Mortgage Bank. It was considered that the debenture issue of a strong central institution borrowing on behalf of all the primary land mortgage banks would be more acceptable to the public than the ill organized and piecemeal issue of debentures by the primary banks scattered over the different parts of the Presidency. The Madras Co-operative Central Land Mortgage Bank was, therefore, started in 1929, and with its formation 'the structure of the mortgage banking system became complete with the machinery for centralised debenture issue and local apparatus for valuation, supervision and inspection of the landed properties of individual borrowers and for distribution of loans to them.'

The Co-operative Central Land Mortgage Bank :—This is a bank of the mixed type. In addition to the primary land mortgage banks, membership is also open to private individuals. The bank has a share capital of Rs. 20 lakhs made up of 20,000 shares of Rs. 100 each. The primary land mortgage banks in the presidency are compelled to subscribe to the share capital of the Central Land Mortgage Bank. The administration of the bank is in the hands of a Board of 18 members and a small executive committee deriving its powers from the Board. The Registrar of Co-operative Societies, who as Trustee of the bank has to see to it that it fulfills its obligations to its debenture-holders, is an ex-officio member of the Board and of the Executive Committee.

The main object of the Central Land Mortgage Bank is the financing of the primary land mortgage banks working in the different parts of the Presidency. The funds needed for this, it raises mainly by the sale of debentures issued on the security of mortgages and other assets assigned by the primary land mortgage banks to the Central Land Mortgage Bank, and the other properties of the bank. To increase the safety of the debentures and to prevent over-issue, a number of safeguards have been provided. Thus debentures can be floated by the bank only up to 25 times its paid-up share capital and reserve Fund. The total amount due on the debentures should not exceed at any time the total amount due on the mortgages on the security of which the Central Land Mortgage Bank has advanced money, and the amounts already collected thereunder.[3] The Registrar of Co-operative Societies as Trustee has to safeguard the interest of the debenture-holders, and all the mortgages and other assets transferred by the primary land mortgage banks to the Central Land Mortgage Bank vest in the Trustee.

These safeguards, sound management, the ungrudging help given by the Government, and the easy money conditions brought about by the depression, all combined to ensure the success of the debentures issued by the Central Land Mortgage Bank. The bank has hitherto issued debentures for 20 years terms, interest being payable half-yearly, and it has been able to borrow at rates as low as $3\frac{1}{2}$ per cent. On the advice of the Reserve Bank of India, the Government have during recent years considered advisable a margin of $2\frac{1}{2}$ per cent. between the interest paid by the bank on its debentures and the rate charged to the ultimate borrower.[4] The Central Land Mortgage Bank, therefore, lends to the primary land mortgage banks at 5 per cent. and these in their turn lend to individual borrowers at six per cent.

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3 For the repayment of each series of debentures commencing from the XXIV series, the Central Land Mortgage Bank now constitutes a separate sinking fund.

4 The margin has recently been raised on the suggestion of the Government to 3 per cent. The individual borrower now pays therefore $6\frac{1}{2}$ per cent.

Till recently, one-fourth of the net profits of the Central Land Mortgage Bank had to be carried annually to the reserve fund. The bank has recently amended its bye-laws and now 40% of the net profits have to be so carried. The dividend on its share should not exceed by more than I per cent. the rate at which its debentures are floated.

The primary land mortgage banks:—Below the Central Land Mortgage Bank are the primary land mortgage banks which deal directly with the agriculturist borrowers. The area of operation of a primary land mortgage bank now extends over the whole of a revenue taluk and membership in it is open to any person who owns agricultural land in the area of its operation. Every such person who needs long-term credit has to subscribe to its share capital an amount equal to one-twentieth of the loan needed by him. For instance, a member to qualify himself for a loan of Rs. 2,000 will have to contribute to the share capital of the primary land mortgage bank Rs. 100. Borrowers are asked in this way to contribute to the share capital of the bank mainly for three reasons. The share capital thus collected forms an additional guarantee for the debenture holder. It also makes the borrower, in his capacity as one of the shareholders, take a real interest in the affairs of the primary land mortgage bank. The maximum borrowing capacity of the primary bank from the Central Land Mortgage bank has been fixed at 20 times its paid-up share capital and reserve fund and therefore, it cannot borrow money from the latter unless its members contribute to its share capital. But the recent Committee on Co-operation in Madras have recommended that "ordinarily a borrower should not be required to buy more than one share compulsorily for each loan if the bank can raise otherwise the required owned capital."

The primary land mortgage banks grant loans to their members generally up to a maximum limit of Rs. 5,000 for the discharge of prior debts and redemption of mortgaged land, for the improvement of land or of the methods of cultivation, and for the purchase of land when such a purchase will enable the ryot to round off his holding and to work it more economically. Loans are advanced on the first mortgage of land up to 50 per cent. of the market value of such lands and are repayable in 20 years.

The procedure followed in the sanctioning of loans shows clearly the working of the primary land mortgage banks. The intending borrower has to apply for a loan to the land mortgage bank working in the area where his lands are situated. The bank with the help of an officer of the Co-operative Department called the Co-operative Sub-Registrar scrutinises the purpose of the loan, the borrower's title to the property offered as a mortgage security, the value and the annual yield of the property and the applicant's repaying capacity. If the bank feels that the loan can be advanced, the loan application is forwarded to the Central Land Mortgage Bank in Madras with the reports of the directors of the primary bank, the Legal Adviser and the Departmental Officer. The Executive Committee of the Central Land Mortgage Bank tries to ascertain whether the loan is asked for a purpose which is legitimate, whether the title of the applicant to the property offered as security is clear and absolute, whether the value of the property offered as security is at least twice the amount of the loan asked for, and whether the applicant has other sources of income from which he can maintain himself and his family without encroaching on the income from the property offered for mortgage. If it is satisfied, it sanctions the loan. On intimation of the sanction the primary bank receives from the applicant the necessary mortgage documents and assign them in favour of the Central Land Mortgage Bank. After this the amount is advanced by the Central Land Mortgage Bank and reaches the applicant through the primary bank.

On the 30th June 1941, 119 primary land mortgage banks were working in the various parts of the Madras Presidency. They covered more than 19,000 villages and loans had been issued in over 5,500. The loans advanced by all the primary banks up to 1939 amounted Rs. 255·36 lakhs.

The lands offered for mortgage by the individual borrowers form the ultimate security for the debentures sold by the Co-operative Central Land Mortgage Bank. The directors of the primary banks, therefore, are expected to inspect and revalue the mortgaged lands once a year. The primary banks are managed by a board, generally consisting of 9 members whose services are gratuitous.

There is, thus, in Madras a co-ordination between the Central Land Mortgage Bank in the capital city of the Province and the primary banks in the mofussil areas. The main function of the Central Land Mortgage Bank is the raising of funds by the sale of debentures; the primary banks are local voluntary associations which act as agents of the Central Land Mortgage Bank in the scrutiny of the loan applications, the supervision of the mortgages and in the disbursement and the recovery of loans.

The outbreak of the War in 1939, especially the war with Japan in December 1941, has created new problems for the land mortgage banks in Madras. The War has led to a steep rise in the value of land, and borrowers from the primary land mortgage banks have found it easy to clear their loans to the land mortgage banks by selling off part of their lands, or by borrowing from other sources. Many loans have thus been repaid in advance and there has been a marked fall in the issue of new loans. The result has been a great decrease in the earnings of the Central Land

Mortgage Bank. The Central Land Mortgage Bank is now, therefore, taking energetic measures to increase the volume of its business. It will be of lasting benefit both to the ryot and to the Central Land Mortgage Bank, if the ryot can be induced to use the increase in the value of his land to take additional loans from the land mortgage bank for making permannent improvements to his land, instead of dissipating it in unproductive loans raised from private lenders. "On a satisfactory solution of this problem of advance payments and issue of new loans for land improvements" depends to a large extent the future of land mortgage banking in Madras.

§ 4. **Government assistance to land mortgage banks in Madras:** If the record of the land mortgage banks in Madras is one of the brighest chapter in the history of co-operation in India, and if the Central Land Mortgage Bank in Madras has been able to float debentures at rates as low as $3\frac{1}{2}\%$, the success is in no small measure due to the encouragement and active support given to these institutions by the Government. The land mortgage banking movement in Madras presents "a good example of a wise combination of State and voluntary effort."

The success of the debentures issued by the Central Land Mortgage Bank is due largely to the direct and indirect financial help given by the provincial Government. Government have guaranteed fully and unconditionally the principal of and the interest on the debentures issued by the Central Land Mortgage Bank up to a maximum of Rs. 310 lakhs. Other facilities given by the Government have served to widen the market for the debentures of the Central Land Mortgage Bank. Thus, the debentures have been declared trustee securities under the Indian Trusts Act. The duty chargeable on deeds of transfer under the Indian Stamp Act has been remitted in the case of these debentures. Again local bodies and municipalities and the provincial and the district co-operative central banks have been allowed to invest part of their funds in the debentures of the Central Land Mortgage Bank. The provincial and the district co-operative central banks have also been allowed to regard investment in such debentures as part of their liquid resources. The district co-operative central banks have in addition been permitted to invest a part of their reserve funds in these debentures. Even more important is the temporary accommodation given by Government to the Central Land Mortgage Bank under certain conditions to enable the latter to issue debentures in bulk once or twice a year, when the market conditions are most favourable.

The Government have granted a number of privileges and concessions to the primary land mortgage banks also. Thus, these

5 The Committee on Co-operation in Madras Report, par. 92.

are charged only half the ordinary fees for the registration of documents and for the issue of encumbrance certificates for loan applications exceeding Rs. 2,000. In respect of loan applications for Rs. 2,000 and below these fees are fully remitted. Again, village maps, settlement registers and copies of the district gazette sheets in the language of the area in which they are working are supplied free to the primary land mortgage banks. To help these in their work of scrutinizing the loan applicants, appraising the value of the mortgaged property and to generally supervise their working, the Government maintain a staff of Co-operative Sub-Registrars. Each Co-operative Sub-Registrar has about 3 to 5 primary land mortgage banks in his charge and inspects them once every month. Above these Sub-Registrars are three Deputy Registrars[6] who are expected to inspect the banks at fairly frequent intervals and to see to it that the movement is progressing on sound and healthy lines.

The Madras Co-operative Land Mortgage Banks Act of 1934 has conferred on land mortgage banks summary powers of speedy recovery of arrears from defaulters through the attachment and sale of their property without the intervention of the law courts. This is likely to facilitate greatly the working of the land mortgage banks.

§ 5. **Future Policy:** Land mortgage banking in India has developed only recently and its development has not been uniform in all the provinces. All the post-depression measures for the scaling down of agricultural debts would have been more fruitful, and a large amount of debt clearance could have been achieved, if in all the provinces there had existed a number of well organized land mortgage banks ready to advance long-term loans to the indebted ryots on the security of their lands for the clearance of their prior debts as scaled down by the debt relief acts. Land mortgage banks working on sound lines would also have done much to increase the income of the ryot by advancing cheap long-term credit for permanent improvements to land and for the creation of economic holdings. But in most parts of India the technique of land mortgage banking is hardly developed, and of the provinces in British India only Madras and Bombay have been able to raise funds by selling debentures to the public. Even in Madras, there are still a number of districts which are not adequately covered by land mortgage banks. For instance, while Tanjore with its eleven taluks has nine land mortgage banks, Vizagapatam with its twenty-one taluks has six and Bellary with its nine taluks only one. Systematic attempts should, therefore, be made to develop a

6 The cost of the Deputy Registrars and of their staff is met by the Central Land Mortgage Bank. The Central Land Mortgage Bank has also been asked to contribute a part of the cost of the Sub-Registrars from 1941-42.

network of land mortgage banks which would cover the whole country and make cheap investment credit available in all areas. It is with this object in view that the Madras Committee on Co-operation have recommended that "there should be a sort of planning so as to cover the whole Province with at least 200 mortgage banks in the next five years, on the basis of at least one bank for every revenue taluk in the deltaic areas and at least one bank for two or three taluks in the dry areas."[7]

But the starting and successful working of land mortgage banks is likely to be particularly difficult in two types of areas, *viz.*, in the dry and the zamindari tracts. The main difficulty in the dry areas arises from the uncertain nature of the agricultural income in purely rain-fed tracts. Land mortgage banks are not likely to work well under such conditions, as the equated instalments due from the borrowers cannot be promptly recovered when the income of the borrower is so irregular and is subject to the vagaries of nature. A land mortgage bank working in such an area will have to evolve a technique of recovery suited to the local conditions, recovering more during the good years and granting liberal extensions during the bad years. This means that the instalments due from the borrowers will have to be regulated not with reference to arithmetical considerations but with reference to the varying climatic conditions. But how is the land mortgage bank to meet its obligations to its debenture-holders if it is to suspend collections from the borrowers during the bad years? One solution of this difficulty is for the land mortgage banks or for the central land mortgage bank acting on behalf of the primary land mortgage banks to sell debentures of longer maturity. Thus, if the usual practice is to lend for 20 year periods the necessary funds may be raised by the sale of 30 years' debentures. But this course is not likely to be practicable in the near future in India as investors might not come forward to invest in such long-dated securities. The Madras Committee on Co-operation have, therefore, suggested that when the land mortgage banks working in the dry areas are forced to suspend collections during the bad years, the Government must offer the Central Land Mortgage Bank temporary accommodation either from the general revenues of the Province or from the Famine Relief Fund and thus enable it to meet its obligations to its debenture-holders. The Government can reimburse itself later on from the periodical collections of the Central Land Mortgage Bank. This we feel is the proper line of advance. The agriculturists in the dry areas stand in no less urgent need of cheap long-term credit for the clearance of their prior debts and for permanent improvements to land than their brethren in the wet areas; the need for investment credit, for such things as the erection of irrigation work or adoption of measures to prevent soil erosion and to

7 The Committee on Co-operation in Madras: Report, par. 93.

retain soil moisture, is, if anything, more urgent in the dry areas. Land mortgage banks, with the appropriate machinery for the recovery of their loans through a flexible system of collections must therefore be started in these areas.

