LINKING BORROWINGS WITH DEPOSIT MOBILISATION BY CENTRAL CO-OPERATIVE BANKS

REPORT OF THE STUDY GROUP

RESERVE BANK OF INDIA
BOMBAY

CONFIDENTIAL

Report of the Study Group on the proposal of the All-India Rural Credit Review Committee for providing Incentives to Central Co-operative Banks for Deposit Mobilisation and Disincentives to Borrowings from the Reserve Bank

Introduction

1.1 The Agricultural Credit Board of the Reserve Bank which considered in its first meeting held on 3 August 1970, among others, the recommendation of the All-India Rural Credit Review Committee (1969) for providing certain incentives to central co-operative banks for deposit mobilization and disincentives to borrowing from the Reserve Bank, agreed in principle with the objectives underlying the proposal, but suggested that a Study Group might be appointed to go into the question of norms for assessing deposit potential in a district and the capacity of a central co-operative bank to tap the same and to examine the impact of differential rates on the interest rate structure in the different central co-operative banks with a view to ensuring that the burden did not fall too heavily on the small farmers. Accordingly, the Governor of the Reserve Bank appointed a Study Group in September 1970.

Its composition was as follows:

1.	Shri Maganbhai R. Patel Chairman, Gujarat State Co-operative Bank	Chairman
2.	Shri S. S. Puri Joint Secretary, Planning Commission, Government of India	Member
3.	Shri K. S. Bawa Joint Secretary, Department of Co-operation, Ministry of Agriculture, Government of India	Member
4.	Shri A. N. Varma Registrar of Co-operative Societies, Madhya Pradesh	Member
5.	Shri V. Alagappan* President, Madurai District Central Co-operative Bank	Member
6.	Dr C.D. Datey Chief Officer Agricultural Credit Department Reserve Bank of India.	Member-Secretary

1.2 The terms of reference of the Group were as under:

(i) To examine the feasibility of the formula for the system of incentives and disincentives recommended by the Review Committee and to suggest appropriate norms for fixing targets for deposits and other procedures relating thereto.

(ii) To consider any other alternative formula, which with due regard to the objectives behind the proposal of the Review Committee, will relate the reward or penalty not to

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* Shri Algappan ceased to be President in January 1971 but continued as Director, Madurai District Central Co-op. Bank.

the amount borrowed from the Reserve Bank but to the extent of deposits mobilised by the central co-operative bank and used in lending for agricultural purposes.

(iii) To examine the impact of the differential lending rates of the Reserve Bank under the formula on the rate of interest charged by the co-operative credit structure to the ultimate borrowers, especially the small farmers.

(iv) To make any other recommendation on matters allied or incidental to the above terms of reference.

1.3 On Shri A.N. Varma relinquishing his post as Registrar of Co-operative Societies, Madhya Pradesh, Shri M. S. Gill ** Registrar of Co-operative Societies, Punjab was nominated as a member. Shri S.S.Dawra, Joint Registrar of Co-operative Societies, Punjab, attended one of the meetings of the Group on behalf of Shri Gill.

1.4 The Group met four times, i.e. on 14 November 1970, 13 August 1971, 10 March 1972 and 19 April 1972 in the Central Agricultural Credit Department, Reserve Bank of India Bombay. In the formulation of its recommendations, the Group had the benefit of the views expressed by the Registrars of Co-operative societies at their conference held in September 1971, by the State Ministers of Co-operation at their conference held in November 1971 and also the Chief Executive Officers of the State Co-operative Banks at a seminar convened by the Reserve

** Shri Gill took over as Director of Information and Publicity, Government of Punjab in January 1972.

Bank in February 1972.

Review Committee's proposal - a critique

2.1 The Review Committee while recognising the fact that in the initial stages of building up the co-operative credit structure in the different parts of the country a substantial volume of resources may have to be provided by the Reserve Bank, felt that "as the institutions grew in terms of volume of turnover, viability and operational efficiency, they would be able to build up larger resources on their own by mobilising deposits and progressively reduce their dependence on the Reserve Bank even though the Bank might not reach the position of a lender of last resort in the foreseeable future so far as these banks were concerned". The Review Committee had observed that although the deposits and owned funds of the state and central co-operative banks had increased over the years, there had been no appreciable decline in the proportionate extent of dependence on borrowings. While the reduction in the extent of dependence on the Reserve Bank is not necessarily an indicator of the progress made by the banks in attracting deposits, it was further pointed out that the incentive for deposit mobilization had been affected, among other factors, by the availability of credit from the Reserve Bank at a concessional rate as resources raised in the form of deposits would be costlier as a source of funds especially where the savings and fixed deposits constituted a large part of the total deposits. For encouraging a progressive increase in the reliance on own resources and a proportionate decline in the borrowings from the Reserve Bank, the Review Committee was of the view that:

(i) the borrowings from the Reserve Bank should be made costlier to a central bank which failed to mobilize deposits;

(ii) a central bank raising the prescribed minimum level of deposits should be rewarded in the form of a reduced cost of borrowing; and

(iii) the present extent of concession in the rate charged should be reduced so that it might act as a disincentive to borrow from the Reserve Bank.

