

Centenary of Indian Cooperative Movement -  
Round Table on Cooperative Banking - CAB, Pune -  
10 December 2005

Key Note Address by Shri Y.S.P. Thorat<sup>1</sup>

I am extremely pleased to be associated with the Round Table<sup>2</sup> on Cooperative Banking organised by the CAB, Pune to commemorate the completion of 100 years of cooperation. The structural arrangement of the Round Table covering two modules - viz., one relating to urban cooperative banks (UCBs) and the other to rural cooperative credit institutions, is both appropriate and timely.

There is a broad agreement between academics, practitioners and policy makers that cooperative credit institutions are passing through a critical phase in their life cycle. In this context the themes identified by the College will go a long way in facilitating the framing of an appropriate road map for urban and rural cooperative credit delivery mechanisms.

I propose today to speak about the recent initiatives taken in regard to the rural cooperative credit institutions. Let me begin with a normative statement. Many years ago, when the Maharashtra State Coop. Bank was being set up, the members of the Board of Directors including persons of eminence such as D.R. Gadgil, Vainkuth Mehta and others, used to come to the Board Meeting with lunches packed from their homes. During the meeting, tea was served but invariably paid for by them. Lunch was a cooperative sharing of 'dabbas' on the lawn outside the office. After the meeting, they would go back by bus. Office cars were seldom, if ever used. The point of narrating this is to draw your attention to the fact that in its origin the cooperative system has been driven by high values,

---

<sup>1</sup> Managing Director, NABARD

<sup>2</sup> This is the text of the speech delivered by him in the Round Table on Cooperative Banking organized by the College of Agricultural Banking of RBI at Pune on December 10, 2005 to commemorate 100 years of Cooperative Movement in India.

principles and ethics. These informed and drove the system. We are heirs to this legacy and we must therefore do everything we can to preserve it – not fritter it away.

Since, we are meeting today to commemorate 100 years of cooperative movement in India, a brief recapitulation of the historical perspective may not be out of context.

Fundamentally, the cooperative movement was the response of an imperial Government to agrarian riots which took place in the Deccan in the late 19th century. These riots in Pune and Supe, brought to the attention of the then Government that farmers were indebted to money lenders. This was evidenced by the fact that large scale transfers of agricultural lands by ryots in favour of money lenders had steadily been taking place.

The agrarian riots prompted the British Government to give an impetus to the system of Taccavi loans to farmers, bring in regulations regarding money lending, and initiate cooperative legislation as an alternative – and competing - credit delivery mechanism to money lenders. It is of note that the entire initiative was driven by the State. In other words, the cooperative system was a creation of the State and did not grow out of the soil of India. It was imposed as being necessary and desirable for it. This is intriguing, because in England, the cooperative system originated as a ground level response to some of the ills of Industrial Revolution. Yet ironically, when the same Government applied this to its colonies, it did so as a supply driven model. This is the original mistake injected into the cooperative movement. The effect is - and research bears it out - that wherever cooperatives have emerged as grass root movements, they have had a much higher chance of success than where they have been “implanted” - whether by a colonial government or the democratic government of a free nation.

Because the cooperative movement was a State driven movement it was inevitable that the State machinery would be involved in promoting it. The rationale for setting up the office of the Registrar of Cooperative Societies (RCS) was precisely this and though there has been criticism over time of this institution, to be fair, there have been a number of outstanding civil servants who have manned this Department including luminaries such as Sir Malcom Darling, Registrar of Cooperative Society, Punjab.

Notwithstanding the enthusiasm characterising the cooperative movement in the early years and some significant legislative work thereafter, the movement took a back seat in the inter-war years. It was only after independence that the attention of the nation was focused on it as the chosen instrument for delivering credit to the farm sector. The importance given to the cooperative movement during this period was dictated by the fact that commercial banks had very low presence in the rural areas. Further, they were all in the private sector and the then Government, given the political imperative was not able to provide an appropriate set of incentives for them to move into the rural areas. Resultantly, the only option were cooperatives which had the advantage of spatial spread and retail outlets at the village level even in remote areas. It was clear that if credit was to be moved to the rural areas, there was no option but to move it through the cooperative structure.

The All India Rural Credit Survey Committee recognised the fact that, the level of capitalisation of cooperatives was very low. Therefore, if they had to lend more, it was necessary for them to borrow more. In order to borrow more, their ability to do so had to be expanded. The committee felt that this could only be done by augmenting their capital base through state support. It is for this reason that State partnership was suggested by the Committee. Of course, in the hindsight of history, this admirable initiative transmitted into State Control. From participating in the share capital of a cooperative and being on the Board,

it was just one step to controlling it. And this is how it happened. I would like to believe that this was not an intended consequence because those were the days of high principles. From the bureaucratisation of cooperatives it was again just one more step towards its politicisation.

The politicisation of cooperative institutions was based on the premise that given their pre-eminent outreach, they could be powerful instruments of political mobilisation. This realisation led to the political structure taking over the cooperative movement and using it, first as an instrument of transmission of state policy and then as an instrument of transmission of narrower sectarian and even, personal objectives.