The difficulties in the way of starting land mortgage banks in the zamindari areas are different; they relate to the ownership of and the title to land. A land mortgage bank lending on the security of landed property, obviously cannot function effectively where the title to the property sought to be mortgaged is itself defective. Many tracts in the zamindari areas have not yet been accurately surveyed and settled. The system of record of rights in these areas is extremely defective and strange cases of actual ownership differing from those indicated by the pattas and village accounts are not uncommon. As recommended by the Committee on Co-operation in Madras, this difficulty can be solved by the adoption of the Torrens system as developed in France. Under this system the land mortgage bank, after satisfying itself of the title of the applicant for the loan to the property offered as mortgage, publishes officially a notice calling upon third parties to show their claims, if any, giving an opportunity to any hidden claimants to make their claims known. If new claimants come forward the bank may either contest their claims on behalf of the applicant or reject the application for the loan; where no claims are presented within the specified time, it is understood that no third party can ever afterwards contest the mortgage lien, while the loan applied for must be granted. But we suggest that in addition to this, the Government should, in a bolder spirit, try to rectify the system of record of rights and lose no time in carrying out a survey of land and fixing up correct pattas in the zamindari areas.

In the loan policy of the land mortgage banks there is need for improvement in certain directions. Most of the loans advanced hitherto by the land mortgage banks have been for the clearance of prior debts. The ultimate aim of the land mortgage bank like that of the co-operative credit society is to raise the income of the ryot, and for this, permanent improvements to land are as essential as is the clearance of prior debts. But very little has been lent by land mortgage banks hitherto for the financing of improvements. The majority of the ryots in India are very small landholders and are unwilling to invest large sums in improvements which might in the end turn out to be unremunerative. As the Royal Commission on Agriculture in India pointed out, "whilst there is some demand for facilities to repay old debts or redeem mortgages, there is no strong demand for long-term money for land improvements in India." Another reason for the small demand for loans for permanent improvements may be the absence of a close co-ordination between the land mortgage banks and the Departments concerned with agricultural improvement, particularly the Agricultural

Department. "As it is, agriculturists are not fully aware what schemes are likely to be beneficial nor do the land mortgage banks possess the necessary machinery for examining such schemes or supervise their carrying out, if they were to grant loans for agricultural improvement."[8] The land mortgage banks should therefore in the future lend more for the financing of permanent improvements which will increase yield from land. In this connection they may, as recommended by the Madras Committee on Co-operation, "explore the possibilities of facilitating the widespread use of hydro-electric power with a view to make agriculture industrially nationalised." To popularise loans for land improvements the land mortgage banks might advance these at a lower rate of interest.

Another complaint against the present loan policy of the land mortgage banks is that they were reluctant to issue small loans to the ryots. The figures given by the Committee on Co-operation in Madras also fairly support this criticism. In Madras, during the period between 1929–30 and 1937–38, loans below Rs. 500 formed only 8·6% of the total number of loans disbursed, and accounted for only 1·6% of the total amount of credit advanced, by the land mortgage banks. Though small loans are relatively more expensive and more inconvenient from the point of view of the bank it is one of the main duties of the co-operative land mortgage banks to provide long-term finance to the smaller landholders. Loans of sums smaller than Rs. 500 should, therefore, be encouraged in the future.

In Madras the great delay in the disposal of loan applications by land mortgage banks has become a byword. This has been found to be due to certain unnecessary stages through which the applications have to pass when they are being scrutinized, the lack of method on the part of the staff of the primary banks, the inadequate staff of Co-operative Sub-Registrars, the reluctance of the creditors to supply the necessary information required by the banks and sometimes the lethargy of the applicants themselves. Some delay is, of course, inevitable as the value of the land, the applicant's title to it, his repaying capacity etc., have all to be investigated, but measures should immediately be taken to eliminate all unnecessary delay. To minimise delay, the abolition of the post of Land Mortgage Banks Deputy-Registrars, an increase in the staff of Sub-Registrars with increased powers for them to deal directly with loans extending up to Rs. 5,000, the grant of increased powers to the President of the Central Land Mortgage Bank to sanction loans not exceeding Rs. 2,000, the abolition of certain formalities which have, at present, to be gone through before loans are sanctioned, and the establishment of some machinery to compel creditors

8 *Reserve Bank of India:* Review of the Co-operative Movement in India, 1939—40, p. 38.

and others who may have a claim on the properties sought to be mortgaged to appear before the primary bank and to receive payment have been recommended by the Committee on Co-operation in Madras.

The land mortgage banks can also be made to play a greater part in the wiping out of unproductive agricultural debts, by ensuring a greater measure of co-ordination between them and Debt Conciliation Boards. Wherever debts have been scaled down either by voluntary debt conciliation or by compulsory legislation and the agriculturist debtor has adequate landed property, the land mortgage bank might usefully step in, advance the scaled down amount to the creditors, and recover the sum from the agriculturist debtor in easy instalments spread over a number of years. To ensure the necessary collaboration, the Madras Committee on Co-operation have suggested that (*a*) land mortgage banks should be allowed to take part in the debt conciliation proceedings if the creditors of the debtor are to be ultimately satisfied by the banks; (*b*) the Debt Conciliation Board should give notice to the land mortgage bank in the area before it goes on with its proceedings; and (*c*) a representative of the land mortgage bank should be appointed a member of the Debt Conciliation Board working in the particular area. The need for some such co-ordination between the agencies for debt conciliation and the land mortgage banks can hardly be disputed.

Co-operative and quasi-co-operative land mortgage banks are intended mainly to help the smaller ryots. They, therefore, cannot advance large sums to the bigger land-owners. To finance this class of landowners, joint-stock land mortgage banks of the purely commercial type can be organized, as recommended by the Central Banking Enquiry Committee and the Agricultural Credit Department of the Reserve Bank of India. The Government can assist such banks by providing a portion of the initial capital and guaranteeing the interest on debentures.

CHAPTER XI

CO-OPERATIVE PROPAGANDA—NON-CREDIT CO-OPERATION

§ **1. Provincial Co-operative Institutes:** In all the provinces in India the function of co-operative propaganda has been taken over from the Registrar by non-official Institutions. The names and the functions of these bodies vary from province to province. "In Bombay there is the Provincial Co-operative Institute. In the Punjab, Madras, and the United Provinces there is the Provincial Co-operative Union; in Bengal and Assam they have the Co-operative Organization Society; in Bihar and Orissa and the Central

Provinces and Behar they have the Provincial Co-operative Federation; while in Burma they have the Co-operative Council."[1] In the Punjab, the audit of the primary societies is carried on by the Union. In Bombay co-operative education and the training of the staff to be employed by the co-operative movement have been definitely taken over by the Institute.

But the majority of these Institutes are mere advisory bodies in charge of propaganda. Some of these are unitary organizations, in which primary societies are directly represented, as, for instance, the Provincial Co-operative Institute in Bombay, while others are federations of societies. Thus, in the Madras Provincial Co-operative Union, membership is open to "Provincial Societies," language federations, local Unions, central banks, urban banks with a working capital of not less than Rs. 20,000, land mortgage banks, co-operative training institutes and primary non-credit societies. Persons of knowledge and distinction in the field of co-operation may be invited to be honorary members, but they are not entitled to vote.

Propaganda is the major function of the Provincial Institutes. They publish journals and pamphlets dealing with co-operation, maintain reading rooms and libraries, and organize lectures by paid or honorary workers. They organize co-operative conferences and agricultural exhibitions.

They also serve as a focussing point of the activities of honorary organizers. Honorary organizers have played an important part in the development of the co-operative movement; almost all the officers of the primary societies do honorary work, and as Dr. Hough points out, "The service of the villagers embodied in the structure are a greater miracle than the structure itself." But there have not been enough voluntary workers hitherto, and very often those who are available lack expert knowledge and experience. If the co-operative movement in India is to spread more rapidly in the future, more voluntary workers with real knowledge of the fundamentals of co-operation and of the working of co-operative societies should come forward to give a right lead to the people in the villages, and here it is that the Provincial Institutes can be of immense value.

Other functions of the Institute are to serve as the recognised exponents of non-official opinion, to undertake co-operative education, and to encourage special types of co-operation, such as co-operative marketing, insurance, and housing.

The following main activities of the Madras Provincial Co-operative Union are typical and illustrate the very valuable work which such unions can do.

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1 *H. L. Kaji, Ed.:* Co-operation in India, p. 202.

"(1) Conducting in English the Madras Journal of Co-operation';

(2) subsidising the language federations and the District Banks of Malabar and South Kanara for publishing co-operative vernacular journals in Tamil, Telugu, Malayalam and Kanarese;

(3) carrying on propaganda in districts by its executive committee members;

(4) preparing for sale magic lanterns and slides on co-operative subjects;

(5) convening the Madras Provincial Co-operative Conference;

(6) arranging for the holding of training classes for panchayatdars and members of societies throughout the Presidency;

(7) conducting institutes for training candidates for employment as supervisors;

(8) maintaining a reading room and library for public use; and

(9) conducting classes for training rural guides."[2]

True co-operation must spring from the people and must be a self-contained movement. The co-operative societies should be able to raise funds by themselves, arrange their own supervision and audit, and the movement should spread by the momentum of its success. In India, where the movement is controlled in all its stages by Government, a gradual de-officialisation is, therefore, extremely desirable and a beginning can be made in this direction by entrusting the Provincial Co-operative Unions or Institutes with more functions. Thus, other provinces can follow the example of the Punjab and gradually hand over the functions of the audit and supervision of primary societies to the Provincial Institutes. Co-operative education also is a function which the Institutes are well qualified to perform and should be in their complete charge.

The All-India Co-operative Institutes Association was formed in 1928. It provides a common platform for the exchange of opinion and aims at promoting of co-operation through member institutes. It also links the co-operative movement in India with co-operation in the outside world as it is affiliated to the International Co-operative Alliance. The Association runs a valuable quarterly journal, "The Indian Co-operative Review," and the opinions of the Association may be said to represent 'a synthesis of the opinions of non-official participants in the movement.'

§ 2. **The State and the co-operative movement:** What should be the attitude of the State to the co-operative movement? Should the co-operative organizations ask for and obtain special

2 *The Committee on Co-operation in Madras:* Report, par. 52.

favours from the State? From the purely theoretical point of view the answer to this question is clear. Co-operation should be based on self-help and should create among the co-operators a sense of self-reliance. If the co-operative societies are given special concessions by Government, this is likely to lead to Government control, to kill independence and the spirit of self-help which are the very foundations of co-operation, and to create in the co-operators a habit of always looking to Government for help. In fact, in many European countries, the co-operative movement in its early stages had to face the distrust, if not the open hostility of the Government. The credit and the productive movements on the continent of Europe were started by philanthropists imbued with a sense of idealism, while in England the consumers' co-operative movement was started by the people themselves. The orthodox view, therefore, is that the co-operative movement should-base itself entirely on self-help, and should claim from the State 'a fair field and no favour.' The State, by legislation, should merely provide the framework within which co-operative societies should work, and can at the most give the co-operative societies some minor concessions, such as exemption from the income-tax on profits, from stamp duty, and from registration fees.

But most modern countries have gone much further than this. The main point is that Government help should not kill self-help and degenerate into Government paternalism, but there is little doubt that the Government can do much without destroying the mainspring of co-operation. Modern Governments have taken an increasing interest in the development of agriculture, and in countries such as Denmark, Canada, the United States, New Zealand, and Australia, the State has helped agriculture by the provision of technical education and expert advice, finding out markets, the dissemination of useful information, concessions in railway rates, the provision of facilities for storage, grading, etc. These have especially benefitted co-operation. As a result of the recent world economic depression, in most countries strenuous attempts have been made by the State to develop co-operative marketing of agricultural products. Thus, in the United States among the main objects of the Federal Farm Board established in 1929 were the organization of producers into effective associations, the financing of marketing schemes, and the organization of the marketing of agricultural commodities on a national basis by building up co-operatives.

Modern experience also shows that in certain circumstances direct money subventions to co-operative societies are desirable. Thus, in a poor and backward country, some initial financial help by the Government, if it does not stifle self-help, will greatly facilitate and quicken the pace of co-operation. Government in all countries have come forward directly to help co-operative housing schemes for the benefit of the working classes; "in Ireland the agricultural banks have been financed at 3 per cent. by the Irish Department of Agriculture and the Congested District Boards."[3]

We can, therefore, conclude by saying the the attitude of the State towards co-operation should not be one of entire neutrality. Co-operation is one of the best methods of helping the poorer classes to improve their economic condition, and is almost the only method of strengthening the position of the small-scale farmer. It, therefore, contributes to political as well as economic stability. The objective of State policy should, therefore, be to encourge co-operation by all means in the power of the State, consistent with the fundamental principles of co-operation, *viz.*, self-help, thrift, mutual help, and mutual supervision.

As already seen, the co-operative movement in India is not a popular movement which has sprung up from the people. It was introduced by the Government mainly to provide the farmers with cheap credit and to wipe out their prior debts, and the co-operative movement is still under tight leading strings. This is shown by the vast powers entrusted to the Registrars of Co-operative Societies, who are responsible not merely for the registration of the societies, but also for their audit and inspection. The Registrar can order an enquiry into the working of societies and after such an enquiry can dissolve those which are not likely to work well. When a Society is dissolved, the Registrar has to arrange for its liquidation. Again, the Madras Co-operative Societies Act of 1932 empowers the Registrar to supersede the managing committee and to appoint a nominee of his own to manage the affairs of a society, if in his opinion it is mismanaged. The co-operative movement is thus controlled and guided by the Government in Inda: and, during recent years, especially as a result of the world economic depression there has been a pronounced tendency to increase the powers of the Registrar, and bring the movement more and more under the control of the Co-operative Department. Such government control and supervision have been necessitated by the illiteracy and ignorance of the large mass of the people.