2.2 The specific steps recommended by the Review Committee for achieving these objectives were as follows:

(i) The Reserve Bank should, at the beginning of each accounting year, set a target for each central co-operative bank in respect of the amount by which it should increase its deposits during the year.

(ii) If a central bank reached or exceeded the specified target, it should be charged interest at ½% below the concessional rate (referred to in (iv) below). On the other hand, if the bank failed to achieve the target, and if the shortfall was less than 50 per cent of the target, the bank should be charged an additional rate of ½% above the concessional rate; and if the shortfall was more than 50 per cent, the additional rate should be increased to 1 per cent.

(iii) Since the reward or the penalty had to be based on the performance during the year, a decision should be taken in this regard after the close of the year and, depending upon the bank's achievement, it should be allowed a rebate on the interest which it had already paid to the Reserve Bank or called upon to pay the additional penal interest over and above the normal rate which it had already paid.

(iv) The concession available to the state co-operative banks in respect of the rate of interest on short-term agricultural loans should be reduced from 2 per cent below the Bank Rate which was the present level, to 1½%. In other words, the effective rate should be increased from 4 per cent to 4½ per cent.

(v)As for the resultant increase in the borrowing rate in respect of banks not achieving the target fully or achieving it partly, it was felt that it should ordinarily be possible for the small increase to be absorbed by the margins at one or more tiers of the co-operative credit structure and therefore, it might not be necessary to raise the ultimate rate charged to the cultivators merely on this account.

2.3 The recommendation of the Review Committee, in effect, meant: (a) fixing a realistic target for deposits for each central bank and (b) charging differential rates of interest on the borrowings from the Reserve Bank depending on the achievement or otherwise of the specified target.

View points on the proposal

2.4 The Group considered the various comments made at the meetings and conferences which discussed the Review Committee's proposal. These are enumerated below:

(i) Absence of incentives to banks achieving targets;

(ii) Heavy penalty for banks failing to achieve targets;

(iii) Difficulty in fixing appropriate targets for deposits;

(iv) Absence of conditions conducive to deposit mobilization;

(v) Difficulties in recovering the penalty at a later date.

These are elaborated in the following paragraphs.

2.5 A view has been expressed that the proposal made by the Review Committee does not provide any incentive to the banks to mobilise deposits because for achieving or exceeding the deposit target, there would be no reward in the form of a lower interest on the loans from the Reserve Bank as the effective rate would be the same as hitherto viz. 2 per cent below the Bank Rate. Banks can attain a higher level of deposits only at a higher cost as the average cost of the deposits works out to more than the cost of borrowings from the Reserve Bank. The additional outlay involved in raising more deposits would not thus be compensated. Further, if the deposits increased at a faster pace than the loans, the banks would qualify for lower limits from the Reserve Bank and the benefit of even the present lower rate would get progressively reduced. The banks would thus have no special incentive to mobilise more deposits.

2.6 The penalty for failure to achieve the targets either fully or partly is very severe as in such cases the entire borrowings of the central banks from the Reserve Bank will carry the penal rate of interest. It will not be possible for the banks and societies to absorb the increase amongst themselves so that the ultimate borrower would have to pay a much higher rate of interest than at present. The expectation of the Review Committee that their proposal would not lead to an increase in the rate to the ultimate borrower may be belied.

2.7 At the instance of the Group, the Agricultural Credit Department of the Reserve Bank of India attempted an exercise in fixing deposit targets in respect of 50 central co-operative banks. The governing considerations were the stage of agricultural development of the district, the availability of banking facilities, the rate of growth of deposits in the past, branch network, the range and scope of services to the customers etc. On a comparison of the targets provisionally arrived at and the actual performance at the end of the year, it was found that 30 central banks did not attain the targets. The important reasons for this failure were: (i) the sudden and heavy withdrawals of deposits of grampanchayats, municipalities etc. (ii) the occurrence of widespread natural calamities in the area of operations and (iii) the high level of deposit targets fixed, based largely on the rating of the district in relation to agricultural development. In regard to some of the banks which had achieved the targets, it was observed that they were crediting the deposit accounts with the loan amounts sanctioned to societies. In a few other cases, heavy amounts representing share capital contribution, managerial subsidy, godown loan etc. by the State Government to the primary credit societies were held back and kept as deposits with the banks. The exercise, though limited, highlighted the practical difficulties involved in deciding on realistic target for deposits and the unforeseen contingencies that may upset the calculations. The factors involved are many and varied and present a formidable task in deciding their relative importance and appropriate weightage. Most of the factors do not permit of an objective assessment of both the deposit potential and the capacity of the bank to attract the same. In the circumstances, the targets could also be disputed as being arbitrary or as not taking due account of all the supposed handicaps of a particular bank. The tendency, therefore, may be to err on the safer side and fix deposit targets at relatively low levels so that the large majority of the central co-operative banks will continue to get credit facilities from the Reserve Bank at the same concessional rate as at present. This would defeat the very objective behind the recommendation of the Review Committee.