Let me step back a minute here and reiterate that the political imperative is not necessarily bad. In fact, there is adequate evidence that popularly elected representatives often provide ground level correctives, exercise beneficial control and sometimes even visionary direction. By itself, therefore, the impact of politics is not adverse. It becomes so bad when political forces seek to use institutional structures to promote narrow personal objectives rather than broader institutional or social ends. The light at the end of the tunnel is that as democracies evolve and become better informed through education, political processes mature and increasingly tend towards broader ends.

As I look back in history, I find these two strands viz. politicisation and bureaucratisation running through the warp and woof of the cooperative movement. Their combined effect on the cooperative credit system led to governance and managerial failure leading in turn to severe financial impairment. It was to address this that committees were constituted from time to time. It was however left to the Vaidyanathan Committee of 2004 to come up with an implementable action plan in the 100<sup>th</sup> year of the Cooperative Movement.

Before, I turn to the strategy adopted by the Vaidyanathan Committee, let me clarify that the two factors of bureaucratisation and politicisation, do not, by any means, explain in full the various impairments characterising the cooperative credit structure. They, however, help us to understand some of the reasons why things happened in the way they did. For a fuller understanding, I would commend you to read the report, particularly the section on the 'historical backdrop' to which, Prof. Sriram, who is here today, has contributed so significantly.

When the Vaidyanathan Committee met for the first time, we asked ourselves one question: should cooperatives be revived or should they be wound up ? This was a real issue with us and one which was debated at length. The case for reviving the cooperatives was weak. It was financially impaired, impaired in terms of governance and management. And, therefore, before we could bring ourselves to look at the task in a positive way, we had to find a set of reasons good enough to justify an expenditure of public funds for recapitalizing the system.

What finally swayed the balance was the fact that notwithstanding all its infirmities the CCS had an unparalleled outreach with outlets located in inaccessible areas with 70% of its clientele drawn from the small and marginal farmers category. Given the paradox that the system was impaired and yet had to be revived, the Task Force felt that the only way out was to link financial restructuring with regulatory and institutional reforms. In other words to combine a strong financial incentive with stringent conditionalities.

We began by scanning the system and found that nearly half the retail outlets of cooperative credit institutions at the ground level were loss making. Thus as on 31 March 2004, 7 State Cooperative Banks (SCBs) and 133 District Central Cooperative Banks (DCCBs) were Section 11-Non Compliant; deposit erosion of SCBs and DCCBs taken together exceeded Rs.3,000 crore and the accumulated losses of the system

including those of the long term structure aggregated around Rs.14,000 crore. Incidentally, this assessment did not factor in deposit erosion at the Primary Agricultural Cooperative Societies (PACS) level. Knowing that such institutions have a propensity for making short provisions, we felt that the actual level of deposit erosion in the rural cooperative credit system could be much higher than the figure of Rs.3,000 crore quoted above.

The Task Force also recognized that financial impairment is not a cause but an effect. The causes lie in impairment of governance and management. Here too, the record of cooperative credit system is poor. In many States, cooperatives are characterised by non-conduct of elections; Boards of many institutions have been superseded and State Governments combine - paradoxically - the role of dominant shareholders, managers, regulators and concurrent supervisors and auditors. Further, the RCS can - and does - influence and direct the cooperative institutions in financial and administrative matters including supercession of Boards, directions on interest rates, interference in loan sanctions, announcement of waivers and even worse, keeping recovery efforts on hold. The impairment of governance is as much due to political interference as to politicisation. Political interference is reflected in matters such as appointment of Directors on the basis of political affiliations rather than on merits, interference in decision making - including loan sanctions - on grounds other than commercial, and so on.

On the management side, the impairment makes equally sad reading. Officials from the State Government are deputed 'en masse' to the top slots in Cooperative Banks. By itself, there is nothing wrong with this but in many cases the persons deputed through good civil servants, are not necessarily good bankers. Further, managers of retail cooperative outlets in many States are drawn from a common staff pool. As a result, they do not feel specifically accountable to the institution they serve and in many cases, draw remuneration without reference to its business level

or business results. The day-to-day management of cooperative credit institutions which should be the responsibility of the Chief Executive Officer is usually discharged by the Board thus creating a fuzziness between governance and management. Coupled with this, there is a whole set of reasons relating to unprofessional methods of operation including poor house keeping, weak internal controls, poor quality of government audits, etc.