The Government in India have helped the co-operative movement in a variety of ways. Firstly, they have given co-operative societies a number of general concessions. Thus, co-operative societies have been exempted from taxes such as income-tax, stamp duty, and registration fees. The share capital of a member of a co-operative society cannot be seized by a court of law for payment of debts. Co-operative societies have been helped in the recovery of their loans by being given a 'prior claim' in certain cases over the other creditors. Again, when a co-operative society or bank

3 Talmaki: Co-operation in India and Abroad, p. 459.

wants to transmit funds to another for a *bona-fide* co-operative purpose, it can have the funds transmitted free through the agency of the Government. Secondly, occasionally they give direct money grants or loans to particular co-operative societies, such as house-building societies and societies in backward areas. Originally the Government used to advance loans to every society equal to the amount of capital raised by it up to a maximum of Rs. 2,000, but with the rise of central financing agencies, this practice has been discontinued. Thirdly, the Provincial Governments have come forward to help central land mortgage banks by guaranteeing the interest on and the principal of the debentures issued by them. In Madras, the Government have helped the land mortgage banks by the grant of subsidies to meet initial expenses; by the cancellation, or the reduction, of registration fees and fees for the issue of encumbrance certificate; by the free supply of village maps and settlement registers: by bearing the cost of maintaining a staff of co-operative Sub-Registrars to supervise the land mortgage banks; by allowing the local bodies, municipalities and the district, central and the provincial co-operative banks to invest a part of their funds in the twenty year debentures of the Co-operative Central Land Mortgage Bank, and by declaring the debentures of the Co-operative Central Land Mortgage Bank trustee securities.[4] Fourthly, the Governments give subsidies to operative federations or unions formed by the societies themselves for the purposes of auditing primary societies, of supervising those in backward areas, and of training probationers. Fifthly, the provincial Governments have also been trying to promote the co-operative sale of produce by helping co-operative marketing societies in a number of ways. For instance, in Madras, the Government have sanctioned the employment at their cost of a number of marketing inspectors for the management of the more important loan and sale societies. To others they have given initial subsidies for the employment of the necessary staff. They have also been helping the sale societies to construct their own godowns for the storage of agricultural produce by granting (from the subvention for rural uplift given to the Provincial Government by the Government of India), 25% of the estimated cost of construction as a free gift, and advancing the balance as a loan at $3\frac{1}{2}\%$ repayable in 30 years.

The state has, thus, played a very important part in the development of the co-operative movement in India. But, as already seen, the real danger in state assistance to the co-operative movement is that it is likely to degenerate into state paternalism, stifling the main objective of co-operation, *viz.*, the promotion of self-help. Reference has already been made to the wide powers enjoyed by the Registrars of Co-operative Societies in the various provinces, and the special circumstances in India

4 See Chapter X, § 4.

which have necessitated Government control. The need for a certain amount of de-officialisation in the Indian co-operative movement has already been discussed in § I of this chapter. It is further examined in Chapter XII § I.

§ **Non-credit agricultural co-operation in India:** Credit is only one of the many needs of the farmer. If it is necessary to rescue the farmer from the exploitation of the money-lender by the provision of cheap credit, it is equally necessary to save him from the exploitation of middlemen. His income must be raised by the promotion of better methods of cultivation, by the introduction of the co-operative purchase of agricultural and domestic supplies, and by the adoption of co-operative marketing. For instance, farmers in a given area can combine to buy collectively their domestic requirements, and the seed and the fertilisers they require for their agricultural operations. They can, thus, not only appropriate to themselves the profits that at present go to the middlemen, but also secure goods of reliable quality at a lower price. In the same way, by joining together in co-operative marketing societies for the joint sale of their produce, the farmers can increase their bargaining power, control the flow of goods to the market in such a way as to avoid a glut at any particular time, eliminate waste in distribution and secure for themselves a larger proportion of the price paid by the consumer. Equally important is the part that co-operation can play in enabling small peasant proprietors to raise a bigger and a better crop, by facilitating the adoption of improvements. Co-operative societies can be organized, to own and let out on hire to their members agricultural implement which they are too poor to purchase individually, to consolidate holdings, to encourge joint cultivation of extremely small holdings, to promote cottage industries which will provide some subsidiary employment to the ryots during the off-season, and to eliminate wasteful social customs and promote a better living. Thus co-operation can and should be extended to cover the whole of the farmer's life, if it is to be really effective in bringing about a regeneration of agriculture. As the Royal Commission on Agriculture in India have put it so well, "The modern conception of the co-operative movement differs markedly from that held at the close of the last century; the term 'agricultural organization', or better still, 'rural reconstruction' expresses more accurately the nature of the activities included within the movement. It is now accepted that co-operative principles can be used in overcoming most of the obstacles to progress in rural communities. Wherever agriculture is the predominant industry, co-operation is coming to be regarded as the natural basis of economic, social, and educational development."

One of the weak spots in the Indian agricultural co-operative movement is the extremely slow and inadequate development of non-credit co-operation. The large volume of rural indebtedness has served to hide the other issues involved in the agricultural problem, and till very recently the starting of village credit societies to provide the farmer with cheap credit was almost the sole aim of the co-operative movement, an obsession with the Co-operative Departments and the non-official co-operators. But experience in India has shown that the root cause of the farmers' trouble is not the rates of interest charged by the money-lenders, but the insufficiency of the agricultural income, and that the village credit societies are not likely to work well untill there is a substantial increase in the income of the agriculturists. No amount of cheap credit is likely to help the farmer, so long as his holding continues to be small and fragmented, his methods and implements continue to be primitive and inefficient and he is compelled by circumstances to sell his produce at unfavourable prices in a falling market and to buy his requisites at exorbitant prices. Cheap credit, again, can hardly be useful in the absence of an organized attempt at educating the ryots, eliminating unneccessary and wasteful expenditure on ceremonial occasions, and promoting 'better living.' It is, therefore, not surprising that the history of the village co-operative societies in India has in many cases been a history of over due loans. In the absence of a co-ordinated attempt to increase agricultural income by the promotion of better farming and by the development of co-operative purchasing and marketing, the village credit societies have failed as they were bound to fail. Thus, one of the main lessons of the history of co-operation in India is that credit co-operation can succeed only when it is combined with the extension of co-operation to all the other spheres of the farmer's life and the consequent rise in the income of the farmer.

But in any attempt to examine the progress in India of co-operation in spheres other than credit, one has at the very outset to face a very important difficulty, *viz.*, the paucity and the inadequacy of the available statistical data. The system followed with regard to the classification of co-operative societies in the various provinces and states is unscientific, and sometimes confusing; nor is it sufficiently detailed as to throw any valuable light on the working of main types of non-credit co operation, *viz.*, co-operation in the sphere of agricultural supply, co-operation in the spheres of consumption, pro- duction and of marketing. In the provincial as well as the all-India statements, all primary societies are classified under the heads of (*a*) credit, (*b*) purchase and purchase and sale, (*c*) production, (*d*) production and sale, (*e*) insurance, and (*f*) others. But the same type of society is often classified in different provinces and states in different ways. Thus, cotton sale societies are classified as agricultural societies in Bombay, but as non-agricultural societies in H. E. H. Nizam's dominions. Consolidation of holdings societies are classified under 'societies for production and sale' in the Punjab, and under 'others' in the United Provinces. Again, consumers' co-operative societies and societies of producers for the joint sale of produce are both classed as 'purchase and purchase and sale societies', though their functions are contradictory; the one aims at buying goods at the cheapest possible price for the consumer, and the other at securing for its members the highest possible price for their products. There is also some over-lapping of functions between the different types. For instance, the loan and sale societies of Madras which advance money to members on the security of their produce and arrange for the sale of their produce, and the cotton sale societies of Bombay are obviously marketing societies. But in the Statistical Statements, the former are grouped under 'purchase and purchase and sale', while the latter are classified under 'production and sale', as they also undertake the ginning of members' cotton. Thus, it is not easy to get a correct idea of the progress and the extent of non-credit co-operation in agriculture from the available statistics in India.

During recent years, however, there has been some progress in non-credit co-operation in almost all the Indian provinces. Co-operative marketing of agricultural produce has attracted increasing attention and some progress has been made in this direction, mainly in the United Provinces, Bombay, Madras and the Punjab. Co-operative societies for the consolidation of holding have achieved striking success in the Punjab and are gradually spreading to the other provinces. The problem of the supply of milk to big towns is being tackled by co-operative milk supply unions; and co-operative societies have been organized for irrigation, cattle insurance, improved sanitation, the develpment of cottage industries, the supply of agricultural and domestic requisites, the promotion of better living, etc. Thus, in Madras in 1938–39, in addition to the societies for the co-operative marketing of produce, for the supply of milk, for the promotion of cottage industries and for the consolidation of holdings, there existed "kudimaramat and irrigation societies, for undertaking kudimaramat work such as removal of silt, and the maintenance of irrigation channels; agricultural improvement and demonstration societies for distribution of improved varieties of seed, manure, for attempts in seed-multiplication, for demonstration of improved methods of cultivation and for conveying to the ryot expert counsel and advice; cattle-breeding societies for maintenance of stud bulls to produce a better breed of cattle and to provide veterinary aid; better living societies for reforming bad social customs and preventing waste of money on festivals, marriages and funerals and inculcating habits of thrift";[5] and two 'mahali' prevention societies in South Kanara for the eradication of the mahali pest in the areas under arecanut cultiva-

5. *The Committee on Co-operation in Madras:* Report, par. 47.

Table No. XIX

NON-CREDIT AGRICULTURAL SOCIETIES IN INDIA. 1940-41.

Province.	Purchase and Purchase and Sale.	Production.	Production and Sale	Other forms of Co-operation
Madras ...	(a) 205	...	(a) 114	(a) 132
			(b) 139	(b) 294
Bombay ...	(a) 62	(a) 3	(a) 97	(a) 175
	(b) 1	(b) 15	(b) 4	(b) 17
Sind° ...	(a) 3	...	(a) 15	(a) 6
Bengal ...	(a) 78	(a) 1,070	(a) 375	(a) 70
			(b) 309	(b) 3
Bihar ...	(a) 33	...	(a) 1,387	(a) 1
			(b) 1	
Orissa ...	(a) 11	...	(a) 6	...
United Provinces ...	(a) 21	...	(a) 1,601	(a) 6,233
				(b) 5

Punjab ...	(a)	16	(a)	662	(a)	2,185	(a)	227
Central Provinces and Berar	(a)	59	(a)	19	(a)	4	...	
	(b)	1						
Assam ...	(a)	1	...		(a)	3	...	
	(b)	13						
North-West Frontier Province ...	...		(a)	9	(a)	79	...	
Ajmer-Merwara ...	...		(a)	3	...		(a)	30
Delhi ...	...		(a)	9	(a)	31	...	
Total (British India)	(a)	489	(a)	1,775	(a)	5,897	(a)	6,864
	(b)	15	(b)	15	(b)	315	(b)	320
Indian States ...	(a)	29	(a)	258	(a)	263	(a)	68
	(b)	14	(b)	3,250	(b)	18	(b)	49
Grand Total	(a)	518	(a)	2,033	(a)	6,160	(a)	6,932
	(b)	29	(b)	3,265	(b)	333	(b)	369

(a) Limited liability. (b) Unlimited liability.

tion. The progress made in non-credit agricultural co-operation in the different provinces in India can be seen from Table XIX.

Agricultural Supply :—Co-operative societies for the supply of agricultural requirements, such as seed, manure, and feeding stuffs for livestock, have played a very important part in almost all the countries of Western Europe. Unlike credit co-operation with its idealitsic appeal and emphasis on thrift and morality, and co-operative marketing with its striking success in Denmark and the United States of America, co-operation in the supply of agricultural requirements has "made no particular appeal either to the conscience or to the eye",[6] and has therefore attracted less attention. But it has contributed no less to the prosperity of the peasant farmers of countries such as Denmark and Germany, by enabling them to adopt really intensive methods of cultivation and to secure some of the marketing economies enjoyed by large-scale farmers. In Germany, as has already been seen in Chapter VII § 2, the Raiffeisen societies undertake the supply of the agricultural requirements of their members. In England, co-operative supply is the best developed side of agricultural co-operation. In 1938, there were about 100 societies for the supply of feeding stuffs, fertilisers, seeds, machinery and miscellaneous farm requirements to their members, and their turnover amounted to nearly £ 10,000,000. Co-operative societies for the supply of agricultural requisites have been organized in a number of other countries such as Denmark, Ireland, France, the United States, and Switzerland. In Japan in the thirties nearly 80% of the 15,000 agricultural societies supplied seeds, fertilisers, implements, etc., to their members. In most countries the local supply societies have in their turn combined into higher federations for purchasing wholesale. Societies for the co-operative supply of agricultural requisites have been able to derive the economies consequent on bulk purchase. With their greater expert knowledge they have been able to ensure quality; experience in marketing, and their greater bargaining power, have enabled them to buy at the opportune time at favourable prices. They have, therefore, enabled their members to obtain supplies of a better quality at cheaper prices, and played a very important part in popularising the use of better seeds, manures and implements.

But co-operation in this sphere has made very little progress in India. A few societies were organized specially for the supply of agricultural requisites in Madras, even before the economic depression of 1929. But almost invariably they failed, and the history of co-operation in the field of agricultural supply has hardly been more creditable in the other provinces. As Mr. K. C. Ramakrishnan has put it, "The rate of infant mortality was phenomenal

6 *Miss Digby*: The Indian Co-operative Review, Vol. IV, 1938, p. 331.

among the agricultural societies organized for supply in spite of their low birth rate."[7] The rural credit societies also have been authorised by their bye-laws, to undertake the joint purchase of the agricultural and domestic requirements of their members, to purchase and let out on hire agricultural machinery and implements, and to promote the spread of agricultural improvements. But they have hardly attempted to discharge these functions. For instance, in Madras in 1938–39 all the 10,963 agricultural credit societies taken together had bought on behalf of their members agricultural and other requirements to the value of only Rs. 6,681.