2.8 Before penalising the banks for their failure to tap deposits of a given order, it would be necessary to create conditions favourable for building up deposits by removing the restrictions on placing the surplus funds of local bodies, quasi-government institutions and trusts etc. with co-operative banks and by extending the insurance cover available under the Deposit Insurance Act to these banks. We understand that only in five States (Gujarat, Jammu & Kashmir, Madhya Pradesh, Maharashtra and Tamil Nadu) the local bodies, universities and other quasi-government institutions have been permitted by the respective State Governments to keep deposits with the central co-operative banks. In four States (Assam, Bihar, Punjab and Haryana) similar permission has not yet been accorded. In Andhra Pradesh, Kerala, Rajasthan and West Bengal, Municipalities/educational institutions and/or religious bodies are not allowed to keep their funds with the central co-operative banks owing to certain restrictive provisions contained in the relative State enactments. As regards the deposit insurance cover, only three States namely Andhra Pradesh, Madhya Pradesh and Maharashtra and the Union Territory of Goa, have suitably amended their Co-operative Societies Acts and consequently the Deposit Insurance Act has been extended to the co-operative banks in these areas. The other States are yet to initiate concrete action in this regard. Not all States could, therefore, be said to have created favourable conditions in the manner and to the extent required.

2.9 As observed by the Agricultural Credit Board, the formula suggested by the Review Committee would present certain practical and administrative difficulties in implementation. The suggestion for reduction in the concessional rate of interest, viz. from 2 per cent to 1½ per cent below the Bank Rate (6 per cent at present) would mean a rate of 4½ per cent. This rate, however, is only notional because the effective interest rate, if the rebate and penalty system as recommended by the Review Committee were to be implemented, would vary from bank to bank depending on its performance vis-a-vis the target for deposits as shown below:

Condition	Effective Rate
If the deposit target is reached ($4\frac{1}{2}\% - \frac{1}{2}\%$)	4 per cent
If the shortfall in the target is less than 50% ($4\frac{1}{2}\% + \frac{1}{2}\%$)	5 per cent
If the shortfall is more than 50% ($4\frac{1}{2}\% + 1\%$)	$5\frac{1}{2}$ per cent

According to the proposal, the rebate has to be passed on to the banks concerned after the close of the co-operative year. Similarly, the penal interest has to be recovered if the target is not achieved. Recovery of the penal interest at a later date from the institutions including the ultimate borrowers may present certain practical problems, although the passing on of the rebate may not.

Conclusions

3.1 Any formula for reward or penalty should have a built-in mechanism under which a central co-operative bank raising more deposits and ploughing them in agricultural loans does not suffer any serious loss. To achieve this objective, the Group examined various alternative formulae and found the following the most appropriate.

3.2 The salient features of this new proposal are as under:

(i) The Reserve Bank's lending rate for short-term agricultural purposes may be fixed at $\frac{1}{2}\%$ below the Bank Rate.

(ii) A rebate of 1½% (in the interest on borrowings) may be granted by the Reserve Bank on that part of the borrowings of the state co-operative bank on behalf of a particular central co-operative bank, which represents the level of its borrowings from the Reserve Bank in a base year. In other words, the present concessional rate of 2 per cent below the Bank Rate would apply to the borrowings of a central co-operative bank up to a "base level".

(iii) The rebate of 1½ per cent will be also granted to the borrowings of a central bank over and above the base level to the extent of twice the increase in its involvement out of its own resources in agricultural loans.

(iv) The highest level of borrowings under the short-term limits for seasonal agricultural operations from the Reserve Bank reached during the preceding three years may be fixed as the "base level" for the purpose of granting the rebate under item (ii) above.

(v) The increase in a central co-operative bank's short-term agricultural loans would be the difference between the bank's own maximum involvement (outstandings against societies minus its borrowings from the apex bank) during the calendar year and that during the base calendar year i.e. the year preceding the one in which the scheme comes into force.

3.3 The procedural details in regard to the implementation of the proposal may be worked out by the Agricultural Credit Department of the Reserve Bank.

Comparative merits

3.4 The relative merits of the alternative formula suggested by us have to be viewed against the basic objective underlying the recommendation of the Review Committee, namely, reducing the dependence of co-operative banks on the Reserve Bank and making them progressively more self-reliant. This objective may not be fully achieved under the formula recommended by the Review Committee inasmuch as the increase in the level of deposits may not necessarily result in a reduction in the borrowings from the Reserve Bank, unless the banks do not find an outlet for their funds in loans to marketing societies, consumers' stores, urban banks, industrial societies etc. or as deposits with the state co-operative banks and the commercial banks. The alternative formula provides a definite disincentive to the banks to borrow from the Reserve Bank for short-term agricultural purposes above a given level.

3.5 Secondly, under the Review Committee formula, banks will have no direct incentive to mobilise more deposits as their efforts in that direction may not be adequately compensated. It is true that the banks can hope to earn larger returns by deploying these additional deposit resources in loans to societies which can afford to pay a rate which will leave the banks enough margin even after providing fully for the higher cost of deposits. It is, however, seen that such an avenue is not always available and, therefore, the tendency among the banks is to earn higher returns by keeping the amounts as call or short-term deposits with the state co-operative bank or more often with commercial banks. The objective should be to induce the banks to utilize a reasonable portion of the additional deposit resources in loans to societies for short-term agricultural purposes. It is only then that the objective of reducing the dependence of the banks on the Reserve Bank can be reduced. From the point of view of inducing the banks to utilise more of the additional deposit resources in agricultural loans, the alternative formula has an edge over the Review Committee formula, as the central bank would qualify for additional loans from the Reserve Bank at a concessional rate to the extent of twice the increase in the amount it invests from its own resources in agricultural loans.