Lastly, there are certain legal and regulatory issues which have contributed to impairment. The basic legal issue is that the 'cooperatives' as a form of organisation are governed by the State Cooperative Societies Act. This Act, is in the main, institution neutral. As a result, the same set of rules characterize a Cooperative Bank and a Cooperative bazaar. The special status of cooperative banks is not recognised. It is not recognised that cooperative banks being custodians of public funds must be regulated by the Banking Regulator. It may be interesting to find out why the BR Act was made applicable to cooperative banks in 1966, all the provisions relating to governance and management which had enabled RBI to strengthen and consolidate the commercial banking system in 1949 and 1966 were specifically not made applicable to cooperative banks ? Recently, there has been a considerable dialogue the press regarding duality of control between RBI and RCS. It appears to me that 'duality' is not an unresolved concurrent jurisdiction issue. The real problem is that under the existing framework, the Central Bank is required to enforce its regulatory prescriptions through the RCS. Happily the situation is changing and it is extremely gratifying that the position is evolving for the better with certain State Governments agreeing to execute specific MoUs with RBI in regard to Urban Cooperatives Banks. The Vaidyanathan Committee has urged that the oversight of banking cooperatives must be with the Banking Regulator and suggested the instrumentality of MoUs between RBI and the State Government.

In view of the impairment of the cooperative credit structure the Task Force felt that there has to be a clear approach on revitalisation. The approach as finally worked out rested on 4 pillars -

- that, the quantitative advantages of cooperatives outweigh its qualitative disadvantages and therefore, on balance, there is a case for revival.
- that the revival strategy should be a combination of financial restructuring and institutional reforms.
- that the objective of financial restructuring is to induce regulatory, legal and administrative changes.
- that the purpose of legal and administrative changes is to make cooperatives member-centric, democratic, autonomous and self-reliant institutions.

If I was asked to describe in one sentence what is the key direction of the Vaidyanathan Committee Report, I would say it is “to make cooperatives cooperative”.

As you may be aware, the GoI has since accepted the report and it is now in the process of being accepted by the State Governments. It is expected that implementation will commence shortly.

Some questions remain : What is the incentive for a State Government to implement the report?

I believe that as financial assistance begins to flow in the cooperative credit system, and it becomes increasingly clear that the impact is beneficial, State Governments will be induced to accept the report. The quantum of liability devolving upon the State Government for the package to take effect has also inhibited acceptance. This problem has been recognized and the Central Government's share has been

increased. Another question is whether State Governments be willing to cater into MoUs to ensure sound governance and management? This is a ticklish question but I have sufficient reason to believe that there is a political consistency in favour of reform. Increasingly, there is evidence that informed political leadership recognises that this is the only sustainable way to serve their constituencies best in the long term.

As you are aware, the rural credit market is rapidly changing with increasing number of players, increasing competition and increasing leveraging of information technology. MFIs have come to stay and are likely to evolve their own specialised niches; banks are increasingly becoming aggressive and collaborating with civil society organizations to reach the poor; innovative group mechanisms are also evolving both under the SHG group methodology and under Joint Liability Groups on such a scenario, cooperatives need to introspect to find ways and means on how to retain their market share and how to increase it over time. I remember when I joined Reserve Bank of India, their share was three-fourths and today it is less than a third. The first challenge for cooperatives is to arrest this decline and then to develop strategies for overcoming it.

Cooperatives must also bring about an attitudinal mindset overhaul leading to changes in their methods of operations. They must also innovate in terms of products and processes embrace information technology to yield the most optimum results.

The margin issue also has to be addressed. The three-tier structure absorbs margins of 5% to 6%. How can this be reduced? Higher ground level interest rates reflect cost of funds, risk and transaction cost. Of these, transaction cost represents the biggest element and has to be reduced. The answer is not subsidised refinance.

In relation to the cooperative credit structure, NABARD needs to answer the question as to whether there is a case for incentivising good performance through interest rates on refinance. I believe that in the years to come, this must be the direction we should follow. It must address the rigidities in its refinance prescriptions and perhaps learn to say 'No' to the undeserving.

There is a distinguished gathering of cooperators here today. I would beg you to ask yourselves as to what innovations you have made in the last decade. The production oriented system of lending continues to dominate the basic structure of lending while just across the street, you have a host of banks experimenting with newer products, newer processes and newer services. Let me assure you that if you take the first step, NABARD will support any endeavour seeking to reduce costs, improve efficiency or experiment with better products and processes. I would have no hesitation in supporting such action research. Cooperatives have inherent strengths; if we can capitalize on this there is no reason why we should not see a turnaround, now that the system is on the threshold of being recapitalised.

In the end, I would like to quote from the speech given by the Prime Minister when he spoke to us recently at the National Development Council. He said - "Today, India is at a historic point in its development trajectory. We are now at a point in time where we can deliver growth at a rate of 7% - 8%. At this point in time, owing to the developments over the last two decades, there are no external constraints to the growth of our country. It is very much in the realm of possibility for this country to become a prosperous nation, rid of poverty, ignorance and disease. The world is today looking at India with great interest as the saga of our development and rise to prominence on the international stage unfolds. Rare are such moments in history when a nation suddenly captures the imagination of the world.

In such circumstances, if there are any constraints, these are purely internal. Our success in living up to our potential depends solely on us. No external force can be blamed if we do not rise up to everyone's expectations. Therefore, it is incumbent on all of us to ensure that we realize this potential. It is this vision of a resurgent India that must guide our actions while discharging our duties.”

-----