But, at present, in all the provinces, agricultural supply is being increasingly undertaken by the 'purchase and sale' societies. Societies primarily organized for the marketing of agricultural produce have also undertaken the supply of agricultural requisites, such as seeds, as one of their functions. Thus, the cotton sale societies of Bombay have done pioneer work in the spread of better varieties by undertaking the supply and multiplication of seed, and the loan and sale societies of Madras attempted to supply to their members better seeds and implements. But it is impossible to estimate accurately the part played by these societies in the supply of agricultural requisites, as in the statistical abstracts published by Government both co-operative supply and marketing are clubbed together under the heading purchase and sale societies. It is, therefore, difficult to find out how many were doing purchase alone, how many sale alone, and how many both.[8] Special societies such as the agricultural improvement societies in Madras, the agricultural requisites societies, machinery and implements societies, and the taluk development associations in Bombay, the agricultural associations of the Central Provinces and rural reconstruction societies of Bengal, have all attempted agricultural supply.

But the progress hitherto has been extremely slow: This is brought out vividly by a comparison with Japan. Agricultural societies of all types in India sold to other members goods worth only Rs. 200 lakhs in 1940–41 ; in Japan, where the cultivated area amounts to only 18 million acres, the agricultural societies supply requisites such as fertilisers, agricultural implements, seeds, eggs of silk worm etc., valued at nearly Rs. 5 crores per annum.

A number of reasons account for this tardy progress of co-operation in the sphere of agricultural supply. The majority of small farmers in India use local seeds, manures, and implements. Unlike in England or in Denmark, there has been little demand hitherto in the Indian villages for considerable quantities of feed-

7 *Mr. K. C. Ramakrishnan*: ibid., p. 342.
8 ibid.

ing stuffs and chemical manures, and the urge to organize the supply of agricultural requisites on co-operative lines to prevent adulteration and to ensure cheap supplies has, therefore, been lacking. Under the Indian conditions there is little likelihood of a society organized only for the purpose of agricultural supply succeeding, as it is likely to have very little work and is likely to 'hibernate' between one season and the beginning of the next. It seems, therefore, best to tag on agricultural supply to some other object. This has been tried in India; for, as seen above, societies organized for the sale of agricultural produce also undertake the supply of agricultural requisites such as seed to their members. But to combine co-operative supply with co-operative marketing seems extremely unscientific and risky. For, as experience in Europe has shown, while the purchase of requirements on a co-operative basis can be easily successful, the co-operative marketing of produce is relatively more difficult to organize and is likely to be successful only when the society possesses expert knowledge, skilled management, completely loyal members, and a large volume of business.

The best solution, therefore, seems to be to make the village credit societies undertake the supply of agricultural requisites. As seen above, even at present, the village credit societies have been authorised by their bye-laws to undertake agricultural supply but they have done very little supply business hitherto. This is because the majority of their members are small farmers, among whom there is little effective demand for such things as fertilisers and costly implements. During recent years, the use of better seeds, of chemical manures, of oil-cakes, and of improved implements, such as iron ploughs, seed drills and bullock-hoes, has been spreading, especially in the wet areas; but the more solvent farmers who buy these things have kept away from the village credit societies, as these societies have been organized on the basis of unlimited liability. The correct line of advance is, therefore, to reorganize the village credit society on a limited liability basis, to bring within its abmit all the landowners in the village, and to make it an agency for the supply of better seed, better manure, and improved implements at reasonable prices. The reorganized village credit society should not content itself merely with the supply of these requirements, but should play a leading part in the campaign for intensive cultivation and should become a propagandist agency for the spread of improvements among the smaller ryots.[9]

Consumers' co-operation in rural areas:—Consumers' co-operation, with a few exceptions, has made little headway in India, and in the rural areas it is almost unknown. The reasons are not far

9 See Chapter VIII and Chapter XIX, § 7.

to seek. The villages in India are relatively more self-sufficient than the villages in the West; the standard of living of the people in the rural areas is extremely low and the few things that the villagers need, such as clothes, kerosene oil, matches and spices are bought in the local shandies. Again, consumers' co-operation can be successful only when it is confined to persons with a settled periodical income, and the income from agriculture is extremely irregular. It is also difficult to ensure that societies in the rural areas are efficiently managed and supervised.

The outbreak of the war, with the consequent tendency on the part of retail shop-keepers to raise prices and to exploit the public, has given an impetus to the consumers' co-operative movement. A number of co-operative stores have been organized in different part of the Madras Presidency to supply articles to their members at reasonable prices. The following figures reveal clearly the rapid war-time development of the consumer's co-operative movement in the province of Madras [10]

Year	No. of Primary Stores	No. of Members.	Paid-up Share capital (Lakhs of Rs.)	Amount of Sales (Lakhs of Rs.)
1939–40	237	34,400	3·20	36
1940–41	354	54,800	4·91	58
1941–42	432	71;700	6·64	96
1942–43	956	179,303	19·29	270
1–7–43 to 31–12–43	1,131	268,305	31·71	316

With the rapid increase in the number of primary stores, co-operative wholesale stores have been organized to purchase in bulk the articles required by the primary stores in a given area, either directly from the producers, or wherever possible through the co-operative sale societies. Between 1939–40 and 31–12–43 the number of co-operative wholesale stores in the Province rose from 2 to 21, their paid-up share capital from Rs. 0·19 lakhs to Rs. 11·81 lakhs. The sales by co-operative wholesale stores rose from Rs. 7·72 lakhs in 1939-40 to Rs. 180 lakhs for the first six months of 1943–44,

10. Madras Journal of Co-operation, March, 1944.

Whether this rapid spread of the movement will survive the war to which it owes its origin is doubtful. The difficulties which societies organized specially for the supply of domestic requirements in rural areas are likely to encounter have already been discussed above. Here again, the best line of advance seems to be that recommended by the Committee on Co-operation in Madras (1940), to make the village credit societies undertake the supply of the domestic requirements of their members on an indent system. The village credit society can pool the orders of its members for articles such as clothes, purchase them in bulk, and thus effect economies; if necessary, a central wholesale store to purchase the goods needed by the primary societies can be organized for each district, as in the case of the Raiffeisen societies in Germany.

Co-operative societies for processing and sale:—Small scale farmers always need a subsidiary industry to supplement their income from agriculture, and in the development of such industries co-operation can play a very important part. In almost all foreign countries agricultural co-operation has been most successful in the case of societies for production and sale. In Denmark and Ireland it is the co-operative dairy or creamery which gave a new lease of life to the peasant farmer. Here again, no systematic attempt was made in India till very recently to organize production on co-operative lines. Co-operative milk supply unions for the sale of milk are gradually coming into prominence in almost all big cities of India and co-operative societies for encouraging cottage industries by supplying the raw materials they need and arranging for the marketing of their products are being started in almost all the provinces.

In Madras separate societies have been organized to help fruit growers, to encourage the manufacture and sale of sugar in the important sugarcane growing areas, and to encourage the production of ghee, palmyra jaggery, hand-pounded rice, eggs, and honey.

The main object of the fruit growers' societies is to arrange for the marketing of the fruit produced by their members and to advance loans to members for cultivation expenses. The most important of these are the Kodur Fruit Growers' Society in the Cuddapah district which deals mainly in Sathukudi oranges, mangoes, limes and sapotas, the Michaelpalayam Fruit Growers' Society which deals in grapes, the Kadayam Limes Marketing Society and the South Kanara Fruits Growers' Society.

Societies for encouraging the cultivation of sugarcane and for the co-operative manufacture and sale of sugar have been organized in Madras in the important sugarcane growing areas. The Government of India have helped these organizations with a subsidy offered from the proceeds of the excise duty levied on sugar, and the Madras Government have sanctioned a special staff to help in their formation and working. The most important of these is the Vuyyur Industrial Society, which during 1938-39 crushed 46,857 tons of sugarcane and manufactured 3,628 tons of sugar at a coast of Rs. 10·57 lakhs,[11] and its working has shown that farmers can successfully combine for the co-operative manufacture and sale of sugar. In the areas suitable for the cultivation of sugarcane there is a strong case for the organization of small jaggery-making societies with power crushers and improved furnaces.[12] This will encourage the small farmers to grow a more paying crop by providing for the sugarcane a ready market, and at the same time expanding the market for jaggery by reducing its costs and price. A few societies for the manufacture of palmyra jaggery have also been started during recent years in the districts of Salem and North Arcot to provide work to the toddy tappers who had been suddenly thrown out of employment by the introduction of prohibition.

Another significant and promising line of advance is the organisation of societies for the production and sale of hand-pounded rice. Research into the nutritive value of the different types of Indian food-stuffs has served to bring out the greater vitamin content of hand-pounded rice. The demand for hand-pounded rice has been steadily increasing and societies for the production and sale of hand-pounded rice are being organized. Ths existing loan and sale societies also are being encouraged to take up this line of business, and the Madras Provincial Marketing Society has undertaken the sale of the hand-pounded rice sent to it by its member societies. Not only the hand-pounding of rice but the processing of other crops also, such as cotton, groundnuts, and the other oilseeds can be organized on co-operative lines.

The production and sale of dairy products such as milk and ghee is one of the ideal subsidiary industries which the ryot can engage in. Farmers near the big urban markets can concentrate on the production and sale of milk, while those in places far away from towns can develop the production and sale of ghee. In almost all the big cities of India, especially in Madras, Bengal and the United Provinces, the milk supply is being gradually organized on co-operative lines. The usual organization is a milk supply union with its headquarters in the city, to which are affiliated a number of milk supply societies in the neighbouring villages with members who maintain milch cattle for the production of milk, often as a side-line to agriculture. But little progress had been made hitherto in the co-operative manufacture and sale of ghee except in the United Provinces. In Madras Province a number of milk supply societies were started in 1926-27 in the villages round about Madras to enable their members to purchase and maintain good milch

11. *The Committee on Co-operation in Madras, Report, par. 46.*

12. *Mr. K. C. Ramakrishnan:* Economic Factors in Agricultural Development—Journal of the Madras University, January 1941.

cattle, to arrange for the sale of their milk to the best advantage, and to supply pure milk produced under good sanitary conditions at reasonable prices to the residents of Madras. These combined in 1927-28 into the Madras Co-operative Milk Supply Union. The main objects of this Union are:—

"(1) to purchase and dispose of to the best advantage, the milk and milk products of its members or of the members of the affiliated societies;

(2) to purchase at wholesale rates and to distribute to its members cattle food and such other commodities as they require;

(3) to establish model dairy farms and modern dairy plant for pasteurizing milk and producing butter; and

(4) to own or to hold on lease or otherwise, pasture lands, and undertake the maintenance of dry animals of the members of affiliated societies and on those lands, charging reasonable fees for the maintenance of each animal."

The milk supply unions have on the whole worked well, and those in some of the bigger Indian cities have established plants for the pasteurisation of milk. But such unions and milk supply societies must take up in the future a more vigorous programme of improvement of the breeds of cattle and of fodder supply. Again, as pointed out by Dr. N. C. Wright in his Report on the Cattle and Dairy Industries of India, it is extremely doubtful whether western methods of handling and distributing milk are suited to the conditions prevailing in India; the milk supply unions here will have to evolve a technique suitable for tropical and sub-tropical conditions. The milk supply unions will also have to be protected more effectively in the future, from the competition of the unscrupulous local 'gowalas' and private distributors of milk, by legislation to check adulteration.

Next to liquid milk, ghee is the most important dairy product in India. Societies merely to collect and sell ghee produced at home by members such as those organized in the United Provinces are not likely to be successful as "it is doubtful whether with the best precautions of the societies and even good intentions of members, genuine ghee can be collected and marketed."[13] The production of ghee therefore, will have to be centralised and will have to be undertaken by co-operative societies organized for the purpose. To popularise ghee production as a subsidiary industry to agriculture, co-operative societies for the production and sale of ghee have been started in Madras at Rasipuram, Periannaickenpalayam and Avanasi. The society at Rasipuram collects the butter from its members, melts it, and arranges for the sale of the ghee through the Provincial Marketing Society in Madras. During 1940-41, it sold ghee worth Rs. 22,796. There is a wide market for

13. Ibid.

ghee in India, and societies for the manufacture of ghee which are well managed have a very bright future.

Co-operative insurance:—The principles of co-operation can also be applied to the insurance of cattle and of crops (*i.e*,. insuring the ryots against damage or loss in yields due to unavoidable causes such as drought, flood, plant diseases, etc.). A few societies for the insurance of cattle were started in Madras between 1925 and 1927 but almost all of them have had to be liquidated. Even in Burma where cattle insurance had been organized on a large scale, only six societies out of a total of 219 were working in 1938-39. The reasons are not far to seek. Cattle insurance is one of the most difficult forms of co-operative effort, and it is almost impossible to attempt it successfully in a country like India, where statistics relating to cattle mortality are either not available or are extremely meagre. Other difficulties in the way are the impossibility of ensuring that the ryots keeps the animals well-fed and in good condition, and the absence of an adequate organization for the control and prevention of infectious diseases and the provision of timely and adequate veterinary aid. Crop insurance has not been wholly successful even in advanced countries such as the United States of America, and in India, with her frequent floods and droughts and the vagaries of the monsoon, it is likely to be even more difficult. Co-operative societies for the insurance of crops and cattle have, therefore, little chance of succeeding in India as conditions are at present.