3.6 Thirdly, as pointed out earlier, for failure to achieve the deposit targets, the banks will have to pay penal interest on all the borrowings from the Reserve Bank. Under the alternative formula, borrowings up to the base level will continue to be charged interest at 2% below the Bank Rate to the state co-operative bank and this concessional rate would apply also to further borrowings to the extent of twice the increase in the investment made by the central co-operative bank in agricultural loans from its own resources. Thus, the banks which fail, for example, to achieve even 50 per cent of the deposit target under the Review Committee formula, will have their borrowings protected atleast up to the base level.

3.7 Fourthly, there will be no need to fix targets for deposits under the alternative proposal. The eligibility of banks for rebate on the borrowings from the Reserve Bank will be dependent on the deposits raised and utilised in enlarging their advances for agricultural purposes.

3.8 We are of the view that on the foregoing considerations the alternative suggested by us combining as it does both the elements of incentive to deposit mobilisation and disincentive to borrowing from the Reserve Bank in appropriate measure is preferable to the formula of the Review Committee and recommend its implementation from the year 1972-3.

Safeguards and precautions to be taken

3.9 In implementing the system of incentives and disincentives the Review Committee itself did not favour any abrupt or substantial reduction in the existing concessions and in fact appreciated the practical difficulties likely to be encountered in bringing about the transition. Besides, it would also be necessary to ensure that the proposal does not unduly hinder the flow of credit through the co-operative agency for agricultural production. There should be enough time and opportunity allowed to the central banks in adjusting themselves to the new system of incentives and disincentives. This is particularly important for the reason that the stage of development of the central banks and their financial position and operational efficiency vary rather widely from State to State and even within the same State. Obviously, not all banks could be subjected to the discipline straightway. Hence we recommend that the proposal made in para 3.2 above may not apply to banks which in any of the three years ended 1970-71 did not enjoy from the Reserve Bank a credit limit exceeding Rs 50 lakhs for financing seasonal agricultural operations and also if they have not attained a loan business of Rs 1 crore. In other words, banks which have already attained a loan business of Rs 100 lakhs and above will be subjected to the proposed discipline and the non-viable banks should continue to enjoy finance from the Reserve Bank at the same rate as before. It is necessary to make these banks viable in the quickest possible time and in this context the continuance of credit facilities at the concessional rate of 2 per cent below the Bank Rate will be of great assistance to them. There are presently 120 such banks in the country as listed out in Appendix I.

3.10 Our proposal for fixing the base level at the maximum of the outstandings reached over a period of time should give the banks the maximum protection in regard to the continued availability of finance from the Reserve Bank up to this level at the existing concessional rate of interest. During the 3 years ended 1970-71, the maximum outstandings under short-term credit limits sanctioned by the Reserve Bank were of the order of Rs 280 crores. Borrowings up to this level would carry concessional rate. This accounts for roughly 1/3 of the outstanding loans at the primary level. Considering, however, the magnitude of the credit needs for agricultural production estimated at Rs 2,000 crores and the principal role assigned to co-operatives in meeting the credit needs to the extent of about Rs 700 crores, it will be unrealistic to expect the banks to borrow the entire part of the additional finance from the Reserve Bank at a rate higher than the existing concessional rate. It should also be at the same time noted that any incentive over and above the base level protection should necessarily be related to the additional involvement of banks out of their own resources in agricultural loans. It is for this reason, the alternative proposal provides for the same rate of interest on the additional borrowings over the base level for an amount equivalent to twice the increase in the involvement of the bank from its resources. This additional entitlement together with the base level protection mentioned above would ensure the availability of bulk of the Reserve Bank's borrowings at the existing concessional rate. It is only the borrowings in excess of the entitlement at the concessional rate that will be subject to interest at ½% below the Bank Rate. Since this will be only a small proportion of the total, the increase in the cost of borrowing should not necessitate a significant increase in the rate of interest to the ultimate borrower even in cases where it cannot be easily absorbed within the structure.

3.11 A concrete example will illustrate the point. Let us assume that a central bank wants to increase its short-term agricultural loans by Rs 3 lakhs. If it puts in Rs 1 lakh from its deposits in the loans it will qualify to receive Rs 2 lakhs from the Reserve Bank at 4½% (inclusive of the margin of ½% of the State co-operative bank). If the average cost of deposits is 6 per cent, the cost of borrowing Rs 1.30 lakhs by way of deposits (the additional sum of Rs 0.30 lakh being the liquid assets to be maintained for the deposit liabilities) and Rs 2 lakhs from the Reserve Bank will be Rs 7,800 plus Rs 9,000 i.e. Rs 16,800, or on an average, 5.09 per cent. If, however, the bank puts in Rs 50,000 in short-term loans out of the deposits, it will qualify for Rs 1 lakh only from the Reserve Bank at 2 per cent below the Bank Rate and have to pay a higher rate at ½ per cent below the Bank Rate on the balance of Rs 1.5 lakhs borrowed for the loan programme of Rs3 lakhs. The cost of the funds will thus be Rs 3,900 plus Rs 4,500 plus Rs 9,000 i.e. Rs 17,400 so that the average cost will work out to 5.53 per cent. This will be higher by 0.44 per cent than in the earlier case. If the involvement of the bank in the additional loans is even less than 1/6th, the cost of borrowing will be higher still. But then this is what it should be, so as to provide a disincentive to borrowing from the Reserve Bank and an incentive to mobilise deposits. It may be mentioned, however, that the increased cost worked out above is only in respect of the additional funds invested in short-term agricultural loans and additional borrowings over and above the base level. If the protection offered for the base level borrowings from the Reserve Bank is taken into account, the increase in the cost of borrowings would not be large and it should be possible for the banks and the societies to absorb a substantial part if not the whole of it.