Better-living societies:—Even more important than the material benefits conferred by co-operation on the small peasants, is the moral tone which it gives to agricultural life, with its insistence on self-help, mutual aid, and the elimination of unproductive expenditure. One of the main reasons why co-operation in India has so grievously fallen short of the expectations of its promoters is the fact that it has done little to remove the illiteracy, superstition, the insanitary conditions of living, and the extravagant expenditure on ceremonial occasions so common in our villages'. Experience in India has shown, as pointed out by Dr. C. R. Fay, that a better living should precede and not succeed better farming and better business. The real aim of agricultural co-operation is rural reconstruction, the achievement of a better living, and a change in the mentality of the farmers; societies organized for special purposes such as the provision of cheap credit, or cheap supplies, have achieved only partial success as they have relegated this main objective of agricultural co-operation to the background. The Punjab has taken the lead in the organization of better living societies of which there are nearly 300 in that province at present. The object of these societies is to prevent extravagant expenditure by members on cermonial occasions, such as marriage, to combat drinking and gambling, and to improve the health and the sanitation of the villages. "Some of these societies have levelled and paved and swept the village roads, some have promoted sanitation, some have induced the villagers to improve the ventilation in their houses, some have repaired and roofed the village drinking well, some have arranged that all manure shall be pitted, some have discouraged expenditure on jewellery, and some have stopped waste on farms."[14] Better living societies have thus played a very important part in the improvement of village life in general. The Punjab has also taken the lead in the organization of arbitration societies, the members of which pledge themselves to submit their disputes to local arbitration instead of going to courts. An attempt is thus made to discourage litigation and to provide for the dispensation of justice cheaply and promptly. The other provinces should follow as quickly as possible the lead given by the Punjab. A separate society for the promotion of better living is not always necessary; the functions of the existing village credit societies should be expanded to include the promotion of better living. They will thus not only help in a programme of rural reconstruction and village uplift, but will also strengthen the economic position of their members.

Single versus *multi-purpose societies* :—Before concluding this discussion on the progress of the non-credit co-operative movement in India, it is necessary briefly to refer to the controversy which has raged round the question of single *vs.* multi-purpose societies. The need for broadening the sphere of co-operation and for the organization of societies for purposes other than credit, such as supply and marketing, is universally admitted. But is this ideal to be achieved by the organization of one society for each purpose, or by the organization of multi-purpose societies which will discharge a number of functions?

Till recently Denmark was held out as the example which India ought to follow and a separate society was advocated for each purpose. The bye-laws of the village credit societies provided for the discharge by them of a number of functions, but they concentrated merely on the provision of credit. But experience has shown that India would do well to follow the example of countries such as Japan, where the same society combines the provision of credit with supply and sale. For one thing, the farmer in India has been accustomed to deal with the same person, *viz.*, the local merchant-cum-money-lender, for all his needs, such as 'credit, seeds, manure and the sale of his produce and dislikes having to deal with a number of agencies. For another, there are not enough educated persons in a village to undertake the management of a number of societies; even if this difficulty could be overcome, 'the one purpose one society principle' demands from its members "a capacity to serve willingly and efficiently on innumerable

14. The Indian Year Book, 1941-42 : p. 434.

committees which is apparently a Danish and an English and not a universal character", and the majority of the ryots in India will regard this as a nuisance. Again, the credit society will be able more easily to achieve its objective of controlled credit if it also undertakes the supply of the agricultural and domestic requirements of its members and arranges for the sale of their produce. This will enable the society to prevent the misapplication of the loan and to ensure its prompt repayment. The 'one village one society' principle is therefore, preferable in India to the 'one purpose one society' principle.[15] The Agricultural Credit Department of the Reserve Bank of India and the recent Committee on Co-operation in Madras have warmly advocated the re-organization of the present village credit societies into multi-purpose societies, which would include every eligible person in the village, and bring within their ambit the whole life of their members. Such multi-purpose societies will be better able to secure and maintain the loyalty and the continuous interest of their members, to secure economical and efficient management with the help of paid employees, and to bring about an increase in the incomes of their members.

The danger in converting the village credit societies into multi-purpose societies is that they have at present an unlimited liability, and it would add to their already heavy financial responsibility, to make them undertake a number of functions. But, as seen in Chapter VIII, the principle of unlimited liability has outlived its utility, and the time has now come when the village societies should be reorganized on a basis of limited liability. When the village societies have been reorganized in this way the first obstacle to their conversion into multi-purpose societies is the difficulty of some forms of co-operation. Thus co-operative marketing requires expert knowledge and management, and will have to be undertaken by societies specially organized for the purpose. The village credit societies can, however, undertake the joint purchase of the agricultural and domestic requirements of their members on an indent basis; the promotion of intensive cultivation and of cottage industries, the elimination of wasteful expenditure and the promotion of better living. They should arrange for the sale of produce of their members through the co-operative marketing society working in the area. In such a simultaneous expansion of the activities of the village credit societies, and a rapid development of co-operative marketing lies the future of the Indian co-operative movement and of Indian agriculture.[16]

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15 When the village is too small, the area of operations of a society may, of course, be made to extend over a group of neighbouring villages as has been suggested in Chapter VIII.

16 Co-operative societies for the consolidation of holdings and co-operative marketing in India are discussed below in Chapter XVIII and XXIV respectively.

CHAPTER XII

AN ESTIMATE OF THE INDIAN CO-OPERATIVE MOVEMENT

§ 1. The Agricultural Co-operative Movement in India: *Its achievements and short-comings* :—Almost forty years have passed since the co-operative movement was inaugurated in India, and there has been a steady increase in the number of societies, their membership, and their total working capital. The structure of the co-operative organization has also been progressively perfected with higher agencies for finance, supervision, administration, and propaganda. But have the foundations been truly laid ? Has co-operation in India as in Denmark and in Ireland, galvanised the illiterate and indolent peasant into activity and led to a social and economic regeneration of the peasantry ?

Started mainly with the object of freeing the farmers from the clutches of the money-lenders, co-operation in India has not been able to achieve completely even this limited objective. In all the provinces the money-lender still continues to be the main source of credit. "So far as we can see" wrote the Assam Banking Enquiry Committee "the exploitation of cultivators by village mahajans ....and others is on the increase;" and the Bengal Banking Enquiry Committee found the money-lenders "still flourishing as well as ever in every part of Bengal." The co-operative societies have provided less than even 10% of the credit needs of agriculture in almost all the provinces, and even the members of societies have often had to borrow from outside sources.

Beneficial results:—But the co-operative movement has had some beneficial results. Its competition has brought about a general reduction in the rates of interest charged to farmers. Co-operative societies have thus benefited not only their members, but also non-members who borrow from the money-lenders and, as pointed out by Sir M. L. Darling, "even where the money-lender's financial hold is unshaken, his psychological influence is weakening."[1] According to Sir Edward Maclagan, the members save Rs. 10 lakhs by way of interest on every one crore of rupees lent by the primary credit societies and the total saving effected to the farmers in this way has been calculated at 3 crores of rupees.[2]

The successful working of the higher financing agencies like the district central banks and the apex is certainly a feather in the cap of the Indian co-operative movement. They have served to spread the banking habit both in the urban and rural areas and to fight the evil of hoarding.

1 *Sir M. L. Darling*: Rusticus Loquitur.

3 *E. M. Hough*: The Co-operative Movement in India, p. 245

Again co-operative societies have in many cases helped the Agricultural Departments to popularise agricultural improvements. The co-operative society exercises an educative influence and its members, are as a rule, more willing to try out the improved methods suggested by the Department than the non-members in the village. Much more can be done, as we shall see later, by using the village co-operative society as a link between the Government expert department and the farmer in the village.

Co-operative societies have in some cases attempted successfully to deal with the problems of rural sanitation and the provision of medical facilities in rural areas. Thus, Sir M. L. Darling refers to societies in the Punjab which insist on manure being pitted, on their members not keeping their cattle in their houses and to societies encouraging vaccination. Some societies make contribution for various charitable and public purposes. Thus, the Naogaon Ganja Cultivators' Co-operative Society in Bengal maintains three charitable dispensaries, and makes creditable contributions to the maintenance of local roads and bridges.

The provision of a valuable training in business methods is another benefit conferred by the co-operative societies. In societies which work well members take an interest in the working of the society, keep track of the way in which members are employing funds, and pass the accounts presented by the panchayat. Thus members get a training in the use of money and in its control; the members of the board of management get training in the keeping of accounts. The primary societies can, therefore, be regarded as a "network of elementary schools in rural finance."[3] They give the Indian farmer, who is a very poor business man, a good training in business methods.

Co-operative societies, wherever they work, create in the members a desire for education. This proves that co-operative societies are the best agencies for the spread of adult education, though in many cases the initial enthusiasm turns later into tepid indifference.

Societies where they have worked well have improved the morale of their members. Co-operation, as already seen, emphasises thrift, self-help, and the productive use of credit. Very little has been achieved by way of encouraging thrift in India, *pace* the Bengal Banking Enquiry Committee; but the co-operative society gives at least a chance to the honest and provident farmer to make good. Again, a member of a co-operative society cannot afford to be flagrantly extravagant. There is a premium on reduction of unproductive expenditure; on the avoidance of litigation, and on temperance. The co-operative movement in India has therefore, exerted a pull, weak though it may be, towards a better living.

3 Sir M. L. Darling: The Punjab Peasant in Prosperity and Debt, p. 250.

But the fact remains that in India co-operation has not been the great moral force that it has been in Germany or in Ireland—a force which has revolutionised the lives of their exploited and ignorant peasantry and paved the way for their material prosperity. The village credit societies—the foundation stones of the co-operative movement in India—are in a state of suspended animation: most loans given by them have been overdue for years, and the problem of rural indebtedness and the poverty and illiteracy of the ryots are today as acute as they were when the co-operative movement was started. What is the reason?

Defects:—The main reason is to be found in the fact that the co-operative movement in India has been started and built up by the Government; it is not based on the organized will of the people to help themselves. The urge for co-operation has come from the top and not from the people themselves. While in such countries as Germany and Ireland, co-operative societies were organized by co-operative enthusiasts like Raiffeisen and Sir Horace Plunkett, who created in the people a desire to secure the benefits of co-operation, in India the movement was started by Government as a cure for the problem of rural indebtedness, and the organization of co-operative societies was entrusted to official Registrars. The registration of a society, the supervision of its working, and its subsequent winding up, if it does not work well, are all statutory functions of the Registrar, and he has been rightly termed "the Brahma, Vishnu, and Siva of a co-operative society" in India. A co-operative society can work well only when its members realise the need for self-help and co-operation, and when the internal urge for co-operation is lacking as in India, mismanagement is the inevitable result. In the village credit society, the members are usually sleeping partners and their interest in the society ceases when they have secured the loan. As Sir Horace Plunkett has put it so well, co-operation in India is not "so much a movement as a governmental policy." Co-operation if it is to be real must spring from the people and should insist on self-help. This is one of the vital defects of the co-operative movement in India, and accounts for most of the other bad features.

The second main defect of the Indian co-operative movement is the appalling ignorance of the members of co-operative societies regarding the very fundamentals of co-operation. In a country like India where the majority of the cultivators are illiterate, and disinterested non-official workers with a missionary spirit are not forthcoming in sufficient numbers, the initiative for the starting of co-operative societies had rightly to come from the Government. But the starting of co-operative societies should have been preceeded by a period of intensive education and propaganda among the would-be members, with the objective of creating amidst them a desire to improve their economic condition through self-help. In other words, the Co-operative Department should have concentrated on creating in the people a desire for self-help and economic regeneration through co-operation. But there was a tendency to measure the success of the Co-operative Department by the number of societies it started, and there was almost a rivalry in this respect between the different provinces. The result was a rapid expansion of the movement, and in the majority of cases neither the members of the co-operative societies nor the staff of the Co-operative Department which was intended to supervise their working, knew the fundamental principles of co-operation. "We have been much impressed," wrote the Townsend Committee on Co-operation, "by the lack of knowledge of even the commonplace of co-operation, shown not only by the members of primary societies but also by office-bearers and even by the staff employed by the various non-official agencies...Even the official staff is, we consider, in many respects insufficiently trained for the proper discharge of its duties." Societies have, therefore, been started rapidly and the majority of their members regard the society as a mere government agency from which they can borrow at low rates of interest. As the Assam Banking Enquiry Committee have put it, "All that the rural society means to them is that it is a bank somehow or other connected with Government, from which they can get money at a cheaper rate than from the money-lender or mahajan, that there is no particular hurry in repayment and that it does not matter much if they utilise the loan for some purpose other than that for which they professedly took it; that there is no reason why they should work harder, be more thrifty, or spend their money more carefully than they did before they became members." What a fall from the co-operative principle, *viz.*, that members are thrifty, pool their savings and lend to each other for productive purposes! The members of the primary co-operative societies do not often know what co-operation is and what Gilbert Slater wrote in 1920 is still largely true: "What has been estalished has been by Government initiative, kept in order by Government audit, and really financed by Government credit, because funds came from people who, as a rule, would not trust their money to the bank unless they knew the Government was behind them." If co-operation is to succeed, the members should understand the fundamental principles of co-operation; but in India "there has been lack of patient and persistent education of the members in the principles and meaning of co-operation by teachers competent to perform their task efficiently under adequate supervision."

The ignorance of the members leads to inefficient management of the co-operative societies—the third main defect of co-operation in India. A co-operative society is after all what its members make it, and as it is a democratic institution members must know

4 *The Royal Commission on Agriculture in India*: Abridged Report, p, 51.

the fundamentals of co-operation. The emphasis on thrift, on productive borrowing and punctual repayment, the very bedrock of co-operative credit, is hardly found in practice. Only a very small portion of the working capital comes from deposits from members. The major portion of the funds of an agricultural society are provided by the co-operative central banks. Many village credit societies are, therefore, mere 'groups of borrowers.' The fact that a major portion of the funds comes from outside sources, makes the members of the society indifferent with regard to the recovery of loans. When a borrower fails to repay a loan, the other members have no incentive to enforce repayment. Very often the members of the board of management are themselves defaulters and no prompt action is taken to recover the loans. The funds of the society thus get frozen with a few defaulters. The society becomes moribund; the honest members who have repaid their previous loans promptly, when they want new loans have therefore to approach the money-lenders and this further weakens the financial position of the society. The result is an accumulation of arrears and the ultimate recovery of the loans by the central financing agencies by the enforcement of unlimited liability, which results in losses to all the parties concerned. Overdue loans have become a serious problem in almost all the provinces and "unless loans are repaid punctually, co-operation is both financially and educationally an illusion."

Nor has co-operative credit been in India till now the *controlled credit* that it claims to be. Almost all the members of the society join it merely to borrow from it, and few understand the need for restricting credit for productive purpose. It is not, therefore, unusual for a member to borrow ostensibly for an improvement to his land and to spend the amount on a marriage, and for the other members to connive at it. Again, according to theory, the maximum credit limit for each member is fixed by the general body, but this provision is circumvented when an obliging friend borrows in his name for another, who has already borrowed up to the maximum limit fixed for him. Book adjustments are often made showing old loans as having been repaid and new loans as given. Such concealment of the object of the loans and benami transactions are hardly possible when the majority of the members realise and value the principles of co-operation, and the funds of the society come mainly from the savings of its members. Cases are not unknown of big landlords in the village who undertake money-lending and who have borrowed from the village co-operative society to relend at higher rates of interest. Thus the society at Gangaikondan "is now said to be controlled by a few Brahmin money-lenders who borrow at cheap rates and relend at usurious rates to the poor."[5] In such cases the village society actually becomes the ally of the

5 *P. J. Thomas and K. C. Ramakrishnan:* Some South Indian Villages, A. Resurvey, p. 376.

money-lender in exploiting the poor! The ideal of 'controlled co-operative credit' is, therefore, yet to be realised in India.

The apathy and ignorance of the rank and file lead to another vital defect in management, *viz.*, the concentration of control in the hands of the board of management. When the members are literate, the board of management becomes all-powerful and very often its members help themselves to the lion's share of the funds. Nor is it unusual for a co-operative society to become the battle-ground of warring village factions. All these defects which reduce co-operation to a mockery are the direct consequences of the fact that societies have been started without proper education of the members in the principles of co-operation.

An additional defect in management is that very often loans given by the primary societies are inadequate and are given only after a long delay. This inelasticity of co-operative finance forces members to borrow from money-lenders and thus leads to a division of the members' loyalties and weakens the financial position of the society.

A fourth defect of co-operation in India is the fact that till very recently no provision was made for the supply of long-term credit to wipe out the prior debts of the ryots. The fact that the majority of their members had a large volume of ancestral debt led directly to the emergence of overdues in the village credit societies. Land mortgage banks are of relatively recent origin, but attempts to reduce prior debts by debt conciliation or compulsory debt relief and to wipe them out through the agency of land mortgage banks should have preceeded and not followed the starting of co-operative credit societies to advance short and medium term credit.

Fifthly, the development of the Indian co-operative movement has been extremely lop-sided. Non-credit co-operation has made very little progress especially in agriculture. What Indian agriculture needs is not more cheap credit but a reorganization, and failure to achieve this has in its turn contributed to the weakness of the co-operative credit societies. What must be solved is the problem of rural poverty, and for this attempts should be made to increase the income of the farmer by all possible methods, such as the promotion of better methods, better marketing, etc. It is of course true that a credit society is the simplest to manage, and that when co-operation has to be introduced among backward rural communities, it is best to begin with credit societies. But the credit society can work successfully only if the income of the farmers has been raised, and this postulates a development of non-credit types of co-operative societies also.

Sixthly, the rapid development in the number of societies has meant inadequate supervision and stop-gap arrangements for supervision and audit. As seen in the discussions on the village credit society, on unions and on provincial institutes, "There has been not a little confusion about the differentiation of the functions of audit, inspection and supervision, and where the responsibility for the latter two should rest. There is no uniformity of practice. In some provinces two agencies handle the three functions; in others they are entrusted to three agencies, while in Baroda the Co-operative Department discharges all the three."[6] The staff employed by the Co-operative Departments and supervising unions often lack adequate training, and frequently the audit is superficial, as the auditors are in charge of an unmanageable number of societies. Thus, in Bengal in 1928-29, each auditor was supposed to audit 160 primary societies, which the Provincial Banking Enquiry Committee pronounced a physical impossibility.[7] Such perfunctory audit is worse than no audit at all, as it does not reveal the position of the society correctly. In a country like India, where the majority of the members of the primary societies are illiterate, the responsibility of the staff of the Co-operative Department and of the central banks and supervising unions is proportionately greater, and no progress is possible unless there is a decided improvement in the quality and morale of these employees.

This leads us to the fact that very little attention has as yet been paid in India to the systematic organization of co-operative education. The need for co-operative education and training for all grades of workers, official as well as non-official, engaged in the movement can hardly be exaggerated but arrangements for such education and training have been halting and have been undertaken piecemeal. Thus, in Madras the responsibility for such co-operative education and training is shared by the Registrar and the Provincial Co-operative Union. But as the Madras Committee on Co-operation (1940) have pointed out, "To ensure efficiency in service, the paid staff in the movement should be adequately trained for their jobs and the members and honorary office-bearers of societies should be taught the theory and practice of co-operation. This should be a normal feature, and not a periodical activity.

Any discussion of the defects of the Indian co-operative movement would be incomplete without a reference to the demand for the "deofficialisation" of the movement. As we have already seen, the movement is under the tight control of the Government in India, and the Registrar of Co-operative Societies is almost "all powerful'. It has been argued that as the fundamental basis of co-operation is self-help, the powers of the Registrar should be severely curtailed, and that there should be a progressive relaxa-

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6 *E. M. Hough*: The Co-operative Movement in India, p. 91.

7 The Bengal Provincial Banking Enquiry Committee: Report, Vol. I. p. 160.

tion of official control. Thus, according to Professor Kaji, "The popular movement should be handed back to tho people...the continuance of State control at every turn is detrimental to the highest interests of the movement."[8] Sound as this opinion is theoretically, it is extremely doubtful, whether, as things are at present, the movement can gain by the relaxation of Government control. A beginning can of course be made, as seen in the previous chapter, in the de-officialisation of the movement by handing over some of the functions, such as co-operative education, audit and supervision of co-operative societies, to the provincial co-operative institutes or unions; but for some time to come the ultimate control of the movement must still remain in the hands of Government. The co-operative movement in India will be self-regulating only when the members of the primary societies are animated by the co-operative spirit, and are well equipped to protect their own interests. At present, the majority of the members of co-operative societies are either ignorant or indifferent, and non-official co-operators with a real enthusiasm for honorary work are few. A complete devolution of powers to non-official bodies at this stage will, therefore, mean only the handing over of control to a few individuals who claim a monopoly of all co-operative knowledge and hence will be against the best interests of the movement as a whole. The co-operative movement having come to be, for good or for bad, closely dependent on the Government, what is needed in the near future is rather a more thorough supervision and control by the Government than has been the case in the past. But the aim of the Government should be so to do this work, and so to educate the members of co-operative societies in the principles and methods of co-operation, as to make its supervision and control superfluous. In other words, the Government should work with the definite objective of ultimately handing back the popular movement to the people, and the extent to which the Co-operative Department is able to delegate its powers to the co-operatives themselves without a falling off in efficiency should be the true measure of its success.

Thus co-operation in India has not been a living, dynamic force contributing to the moral, intellectual, and economic regeneration, bringing new life and hope to the farmers. It has not become with them, as with the farmers in Denmark, 'a way of life' but has remained a Government agency from which they can obtain cheap credit. The very slow progress of co-operative societies for purposes other than the provision of credit, *e.g.*, societies for the joint cultivation of holdings, for the consolidation of holdings, for the purchase of supplies, and for the sale of produce, proves that the real message of co-operation, *viz.*, that of self-help and mutual association for common economic benefits has not been grasped by

8 *H. L. Kaji*: Co-operation in Bombay, p. lvi.

the ryots in India. This explains why even after nearly 40 years of co-operation, the movement is not spreading by its own momentum. As we have seen above, societies in India have been started in a hurry without adequate education of the members in the fundamental principles of co-operation, and "the result is that there has been a number of still births, a high early mortality and a large proportion of derelicts," as is shown in Table XIX.

Thus 53% or more than half the number of societies have been wound up or are on the way to liquidation and, as pointed out by the Bulletin on Village Banks of the Reserve Bank of India, these figures have a lesson for us. "A co-operative village bank cannot be brought into existence by mere mechanical methods or departmental fiat. It is a human institution which must grow out of a felt want."[9] Co-operative societies in India have thus failed to conform to the ideals of co-operation and have degenerated into mere agencies for the provision of cheap credit. They have failed appreciably to raise the standard of life in the villages of India.

§ 2. **Reorganization of the co-operative movement:**[10] Co-operation, which gave the small farmers of Denmark a standard of life which is the envy of the civilised world, has achieved very little in India hitherto, mainly because of two reasons, *viz.*, (*a*) it has not been planned thoroughly so as to include the 'whole life' of the farmers; (*b*) it has not been based upon education.

Started mainly to deal with the problem of rural finance, the provision of cheap credit became almost an obsession with the co-operative movement in India. The fact that the true aim of agricultural co-operation is rural reconstruction, that it is not the more provision of cheap credit, or of efficient marketing, but a reorganization of agriculture on more profitable lines, was not clearly realised.

In other words, co-operation in India has not achieved much, partly because it has not attempted to tackle and solve the problem of rural poverty 'as a whole.' The co-operative credit societies have failed mainly because they have tried merely to provide cheap credit without trying to remove the other causes of the farmers' bad economic condition, *viz.*, the ignorance and illiteracy of the farmers, the antiquated methods of production, the absence of subsidiary industries to occupy the spare time of the farmer, extravagant expenditure on social functions, defective marketing, etc. Attempts should have been made simultaneously to increase the income and reduce the expenditure of the farmers. "The former

9 Ibid,, p. 40.

10 Only the fundamental principles are discussed here. Suggestions for improvements in the working of the village credit societies, central banks, land mortgage banks, etc., have been discusssd in the previous chapters.

Table No. XX[11]

Province.	Number of primary societies in 1934.	Societies put into liquidation since the beginning of the movement.	Percentage of column 3 to total number of primary societies	Percentage of unfit societies (*viz.*, D. E. Class) to Column 2.
Bengal	19,890	1,991	9	22.3
Punjab	21,276	3,903	15	13.5
Bihar & Orissa	8,789	2,404	21	21.1
Madras	13,211	752	22	13.3
Bombay	5,675	1,737	23	11
United Provinces	5,970	3,690	38	72
Central Provinces	3,847	3,998	73	47.3
Burma	1,460	3,633	49	31
Total	80,118	25,108	24	28.9

11. *The Reserve Bank of India*: Bulletin on Village Banks, p. 39.

involves consolidation of his holding, improvement of his land...... the amending of his method of cultivation, encouraging the pursuit of one or more supplementary occupations, or enabling more profitable disposal of his products. The reduction of expenditure insolves sound systems of land-holding and land revenue assessment, the availability of required supplies as well as credit at reasonable rates, the reduction of unnecessary expenditure on social ceremonies by a reform in public opinion, the encouragement of thrift......and especially education, which not only will facilitate most of the foregoing objects, but will help to safeguard the peasant against exploitation." No doubt attempts have been made in India to start co-operative societies for most of these purposes, but they are of relatively recent origin and have not been co-ordinated. For co-operation to be successful, the problem of the farmer should be visualised as a whole, and the co-operative attack should be directed simultaneously on as many fronts as possible. As Sir Horace Plunkett has said, co-operation will succeed only "as an integral part of a comprehensive agricultural policy." In the future, co-operation in India should attempt to tackle the problem of agricultural improvement 'as a whole,' and not piecemeal. The village co-operative society should not only provide cheap credit, but should help the farmer to raise his income and reduce his expenditure and thus achieve a better living.'

The society in the village must continue to be the basis of the whole co-operative movement, but the working of the village credit societies should be modified on the following lines as suggested by the Reserve Bank of India. (1) The village credit society should take up the whole life of the village within its ambit. (2) It should aim at including everyone in the village. (3) It should have constant dealings and maintain continuous touch with its members. (4) It should try to adhere more to co-operative principles. The first three objectives can be achieved if the village credit societies undertake, as has been already suggested, in addition to the supply of credit, the supply of agricultural improvements, and the promotion of co-operative marketing and subsidiary industries. Greater adherence to co-operative principles would mean that in the future, outside borrowing by members of co-operative societies should be prevented; it would also mean the provision of 'full finance' by co-operative societies to their members, the prompt sanction of loans and their strict recovery, greater emphasis on thrift than has been the case in the past, and a more rigid control of the unproductive expenditure on social functions by members. The societies should also undertake rural reconstruction work and arrange for medical and veterinary assistance and the arbitration of disputes. In short, the aim of the co-operative society in the village should be not the mere provision of credit, but the promotion of a "better farming, better business, and better living."

The possibilities of the village society as an agency for the promotion of better farming can hardly be exaggerated. The improvements suggested by the Agricultural, Veterinary, and Industries Departments can be popularised only through the co-operative societies. As the Royal Commission on Agriculture in India put it "only through the medium of co-operative association can the teaching of the expert be brought to the multitudes, who could never be reached individually." The village society should be the agent and ally of the Government Development Departments in the spread of better varieties, better implements, better livestock, and better methods of cultivation. At present, the Departments approach the farmer direct and there is no co-ordination either between the heads of Departments at the Provincial headquarters, or between the efforts of the officers of the various Departments in the districts. Rural reconstruction schemes, which aim at securing such co-ordination of efforts between the various development departments and focussing them in the village society, are at present in operation in Bombay, the United Provinces and the Punjab, and the recent Committee on Co-operation in Madras have suggested the creation of a Provincial Standing Committee of the heads of Departments and non-officials to formulate measures of rural uplift, to watch their execution and to review the progress made.[15] The experts in the Departments should thus evolve a common programme of rural uplift and their local officers should use the co-operative society in the village to carry it out. Up till now the co-operative societies "have been living an unprofitable existence where they could have been spear-heads of the campaign for improved cultivation and less ignorant villages." In the future they should serve as "a link between the will to self-help through honesty and industry of the individual and the special knowledge and ability of outside experts."