3.12 The dependence of central co-operative banks on the Reserve Bank in respect of short-term agricultural loans, as may be seen from the statement given in Appendix II, was about 50 per cent up to 1964. In the later years it has shown a declining trend. This by itself cannot be interpreted to mean increasing self-reliance on the part of the banks, as there are other factors like the non-overdue cover condition which have prevented them from availing of the limits sanctioned by the Reserve Bank in full. It is hoped that the position of recoveries will improve appreciably in the immediate future so that the banks can take full advantage of the credit facilities from the Reserve Bank to provide greater assistance to the smaller farmers. While, therefore, the banks should be expected to raise as large a part of the additional resources required by way of deposits and owned funds, the proportion of the finance provided by the Reserve Bank over and above the existing level may have to be higher than 50 per cent. Hence we have recommended that for every one rupee invested in the short-term agricultural loan business a central bank should qualify to receive Rs 2 from the Reserve Bank at the concessional rate of 2 per cent below Bank Rate. We also recognize the need for providing an inducement to the banks to go all out to meet the credit needs of small and marginal farmers in the Small Farmers Development Agency and Marginal Farmers' and Agricultural Labourers project areas as well as outside which has been emphasised by the Registrar's Conference. This inducement may take the form of making them eligible for the concessional finance at 2 per cent below the Bank Rate to the full extent of the additional finance provided by them to such farmers, even if that goes beyond their normal entitlement at twice the increase in their own involvement out of deposits and owned funds.

3.13 It is possible that some banks would not have availed of the maximum loans from the Reserve Bank for various reasons so that in their case the base level might be unduly low. In some others the limit sanctioned by the Reserve Bank may itself be small because of a relatively small programme in the particular years. In such cases if the lending programme warrants, we see no objection to allowing the rebate of 1½ per cent on the additional borrowings even upto 3 to 4 times the increase in the banks own involvement in agricultural loans. This should, however, be decided on the merits of such banks.

3.14 A view has been expressed at the Chief Executive Officers' Seminar that the Reserve Bank which has so far been sanctioning credit limits on the basis of a bank's lending programme may hereafter be guided by its performance in increasing deposits and may reduce the credit limits. The apprehension, in our view, is unfounded. We expect that credit limits would be sanctioned by the Reserve Bank on the same basis as at present with due regard to the realistic lending programmes of the banks. For failure to raise deposits and to use them in agricultural loans, the banks would not have to face a cut in the credit limits, but only to pay a higher rate of interest on that part of the borrowings which are in excess of the base level.

3.15 A review of the position may be made at the end of three years from the year of giving effect to the above recommendations and based on such a review, the need for modifying the system of incentives or disincentives or otherwise may be decided by the Reserve Bank.

Applicability to state co-operative banks

3.16 The incentives or disincentives recommended by us are applicable only in respect of the borrowings of the central co-operative banks from the Reserve Bank for seasonal agricultural operations. ~~and marketing of crops.~~ The borrowings of central co-operative banks for all other purposes will continue to be charged the same rates of interest as at present.

3.17 Since the proposal covers only the borrowings from the Reserve Bank, it follows that it will benefit only the central co-operative banks and not the State co-operative bank which invests from its own resources over and above the borrowings from the Reserve Bank on behalf of the central banks in accomodating the latter for seasonal agricultural operations. A view was expressed at the Chief Executive Officers' Seminar that if deposits were raised at 6 per cent and the advances for agricultural purposes granted at 4½ per cent, the State co-operative bank would incur a loss of 1½ per cent and it would gain ½ per cent if the source of funds was the Reserve Bank. It was, therefore, pleaded that the apex bank deserved to be compensated if it was to supplement the borrowings from the Reserve Bank by deploying a part of the deposit resources whose average cost worked out to more than the rate at which funds were available from the Reserve Bank.

3.18 We have examined the above views and have to observe firstly that the recommendation by the Review Committee does not contemplate any incentives/disincentives to the State co-operative banks for deposit mobilization. These are to be directly related to the efforts of the central co-operative banks in mobilizing deposits and utilising them in making advances for agricultural purposes. It is for inducing the central co-operative banks to utilise their funds raised by way of deposits in agricultural loans carrying a lower rate of interest as compared to the interest rates on non-agricultural loans that, we have recommended the extension of the rebate on borrowings equivalent to twice the increase in their involvement from own resources in agricultural loans.