CHAPTER XIII

THE RESERVE BANK OF INDIA AND AGRICULTURAL CREDIT

§ 1. **The need for a central agency to provide emergency credit to the rural credit institutions**: There are, in India as seen in Chapter V, a number of agencies providing credit to agriculture. But these do not form parts of a scientifically organized and well integrated credit system, and invariably act as independent units. There is no co-ordination between the money-lenders, the indigenous bankers, the co-operative organizations, and the commercial banks organized on western lines. One of the main objects of a good system of agricultural credit, *viz.*, an equalisation of credit terms is not, therefore, realised. The rates charged by the

15 See Part II, Chapter XXII, §

indigenous bankers in Bombay might be higher than those charged by the indigenous bankers in Calcutta, but still funds do not move easily from Calcutta to Bombay. In an agricultural country like India, the demand for credit is seasonal, and the agencies providing rural credit are likely to suffer from a shortage of funds during the busy season when the crops are moving to their markets. But neither the indigenous bankers, who provide most of the marketing credit and part of the production credit needed by the farmers, nor the co-operative organizations such as provincial co-operative banks, have any means of replenishing their funds when the demand for credit expands. The supply of credit is, thus, extremely inelastic and rates of interest rise during the busy season; nor do they move in the same direction in all parts of the country. If the farmers in India are to be provided cheap credit, the supply of credit should be rendered elastic. For this it is essential that the agencies providing rural credit must have a central institution from which they could borrow in times of stringency on the security of agricultural paper. The provincial co-operative banks need such an agency for another reason also. They get most of their funds by way of deposits from the public, and like the joint-stock banks, they also need an institution which would act to them as 'lender of last resort', and would help them to tide over the crisis during periods of emergency. An agency has also long been needed in India which would undertake research in all problems relating to agricultural credit and would give technical advice to the Central and the Provincial Government on all matters relating te measures for the provision of agricultural credit, for agricultural debt relief, and for the control of money-lenders.

Thus, on the eve of the enactment of the Reserve Bank of India Act in 1934, an agency was needed in India (*a*) to study all problems relating to agricultural credit, (*b*) to give expert advice on the subject to the Central and Provincial Governments and banking organizations, and (*c*) to co-ordinate and guide the rural credit agencies such as the co-operative organizations and the indigenous bankers, and to provide them seasonal and emergency finance.

§ 2. **Provision relating to agricultural credit in the Reserve Bank of India Act:** The agency best suited to undertake the above duties is naturally the central bank of the country, and it is therefore not surprising that the Reserve Bank of India Act should have provided for the discharge of these functions by the Reserve Bank of India. There was some opposition to the inclusion of an Agricultural Credit Department in the country's central bank on the ground that the main function of a central bank must be, not the provision of credit to agriculture, but the maintenance of a stable currency. But it was pointed out that in a predominantly agricultural country like India the interest of the agriculturists must be looked after by the central bank. The Australian example was followed in integrating an Agricultural Credit Department with the central bank of the country.

By the constitutional provisions of the Reserve Bank of India Act, the Bank was required to create a special Agricultural Credit Department. Clause 54 of the Reserve Bank of India Act required the Bank to create a special Agricultural Credit Department "(*a*) to maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Governor-General in Council, Local Governments, provincial co-operative banks and other banking organizations, (*b*) to co-ordinate the operations of the Bank in connection with agricultural credit and its relations with provincial co-operative banks and any other banks or organizations engaged in the business of agricultural credit."

Provision was also made in the Reserve Bank of India Act, for the Bank to make loans and advances to the provincial co-operative banks and through them to the co-operative movement, on the security of agricultural paper, the promissory notes of co-operative central banks and marketing societies, Government securities, and debentures of approved land-mortgage banks which are trustee securities and are readily marketable. The Act also required the Reserve Bank to examine the possibility of providing financial accommodation to the indigenous bankers during the busy season by offering them rediscount facilities. Thus, the Reserve Bank was required to submit to the Governor-General in Council, within three years of its inauguration a report, with proposals, if it thought fit, for legislation on the following matters, *viz.* :—

(*a*) the extension of the provisions of the Act relating to scheduled bank to persons and firms, not being scheduled banks, engaged in British India in the business of banking (*i.e.*, indigenous bankers) ;

(*b*) the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enteprise and the operations of the Bank.

The Bank accordingly submitted two reports on agricultural credit : one, a preliminary report in December 1936, with a view to clarifying the issues and eliciting public opinion ; and the other, the Statutory Report on 15th December 1937.

More than ten years have passed since the inauguration of the Reserve Bank of India in 1935, and an estimate of what it has achieved so far in the field of agricultural credit is likely to have some lessons for future policy. The record of the Reserve Bank of India as an agency for research and advice on matters relating to agricultural credit, and as an agency for the provision of emergency finance to rural credit organizations can now be examined.

§ 3. **The Agricultural Credit Department:** The Reserve Bank, as required by the Act, created in April 1935 an Agricultural

Credit Department. The Officer-in-charge of the Department is assisted in the research activities of the Department by a Director of Research. For the purpose of internal administration the Department is divided into three sections, *viz.*. the Agricultural Credit, the Banking, and the Statistical and Research sections. The Agricultural Credit Department has three main functions. Firstly, it studies all problems relating to rural finance, with particular reference to co-operation and to legislation for the relief of rural indebtedness. The result of these studies are issued in the form of bulletins, four of which have been published so far. Secondly, it keeps in close touch with the co-operative movement and deputes its officers to study on the spot the special features of the movement in the different parts of India. The officers of the Department are also in close touch with the other agencies engaged in the supply of agricultural finance. Thirdly, it gives technical advice and guidance on all matters concerning agricultural credit to the Central and the Provincial Governments, to the Registrars of Co-operative Societies, and to co-operative banks and other banking organizations when such advice is asked for.[1]

In the preliminary and the statutory reports issued by the Reserve Bank of India, and in the various bulletins issued by it from time to time, the Bank has indicated the lines on which the co-operative movement can be re-organized to serve the agriculturists efficiently. The reports drew pointed attention to the fact that the economic depression had only served to reveal a number of defects in the co-operative movement which had already existed and had escaped attention during a period of prosperity. Loans had been carelessly advanced to the agriculturist much in excess of their repaying capacity. The societies had done little to encourage thrift and to make members save in good years funds which could have been used to tide over the depression. The surplus income of the good years had been frittered away in unproductive expenditure. Very little had been done to raise the income of the ryot by encouraging co-operation in marketing, the purchase of supplies, etc. The reports point out that many difficulties have to be faced in the task of reconstruction and suggest lines on which the movement has to be reconstructed and revitalised. The views of the Reserve Bank on questions affecting agricultural credit and the lines on which the credit organizations, so vitally necessary for the agriculturists, should be develped are further clarified in the bulletins published by the Agricultural Credit Department.

The bulletin on 'Co-operative Village Bank' (Bulletin No. 2) indicates the lines on which the Reserve Bank wants the village societies to be reorganized. According to it, the village credit societies should cease to be mere providers of cheap credit, and

1 Functions and Working of the Reserve Bank of India. p. 15.

should become real centres of social and economic progress by bringing within their ambit the entire social and economic life of their members. They should include every eligible ryot in the village and should become multi-purpose societies, encouraging better farming methods, better living, co-operative marketing, and subsidiary industries such as the processing of crops and dairy farming.[2] They should adhere to co-operative principles more strictly than has been the case in the past, and should make a real attempt to control the unproductive expenditure of their members. As the reorganization of societies in this way requires much patient work, the Reserve Bank suggested that in the early stages it would be better to concentrate on a few select areas.

The bulletin rightly maintains that "the prosperity of the agriculturist cannot be built upon the scaling down of debts by legislation or its redemption by the State or by land mortgage banks, nor can it be brought about by mere reduction in the rates of interest and allowing repayment in easy instalments." Real improvement in the village economy can be achieved only by village banks which do not confine themselves to the prosaic function of a commercial bank but extend their activities to meet the real needs of the agricultural population.

Two of the bulletins published by the Department explain the working of two model banking unions, one at Kodinar, in Baroda State, and the other at Panjawar, in the Hoshiarpur district of the Punjab. In these bulletins the Reserve Bank suggests that the co-operative district central banks have hitherto confined their activities merely to the financing of their affiliated societies, and that the other equally important functions of education and supervision have been relegated to the background. It has, therefore, recommended that all the rural societies in each taluk or tahsil should in the future join in a banking union, and that all the functions of finance, supervision, and education should be concentrated in the hands of this union. Such taluk banking unions, with a more restricted area of operation than the present co-operative central banks, might be organised either by converting the existing central banks into banking unions (where the area of operation of the former is small) or by separately establishing them and affiliating them to the central banks. "Working in a limited area with agriculturists as its members, a banking union of the type described in the bulletins will concentrate in its hands all the functions of finance, supervision and education for which different agencies are employed at present, resulting in a diffusion of energy and waste of effort."[3] The Department has kept a close contact with the land mortgage banks and has advised them when-

2 See Chapters VIII and XII.

3 The practicability of these proposals is discussed in Chapter IX above.

ever advice has been sought. It has circulated a note to all the central land mortgage banks and Registrars of Co-operative Societies in various provinces, and has suggested certain improvements in the system followed by land mortgage banks with regard to the floatation of debentures and their repayment. A model balance sheet has been drawn up and circulated to all central land mortgage banks for their information.

Another bulletin published by the Department discusses the main features of the scheme adopted in Burma for the rehabilitation of the co-operative movement after its collapse in 1929, and their applicability to India. The Department has now taken up for study credit legislation introduced in the provinces and States, measures taken by Governments and central banks in foreign countries for the financing of agriculture, restrictions on land alienation, consolidation of holdings, the organization of crops and cattle insurance, werehousing, audit, inspection and supervision of co-operative societies, etc.[4]

The Department has also given valuable suggestions to the various Provincial Governments that have approachad it from time to time, for advice on measures for the regulation of money-lending and for the scaling down of debts and on schemes for the rehabilitation of the co-operative movement.

The Agricultural Credit Department of the Reserve Bank of India has thus done much useful work. As an agency for research and for providing expert advice on matters relating to agricultural credit, the Reserve Bank has worked admirably. As a banker, it has not allowed itself, in its judgments, to be led away by sentimental considerations, and has reminded co-operators, that co-operation is, after all, business and not philanthropy, and that co-operative credit societies should work on strictly business principles. It has emphasised the futility of the easy and popular remedies such as cheap credit, scaling down of debts, and long term credit advanced by land mortgage banks for the clearance of prior debts. It has helped to focus attention on the main point, *viz.*, that all the above measures cannot succeed unless simultaneously an attempt is made to raise the income of the agriculturists by the organization of the village credit societies into multi-purpose societies embracing in their sphere of operations the whole social and economic life of the village.

§ The Reserve Bank of India and the provision of agricultural finance—The co-operative movement: As we have already seen, the Reserve Bank of India, when it was inaugurated, was expected to integrate the agricultural credit system and render it elastic by providing temporary financial accommodation to the co-operative movement and to the indigenous bankers.

4 Report of the Fifth Annual General Meeting of the Shareholders of the Reserve Bank of India, 5-2-1940.

This temporary financial accommodation the Reserve Bank is expected to provide only in times of emergency and seasonal stringency. Thus, if there is a run on the co-operative central banks, or if they have advanced all their funds to the primary societies and are in need of further funds during the busy season, they must be able to secure loans from the Reserve Bank against their promissory notes and on the security of agricultural paper. As the central bank of the country, the Reserve Bank cannot be expected to supply these institutions their normal financial requirements. For these, they must depend on their owned capital and on the deposits they are able to attract from the public.

The types of accommodation the Reserve Bank can give to the provincial co-operative banks:—As laid down by section 17 (2) (*b*), (4) (*a*), (*e*) and (*d*) of the Reserve Bank of India Act, the Reserve Bank can provide financial accommodation to the provincial co-operative banks and through them to the co-operative movement under the following heads:—[5]

"(*a*) Loans and advances against Government securities for periods not exceeding ninety days to provincial co-operative banks and through them to the central co-operative banks—Section 17 (4) (*a*).

(*b*) Similar loans and advances to provincial co-operative banks and through them to central co-operative banks against approved debentures of recognised land mortgage banks which are declared trustee securities, and are readily marketable.

(*c*) Discount of treasury bills.

(*d*) Loans and advances for periods not exceeding ninety days to provincial co-operative banks against promissory notes of approved co-operative marketing or warehouse societies endorsed by provincial co-operative banks and drawn for the marketing of crops—secion 17 (4) (*c*); or rediscount of such promissory notes maturing within nine months—section 17 (2) (*b*); or loans and advances for periods not exceeding 90 days on the promissory notes of provincial co-operative banks secured by warehouse warrants issued by corporations independent of the borrower or on the security of promissory notes supported by documents of title to goods which have been assigned or pledged as security for cash credits or over-drafts granted by the provincial co-operative banks to approved marketing or warehouse societies—section 17 (4) (*d*).

(*e*) Advances to provincial co-operative banks for a maximum period not exceeding 90 days against promissory notes of central co-operative banks endorsed by provincial co-operative banks and drawn for financing seasonal agricultural operations or the marketing of crops—section 17 (4) (*c*); or rediscount of such promissory notes maturing within nine months—section 17 (2) (*b*)."

5 Circular Letter No. ABC 90 70-38.

The conditions laid down by the Bank for the grant of financial assistance:—But while the statute has, thus, provided for help being given to the provincial co-operative banks in a number of ways, in practice, little such assistance has been given by the Reserve Bank. In its Statutory Report on Agricultural Credit. and in its circular letters, it has laid down the conditions and terms on which it is prepared to give the credit and rediscounting facilities that have been authorised by the Act, which amount to a virtual denial of these facilities.

Thus, the Reserve Bank wants the provincial co-operative banks and the other co-operative organizations such as the co-operative central banks to modify their present practice in a number of ways, before they approach the Reserve Bank for financial assistance. It requires the provincial co-operative banks desirous of securing the accommodation from it, (*a*) to maintain with it, like the scheduled banks, some minimum balances, the amount of which should not at the close of business on any day be less than $2\frac{1}{2}\%$ of their demand liabilities and 1% of their time liabilities, (*b*) recast their balance sheets and to submit to the Bank the periodical statements prescribed for the purpose, (*c*) to submit themselves to periodical inspection by the Bank.

Before advancing them credit for the financing of seasonal agricultural operations and for the marketing of crops on the security of their promissory notes endorsed by the provincial co-opertaive banks, the Reserve Bank requires the central co-operative banks also to submit to a number of conditions. Firstly, it requires detailed information regarding the financial position of the central banks whose paper is intended to be rediscounted and the working of the primary societies financed by them. Secondly, it wants them to maintain fluid resources in the form of cash and government securities amounting to at least 10% of their deposit liabilities. It has suggested that the provincial and the co-operative central banks should hold 10% of their deposits in the form of cash and balances with other banks, 30 to 49% in the form of government securities and treasury bills, and invest only 50 to 55% of their deposit liabilities in loans and advances. Thirdly, it wants that co-operative central banks and the village credit societies to confine themselves in the future to short-term financing. It has suggested that medium-term loans for the replacement of cattle or implements should not exceed two years, and should form only a comparatively small part of the business of the village credit societies. Fourthly, the Reserve Bank seems to regard with suspicion the present organization of co-operative societies as they "are too one-sidedly representative of the debtor." It requires a reorganization of the directorate of the provincial and co-operative central banks with more representation for the non-borrowing elements before it lets flow any credit to the ryot through the provincial bank.

It is neither desirable nor possible for the co-operative organizations to satisfy some of the above conditions. The maintenance of liquid resources up to 40% of their deposits as required by the Reserve Bank "would practically cripple the business and working of central banks." The co-operative central banks work on small margins and provide credit to agriculture at low rates of interest, and they cannot, therefore, afford to invest a large part of their resources in low-yielding government securities. As pointed out by the Committee on Co-operation in Madras (1940), "if central banks are to adhere to the rates suggested by the Reserve bank ......most banks cannot pay their way or meet their working expenses......much less can they afford to pay a modest dividend to their shareholders, nor can any addition be made to their statutory reserve funds."[6] Moreover, in all the provinces, even at present, the central banks are maintaining certain standards of fluid resources prescribed by the Governments, and few central banks have come to grief on account of lack of such resources. There seems to be, therefore, little justification for the change demanded by the Reserve Bank.

Nor is it desirable for the co-operative societies to confine themselves merely to short-term finance and to approximate their methods of business to those of the commercial banks. The agriculturists require in addition to short-term credit, medium-term credit for periods ranging up to five years for the purchase of animals and implements and for effecting improvements, and if the co-operative societies refuse to provide such credit, a gap is likely to arise in the co-operative credit system.[7] Even with regard to short-term credit for current cultivation expenses, the farmer cannot afford to base himself on the proceeds of only a year's turnover as the yield from land is extremely uncertain. Recent economic thought on agricultural credit has, therefore, favoured the substitution of medium-term loans for even short-term loans. The co-operative societies, therefore, must continue to provide in the future as they do at present, medium-term as well as short-term finance,[8] and they should raise the funds needed for this purpose by deposits of appropriate duration. Co-operative societies have, in fact, been organized mainly because the commercial banks are unsuitable to finance agriculture, and if they were to conform to the practices of the commercial banks they would defeat the object for which they have been started.

The demand of the Reserve Bank for detailed information regarding the working of the co-operative central banks whose paper is brought forward for rediscount and the working of the

6 The Committee on Co-operation in Madras (1940): Report par. 259.

7 There is a good discussion on this topic in the Report of the Committee on Co-operation in Madras, par. 177.

8 See Chapter VIII § 6; Chapter IX § 2.

primary societies financed by them, also seems to be unnecessary. The Reserve Bank is, after all, asked to advance money on their paper only when such paper has been endorsed by the provincial co-operative banks. The provincial co-operative banks advance money to the co-operative central banks only after they have satisfied themselves regarding their soundness, and one does not see why the endorsement of the provincial co-operative banks should not satisfy the Reserve Bank.

The same attitude of suspicion has characterised the relations between the Reserve Bank and the land mortgage banks. The Reserve Bank can help the central land mortgage banks that have been declared provincial co-operative banks, by buying some of their debentures. This would mean very little risk to the Reserve Bank (as the debentures have been declared trustee securities and the respective provincial Governments have guaranteed the interest and the principal of these debentures) while adding greatly to the popularity of the debentures. But the Reserve Bank prefers to wait and see whether the debentures are readily marketable; it has suggested to the land mortgage banks that they should "interest genuine investors in their debentures," before asking the Reserve Bank for assistance. This looks like putting the cart before the horse. One of the best ways of making genuine investors come forward to purchase the debentures of the central land mortgage banks, and of making the debentures more readily marketable, is for the Reserve Bank to step in and purchase the debentures, and to notify its willingness to lend on the security of the debentures.

Thus during the ten years of its existence, the Reserve Bank of India has done very little to render financial assistance to the co-operative movement and give a certain measure of elasticity to the co-operative credit system. A few provincial co-perative banks have been able to secure from it advances on the security of government paper, but no whole-hearted attempt has been made to develop the other types of business authorised by the Reserve Bank of India Act.

§ 5. **The Reserve Bank and the provision of agricultural credit—The indigenous bankers:** With regard to the indigenous bankers the Reserve Bank has followed an even more cautious policy.

The important role played by the indigenous bankers is the provision of credit in India, and the need for linking them to the central banking institution of the country have already been discussed in Chapter V § 2. Such a linking is essential for the provision of cheap and elastic credit to the clarge mass of agriculturists. But from the point of view of the Reserve Bank itself, there is an additional reason why the indigenous bankers should be linked to it; the fact that the Reserve Bank's control over the currency and credit of the country would be hopelessly incomplete until the indigenous bankers, who control nearly 90% of the country's banking, are brought under its sphere of operations. As Sir George Schuster put it so well in 1933 in his speech in the Legislative Assembly, "until the vast portion of India's banking and credit, which is represented by the indigenous bankers, is put into gear with the relatively small machine of the modernised money-market, with the Reserve Bank as its central control, it will be impossible for the Reserve Bank to exercise full control of currency and credit in India...and it will be equally impossible for the masses of the people who populate the country-side of India to get the full benefits of banking and credit facilities on reasonable terms, which a well-organized banking system ought to give."

The Central Banking Enquiry Committee reporting in 1931 had recommended that the indigenous bankers as well as the joint-stock banks should be directly linked to the Reserve Bank, and thereby provided with rediscount facilities with that institution when it should be established. They had also recommended that the provisions requiring the member banks to keep a certain percentage of their time and demand liabilities as interest free balances with the Reserve Bank might be waived, during the first five years of the working of the Bank, in the case of indigenous bankers whose deposits did not exceed five times their capital.

No attempt was made to implement these recommendations when the Reserve Bank of India Act was passed in 1933. But an obligation was laid upon the Reserve Bank by section 55 (1) (*a*) of the Act to make a report to the Governor-General in Council, within three years at the latest, on the extension of the rediscounting facilities given to the sheduled banks by the Reserve Bank to the indigenous bankers also, with proposals, if it thought fit, for legislation.

The Reserve Bank accordingly brought forward its scheme for the linking of the indigenous bankers with itself in May 1937, in a circular letter to all the scheduled banks and to representative indigenous bankers. In direct contravention of the recommendations of the Central Banking Enquiry Committee and of the spirit of the Reserve Bank of India Act, the Reserve Bank proposed to give rediscounting facilities to the indigenous bankers not directly but only through the scheduled banks, who were thus to bear part of the responsibility for financing the indigenous bankers. The indigenous bankers when they needed funds were to get their bills and notes discounted with the scheduled banks, which in their turn were to be enabled to get these notes rediscounted with the Reserve Bank. At the same time the Reserve Bank stipulated certain conditions by conforming to which the indigenous bankers could link themselves directly to the Bank and secure from it rediscounting facilities. These conditions were: (1)

The indigenous bankers should organize themselves into self-contained legal entities with an owned capital of at least five lakhs of rupees. (2) They should maintain as compulsory deposits with the Reserve Bank the same proportion of their time and demand deposits as the scheduled banks. (3) They should separate their banking from their non-banking business. (4) They should maintain properly audited accounts.

These proposals raised a storm of protest. The first two stipulations meant that the Reserve Bank demanded from the indigenous bankers the same conditions that it demanded from the scheduled banks and that no concessions would be shown to the indigenous bankers. To ask the indigenous bankers to raise an owned capital of five lakhs of rupees and to keep compulsory deposits with the Bank before they could approach it for discounting facilities was to ask for the impossible. These stringent conditions and the avowed preference of the Reserve Bank for indirect linking came in for a good deal of criticism, and the Bank was forced to relax some of them to make them more acceptable to the greater body of indigenous bankers. Accordingly, it issued a second draft scheme in August 1937. Under this scheme the Reserve Bank is prepared to give direct rediscount and remittance facilities and advances to the indigenous bankers provided, (*a*) they formalise their methods and make them approximate more and more to those followed by the joint-stock banks and develop the deposit side of their business; (*b*) they have an owned capital of at least 2 lakhs of rupees which might be raised to five lakhs at the end of five years; (*c*) they agree to wind up their non-banking business within a reasonable time; (*d*) they maintain proper books of accounts and have them audited by registered accountants and file with the Reserve Bank periodical statements of the affairs; and (*e*) they publish the statements of their accounts just like the banking companies. Indigeous bankers whose time and demand liabilities are less than five times their capital are not required to keep compulsory deposits wtih the Reserve Bank. These proposals also have not satisfied the indigenous Bankers. They are unwilling to modify their traditional methods of banking and give publicity to their accounts, nor are they willing to wind up their non-banking business. The Reserve Bank, on the other hand stick to the position it took up in the second draft scheme and is unwilling to make further modifications. The result has been a deadlock between the Reserve Bank and the indigenous bankers.

Both parties seem to be responsible for this deadlock. It is unfair to ask the indigenous bankers suddenly to change their methods of business and adopt the modern banking practices followed by the joint-stock banks. On the other hand, the indigenous bankers, as they accept deposits, must be prepared to give up their trading business, as losses in such trade might endanger the security of the depositors. They should also realise that the

Reserve Bank, if it is to finance them, must have the right to know something regarding their financial position. This deadlock should be resolved and a link between the indigenous bankers and the Reserve Bank should be established as soon as possible. The record of the Reserve Bank hitherto in this matter, makes one suspect that the Bank is not anxious to link up the indigenous bankers to the banking system. Such a linking up is necessary as much in the interest of the Reserve Bank itself as in that of the indigenous bankers, as the former's control over the money market is likely to be incomplete as long as it does not extend to the latter. The Reserve Bank should therefore approach the problem of the indigenous bankers with a greater amount of sympathy and a greater will to get things done than has been the case in the past.

Thus the performance of the Reserve Bank as an agency for providing seasonal and emergency finance to the rural credit institutions and for evolving an integrated rural credit system is as disappointing as its performance as a research and advisory agency has been promising. With regard to financial assistance to the co-operative institutions and the indigenous bankers, it has adopted an extremely cautious and conservative attitude. As to the co-operative movements, its zeal for criticism has hardly been matched by an equally ardent desire to help. It has exaggerated the defects of the movement and has not made sufficient allowance for the effects on the movement of the severe economic depression. It has demanded from the co-operative institutions the fulfilment of either impossible or unnecessary conditions, as the price of financial assistance. In fact, it has even refused to give cash credit facilities to the provincial co-operative banks on the ground that they could always borrow from it on the security of government paper. The same over-cautious attitude seen above has characterised the relations of the Reserve Bank with the indigenous bankers.

The aim of the central bank of a country is something more than the mere maintenance of a stable exchange and stable currency. It should be to strengthen the economic system of the country and to maintain full employment. The orthodox English view regarding the functions of banking system, that it should provide short-term credit and should not take any direct part in the financing of industries might have suited 19th century England, where industries had already developed and stood in little need of direct help from the banks, but it is totally unsuited to India[9]. The Indian banking system should approximate more closely to the continental type, where banks are intimately connected with industries and have played a prominent part in their developement. Agriculture is India's main industry, and a system of cheap and

9 Even in the United Kingdom there has been, during recent years, an increasing tendency for the commercial banks to take a more direct interest in the financing of industries.

elastic agricultural credit is a desideratum for agricultural improvement. The sooner the Reserve Bank realises its responsibilities in the matter, the better will it be for the country as well as the Reserve Bank.

§ 6. **Allocation of the Reserve Bank's profits to Agricultural reconstruction :**[10] An interesting suggestion has recently been made by Sir Manilal B. Nanavati, President of the Indian Society of Agricultural Economics, that " half of the net profits of the Reserve Bank of India should be set apart for financing the setting up of an organization for the development of rural life." Since the outbreak of the War in September 1939, the profits of the Reserve Bank of India have been increasing steadily, mainly as a result of the increased issue of currency by the Issue Department. The profits have thus come mainly from the community and there is no reason why the greater part of it should not be spent upon the improvement of agriculture—the sole means of living of the majority of the population. Sir Manilal therefore suggests that half of the profits of the Reserve Bank should be set apart to finance the creation of an organization which will concern itself not merely with the technical aspects of agriculture, but with the whole rural problem, which will collect information, frame policies, and give grants to finance schemes of reconstruction. The funds might be entrusted to the Imperial Council of Agricultural Research which should set up additional committees for (1) the social and cultural life of the people; (2) the finance of agriculture, tariffs and fiscal problems, debt legislation; (3) problems of land tenure and taxation; (4) rural engineering; (5) rural transport; and (6) rural administration and propaganda. The proposal is eminently practicable and we are sure its adoption will help to create an All-India organization concerning itself not merely with technical research but with the whole problem of rural development.

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10 *M. B. Nanavati and J. J. Anjaria*: The Indian Rural Problem, pp. 334-38.