3.19 Secondly, the investment of the State co-operative banks from their own resources as may be seen from the statement given in Appendix II, formed less than 10 per cent of the total short-term agricultural loans advanced by them to central banks upto 1964-65. In later years the proportion has increased to 20 per cent and more largely because these banks have had to invest more from their resources so that the central banks satisfied the non-overdue cover condition. If, as we expect, the position of overdues in the central banks improves, there will be fuller utilisation of the credit limits sanctioned by the Reserve Bank and the investment of the State co-operative banks may again come down to 10 per cent or less as in the earlier years. If the funds derived from the Reserve Bank accounted for 90% of the total, the average cost of borrowing will be only fractionally above the rate at which loans are advanced by the Reserve Bank. Further as the banks have been charging an uniform rate on all their loans to central banks irrespective of the source of funds, they have earlier taken into account this higher average cost in fixing their advances rate. This position does not change even after the proposal made by us is implemented.

3.20 Thirdly, what is contemplated is a rebate on the loans obtained by a State co-operative bank on behalf of a central bank from the Reserve Bank. If a portion of the loans advanced to a central bank comes out of the apex bank's resources and it is to be compensated suitably in that behalf, the Reserve Bank will have to provide the compensation by way of a direct subsidy to the latter bank. There is no provision in the Reserve Bank of India Act for the Bank providing such direct assistance.

3.21 Finally, we observe that the Reserve Bank is already compensating the State co-operative banks to some extent by sanctioning limits at 2 per cent below the Bank Rate under Section 17(4)(a) i.e. against Government and trustee securities, provided the accommodation is for financing seasonal agricultural operations and marketing of crops. We have noted that such limits are generally limited to 10 per cent of the aggregate of the limits sanctioned on behalf of central banks and that the Reserve Bank does not intend to withdraw the existing facility.

3.22 For the reasons given above we feel that there is no need to compensate the State co-operative bank for whatever investment it makes out of its own resources in short-term agricultural loans over and above the borrowings from the Reserve Bank. We expect, at the same time, that the apex bank as the leader of the co-operative banking structure will exert pressure to ensure that the central banks draw up concrete programmes for deposit mobilisation.

<u>Rate of interest to be charged to the ultimate borrowers</u>

3.23 Our recommendation in regard to the continued availability of concessional finance for a good part of the borrowings of the central banks conforming to a certain discipline should greatly lessen the overall impact on the cost of funds and consequently the need for raising the rate of interest may not arise as the small increase that may take place in some banks could as well be absorbed by them. If, however, this becomes difficult in a few cases, the increase in the rate of interest to the ultimate borrower may not be more than ¼% to ½% which may not be considered too high.

<u>Summary of recommendations</u>

4 Our recommendations for achieving the objectives underlying the recommendations made by the Review Committee in regard to the linking of concessional finance from the Reserve Bank with the efforts at deposit mobilization by the

central co-operative banks may be summed up as under:-

(a) The Reserve Bank's lending rate be fixed at ½% below the Bank Rate.

(b) Rebate of 1½% may be allowed on: (i) the borrowings up to the base level (as indicated in para 3.2 (ii) above); and (ii) additional borrowings up to twice the increase in the bank's involvement out of its own resources in agricultural loans (as indicated in para 3.2(iii) above) or to the full extent of the loans to small/marginal farmers (as indicated in para 3.12 above).

(c) Where the banks have not availed of the maximum loans from the Reserve Bank and consequently the base level has been unduly low, the entitlement at the concessional rate may be even higher than twice the increase in the central bank's own involvement and be even three or four times depending on the merits of each case.

(d) The proposal will not apply to central banks enjoying credit limits from the Reserve Bank not exceeding Rs 50 lakhs during any of the preceding three years and also if they have not attained a loan business of Rs 1 crore. All the non-viable banks would continue to enjoy finance from Reserve Bank at 2 per cent below the Bank Rate.

(e) The whole scheme may come into force from the next co-operative year i.e. from 1972-73 and reviewed after three years of operation.

(f) The procedural details in regard to the implementation of the proposal may be worked out by the Agricultural Credit Department of Reserve Bank.

5 The Group would like to place on record their appreciation for the valuable assistance provided by the staff of the Agricultural Credit Department and in particular by Shri R. Sundaravaradan, Assistant Chief Officer and Shri T. Narasingachari, Rural Credit Officer who have been responsible for the tabulation of data, collection of other relevant information and preparation of drafts for the consideration of the Group.

Bombay
19 April 1972

MAGANBHAI R. PATEL

S.S. PURI

K.S. BAWA

V. ALAGAPPAN

C.D. DATEY

Appendix I

List of central cooperative banks which have been sanctioned short-term credit limits of Rs 50 lakhs and less by the Reserve Bank of India and banks which have loan outstandings of Rs 100 lakhs and less during ~~any of~~ the ~~last~~ 3 years ended 1969-70

(Rs in lakhs)

Sr. No.	Name of the bank	Limits for ~~S.A.O. and M.C. from R.B.I.~~ Seasonal agricultural operations and marketing of crops from R.B.I.			Loans outstanding against societies at the end of June		
		1968-9	1969-70	1970-71	1967-8	1968-9	1969-70
1	2	3	4	5	6	7	8
	Andhra Pradesh						
1.	Bhongir	40	30	-	49.63	57.34	55.97
2.	Cuddapah	40	40	40	55.71	68.88	79.71
3.	Kakinada	75	75	75	84.84	90.69	82.61
4.	Khammam	40	50	40	50.01	67.25	83.48
5.	Medak	40	40	45	59.12	76.31	83.69
6.	Nalgonda	40	50	50	74.68	79.91	78.45
7.	Nellore	25	25	25	89.01	92.92	92.87
8.	Ramachandrapuram	65	60	80	60.65	81.21	98.02
9.	Srikakulam	-	-	-	77.96	76.02	80.98
10.	Warangal	25	30	30	56.35	69.50	76.60
	Assam						
11.	Dibrugarh	-	-	-	10.60	12.49	16.13
12.	Kamrup	-	-	-	45.83	55.71	96.20
13.	Sibsagar	-	-	-	36.24	40.27	44.75
	Bihar						
14.	Begusarai	31	25	35	37.58	30.64	38.01
15.	Bettiah	20	35	40	25.46	35.40	47.94
16.	Bhagalpur	25	25	25	91.76	77.62	68.85
17.	Bihar-Barh-Fatwa	49.50	40	35	93.28	83.35	76.07
18.	Daltonganj	-	-	-	47.65	48.19	41.09
19.	Deoghar-Jamtara	15	15	20	26.40	30.54	33.06
20.	Dhanbad	30	25	30	53.55	60.00	77.06
21.	Dinapur-Masaurhi	20	15	15	27.55	19.61	20.39
22.	Dumka-Godda-Rajmahal	30	20	20	51.71	46.78	40.78
23.	Giridih	27	18	15	47.12	54.65	50.17
24.	Gopalganj	25	25	35	31.86	36.44	40.61
25.	Gumla-Simdega	10	10	10	13.52	15.39	19.23

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1	2	(3)	4	5	6	7	8
Bihar contd....							
26.	Madhepura-Supaul	28	20	20	43.37	46.93	57.20
27.	Magadh	50	40	50	91.45	68.17	55.84
28.	Monghyr-Jamui	45	35	-	75.99	62.77	61.23
29.	Motihari	25	25	30	34.02	36.87	49.68
30.	Nawadah	16	12	12	41.06	38.61	40.44
31.	Ranchi-Khunti	25	25	20	39.69	38.69	38.67
32.	Sasaram-Bhabua	53.50	50	50	77.46	87.39	76.17
33.	Singhbhum	15	15	20	27.08	27.59	31.40
34.	Sitamarhi	50	40	40	49.76	61.42	87.99
Gujarat							
35.	Kutch	-	-	-	58.86	73.24	80.85
Haryana							
36.	Brayne	35	35	50	48.23	60.67	66.94
37.	Jind	50	50	65	50.35	65.15	80.34
Himachal Pradesh							
38.	Kangra	-	-	-	60.44	73.87	80.32
39.	Jogindra	-	-	8	14.84	12.68	19.41
Jammu & Kashmir							
40.	Anantnag	-	-	40	89.15	83.51	93.49
41.	Baramulla	-	-	25	33.03	27.57	41.48
Madhya Pradesh							
42.	Bastar	15	17.50	-	88.56	81.00	93.52
43.	Betul	30	35	35	55.51	61.24	60.91
44.	Datia	33	35	25	53.23	57.08	68.20

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1	2	3	4	5	6	7	8
Madhya Pradesh contd...							
45.	Jhabua	15	-	-	58.33	63.64	76.42
46.	Mandla	25	32.50	35	62.08	65.72	78.09
47.	Narsinghpur	20	25	25	51.21	41.63	43.95
48.	Panna	15	13	15	37.37	40.58	41.44
49.	Raigarh	40	40	50	64.30	68,05	92.58
50.	Satna	15	10	10	44.08	52.65	68.05
51.	Shahdol	15	10	-	71.07	68.59	67.50
52.	Sidhi	45	45	45	75.91	91.03	97.90
53.	Surguja	22	-	-	78.88	84.13	72.26
Orissa							
54.	Angul	40	30	30	69.87	60.06	62.30
55.	Aska	40	50	50	106.09	88.49	86.01
56.	Banki	60	50	40	91.86	84.06	64.65
57.	Bhawanipatna	30	25	25	42.87	38.54	40.97
58.	Bolangir	10	25	35	29.16	45.35	85.73
59.	Boudh	15	20	-	34.19	39.39	35.85
60.	Keonjhar	15	15	15	36.63	32.17	33.60
61.	Khurda	-	-	25	115.48	108.88	88.98
62.	Koraput	25	40	50	49.99	53.42	59.77
63.	Mayurbhanj	20	20	15	45.40	45.55	40.47
64.	Nayagarh	60	45	45	89.42	93.97	79.07
65.	Sundargarh	5	5	15	24.19	38.92	46.62
Rajasthan							
66.	Ajmer	30	35	35	63.69	78.93	97.34
67.	Banswara	-	-	-	28.29	33.12	37.24
68.	Barmer	23	23	20	41.05	51.68	73.94
69.	Bhilwara	-	45	45	58.21	78.37	90.80
70.	Bikaner	-	-	-	19.26	26.23	30.24
71.	Bundi	20	25	25	39.72	81.83	68.87
72.	Churu	15	15	15	14.53	38.60	38.26
73.	Dungarpur	15	12	12	23.95	28.28	31.02
74.	Jalore	12.50	12.50	12.50	20.27	39.74	48.66

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1	2	3	4	5	6	7	8
Rajasthan contd...							
75.	Jhunjhunu	-	-	-	18.46	23.42	22.81
76.	Jodhpur	-	10	10	56.27	69.42	98.08
77.	Pali	-	30	30	47.03	58.03	84.88
78.	Sawai Madhopur	40	50	50	52.27	65.22	71.10
79.	Sikar	15	15	15	29.80	37.79	39.89
80.	Sirohi	13	13	10	21.04	26.29	29.02
81.	Tonk	25	45	40	24.70	53.65	70.01
82.	Udaipur	35	45	45	53.15	74.84	81.38
Tamil Nadu							
83.	Pudukkotai	40	25	35	41.34	49.65	73.00
Uttar Pradesh							
84.	Almora	12	12	14	29.83	32.00	53.52
85.	Bahraich	35	35	35	64.20	50.96	59.21
86.	Banda	60	50	50	75.78	90.37	91.66
87.	Barabanki	33	30	30	42.49	49.46	66.70
88.	Chamoli	10	-	-	11.38	9.30	14.01
89.	Etah	35	-	-	72.61	77.74	99.80
90.	Faizabad	40	40	40	60.95	59.17	63.68
91.	Fatehpur	45	45	45	71.08	80.85	95.47
92.	Garhwal	15	15	20	33.53	34.99	39.02
93.	Hamirpur	-	-	-	60.68	59.01	69.01
94.	Hardoi	-	-	25	51.94	58.83	68.81
95.	Jalaun	60	60	60	66.85	51.96	59.61
96.	Kanpur	-	-	-	68.57	67.90	67.36
97.	Mainpuri	40	40	40	96.28	98.79	98.79
98.	Mohanlalganj	32	25	20	31.32	33.26	35.50
99.	Pithoragarh	9	-	10	12.28	11.56	15.64

1	2	3	4	5	6	7	8
Uttar Pradesh contd...							
100.	Pratapgarh	40	40	40	86.09	95.60	95.88
101.	Radhasoami	-	-	-	0.80	0.85	0.99
102.	Roorkee	50	40	50	53.30	62.60	82.07
103.	Sultanpur	70	70	-	96.89	96.21	87.28
104.	Tehri Garhwal	20	20	22	38.49	30.89	39.47
105.	Unnao	-	-	-	47.76	51.12	56.48
106.	Uttar Kashi	-	-	-	-	16.39	19.83
West Bengal							
107.	Balageria	10	15	15	23.12	25.48	32.65
108.	Balurghat	-	-	-	35.70	38.43	50.23
109.	Bankura	16	20	35	46.69	54.70	82.92
110.	Cooch Behar	14	10	-	26.59	24.30	32.13
111.	Darjeeling	-	-	5	3.39	3.29	2.66
112.	Hooghly	30	30	30	73.39	74.68	84.58
113.	Howrah	30	30	30	44.18	44.95	53.55
114.	Jalpaiguri	30	15	-	52.60	45.75	45.33
115.	Kalna-Katwa	40	30	30	59.72	66.02	72.51
116.	Malda	30	30	30	41.59	48.03	60.57
117.	Mugberia	-	-	-	45.13	49.90	53.75
118.	Murshidabad	50	40	40	77.78	69.30	94.47
119.	Purulia	5	5	-	12.81	12.25	15.35
120.	Raiganj	20	20	20	29.78	28.75	45.37

~~* Figures for 1970-71 are not available~~

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24.4.

APPENDIX - II

Statement showing the borrowings and lendings of state and central co-operative banks for seasonal agricultural operations and marketing of crops

(Rs Crores)

Year	* Borrowings of state co-operative banks from Reserve Bank (outstanding as on 30 June)	Lendings to central co-operative banks (outstanding as on 30 June)	@ Lendings to primary agricultural credit societies (outstanding as on 30 June)	% of Col. 2 to Col. 3	% of Col. 2 to Col. 4
1.	2.	3.	4.	5.	6.
1960-61	100.11	102.38	173.87	97	57
1961-62	115.20	125.66	200.81	91	57
1962-63	124.28	138.75	225.40	89	55
1963-64	146.54	152.60	263.62	96	56
1964-65	150.51	159.41	287.20	94	52
1965-66	143.67	166.42	320.68	86	45
1966-67	135.38	169.72	369.91	79	37
1967-68	137.17	182.65	412.19	75	33
1968-69	183.09	226.65	471.92	80	39
1969-70	214.11	275.93	494.58	77	42

* Including those of State co-operative banks in Union Territories.

@ Including the lendings in Union Territories.

Note: Figures in Col. 4 are provisional. As break up of short-term loans into seasonal agricultural operations and others is not available in respect of Madhya Pradesh, Mysore, Orissa and Rajasthan the entire short-term loans are shown in respect of these States.