

THE HISTORICAL PERSPECTIVE OF AGRICULTURAL CREDIT INSTITUTIONS

In the early 1950s, when the First Five Year Plan was initiated, Nepal severely lacked both a physical and institutional infrastructure. In the financial sector, it had only one commercial bank (Nepal Bank) which by 1955 had 8 branches - 1 in Kathmandu, 2 in the eastern *Terai*, 3 in the central *Terai*, and 1 in the western hills. In July 1957, the total deposits amounted to about Nepalese Rupees (NR) 35 million and the total assets about 44 million. Its credit facilities were concentrated on the trade and consumption sector and its contribution to the agricultural and rural sector was negligible.

Cooperative Societies

In this context, for the first time, cooperative societies, proposed under the Rapti Valley (Chitwan) Development Scheme, provided institutional credit to the farmers in Nepal. Initially these institutions were established under an executive order and later their operations were carried out under the Cooperative Department, established in 1954.

Further impetus in the expansion of cooperative societies came during the First Plan Period (1956-61) with a gradual extension of the cooperative movement in all parts of the country. The Plan targetted to organise and register 4,500 societies against which 378 cooperative societies with a total membership of 11,059 were established. The paid-up share capital reached NR 0.362 million and altogether NR 1.61 million was lent out by the Government to these societies. An important development during this period was the enactment of the Cooperative Societies' Act of 1959.

The Cooperative Bank

Later on, it was felt that a separate institution was necessary both for financing cooperative societies and for supervising them. Accordingly, the Cooperative Bank was established in the year 1963 under the Cooperative Bank Act of 1963.

The main objectives of this Bank were as follows :

- o to increase agricultural production by financing farmers through Cooperative Societies,
- o to grant loans to cooperative societies for the development of agro-trade and small agro-industries established in a cooperative way,
- o to grant loans to the societies for the marketing of agricultural products, and
- o to provide commercial banking facilities where such facilities were not available.

A board consisting of seven members, representing various ministries, Nepal Rastra Bank, and one person each from the Cooperative Societies and from among the private share-holders, was constituted as the supreme policy-making body of the Bank.

The authorised capital of the Bank was NR 5 million; 51 per cent provided by His Majesty's Government and the remaining 49 per cent by the cooperative societies and others.

By the end of the FY 1966/67, the Bank had opened 14 branch offices and had disbursed about NR 8 million through 900 loans. The major purposes for which loans were disbursed were agricultural production (crops, livestock, and irrigation), followed by marketing, warehousing, and resettlement programmes. During the same period, the Bank collected about NR 3.6 million and by mid-July 1967 the loans outstanding amounted to 4.6 million¹.

Village Committees

The Village Committees came into existence with the enactment of the Land Act, 1964 which was intended to not only put a ceiling on the size of land holdings and secure tenancy but also to mobilise savings compulsorily from the farmers. Under this compulsory savings scheme, land-owners were made to deposit a certain fixed amount in cash or in kind on the basis of the amount of land they cultivated. The collection of savings was to be conducted by the Ward Committees which were organised within the political framework of the *Panchayat* System. Within this framework, each Village *Panchayat* also served as a Village Committee under which the nine Ward Committees were organised. Each Ward Committee would have three members - one was the member representing the Ward on the Village *Panchayat* and the remaining two would be nominated by the District Land Reform Officer.

The Ward Committees were responsible for collecting the compulsory savings, repaying deposits, providing loans to the farmers, collecting loans, and handing over excess funds to the District Reform Offices. Ward Committees were allowed to provide loans to farmers for both production and consumption purposes. The interest rate to the depositors was fixed at 5 per cent whereas the Ward Committees were lending at an interest rate of 10 per cent to the farmers.

Land Reform Savings' Corporation

The Land Act came into force in 16 districts in 1964 and 25 more districts were brought under the programme in 1965. This placed an increased management responsibility on the District Land Reform Offices. The Land Reform Savings' Corporation was established in 1966 under the Corporation Act of 1966 to mitigate these problems. The basic objectives of the Corporation were :

- o to coordinate and supervise the savings collected from all over the country;
- o to finance farmers for the procurement of various inputs; and
- o to finance and invest in agro-trade and agro-industries.

The Corporation worked under a Board of Directors consisting of representatives from various Ministries and the Nepal Rastra Bank and two economists nominated by His Majesty's Government. The Minister for Land Reforms was the Ex-officio Chairman of the Board. Under the Board, a standing Loan and Investment Committee was formed to scrutinize the loan applications and investment projects and also to sanction loans. The General Manager was the Chief Executive of the Corporation.

1. See the Annual Reports of the Cooperative Bank

The Agricultural Development Bank

Under its charter, the Cooperative Bank was authorised to lend to cooperative societies only and so could not lend directly to individuals or corporate bodies. This scope was found to be too narrow and so an Agricultural Development Bank Ordinance was issued in 1967 and the Bank was established in 1968 as a successive institution to the Cooperative Bank. Later on, in 1973, the Land Reform Savings' Corporation was merged with ADB/N as it was thought to be duplicating the function, of ADB/N. Since then, ADB/N has acted as the sole financial institution specialising in agricultural and rural credit in Nepal.

Under the new Act, the Bank could provide loans directly to individuals, companies, cooperative societies, and any other type of institution engaged in agricultural development, agricultural trade and marketing, agro-based industries, and irrigation for short, medium, and long-term durations. The later amendments of the Act empowered the Bank to finance small farmers on a group liability basis and expanded its scope of financing to include cottage industries. The original Act and the amendments permit the Bank to raise funds from domestic as well as international agencies and also engage in commercial banking activities under the Commercial Banking Act.

A Board of Directors, constituted and appointed by the Government, is ADB/N's policy and decision-making body. The Board consists of seven members, including ADB/N's General Manager. Other members include representatives from the Ministries of Finance, Agriculture and Land Reforms, Nepal Rastra Bank, the cooperatives, and individuals. ADB/N started with a modest resource base of NR 12.6 million in 1968 - comprising of 7.4 million NR from share capital, 3.3 million NR from deposits, and 1.9 million from miscellaneous sources. There has been a tremendous change in the resource base in later years and, by mid-July 1988 the Bank had NR 290 million in share capital, NR 1805 million in disbursed credit, and NR 586 million in deposits².

Commercial Banks and the Priority Sector

Nepal Bank Limited, the first commercial bank in the country, was established in 1937 in the private sector, and was converted into a semi-governmental institution in stages. It was followed by the establishment of another commercial bank, as a full government-owned bank, in 1963. In the mid-eighties, three more commercial banks with the participation of foreign banks were established in Nepal. But, since their operation, until now, is limited in the Kathmandu Valley, their share in total institutional credit to agriculture is very limited.

The amount of loans and advances of the commercial banks increased sharply during the last 13 years. During the first two years of the Seventh Plan, the amount of loans and advances increased from NR 7.5 billion in mid-July 1985 to 10.7 billion in 1987, registering an annual increase of 20 per cent. The total volume of loans and advances was NR 1.3 billion in 1975. This shows that this amount has been increasing at an annual rate of 19 per cent between 1975 and 1987³.

2. See the Annual Reports of the Agricultural Development Bank.

3. HMG, Ministry of Finance, Economic Survey, 1986/87, pp 79-80.

Remarkable changes have also been taking place in the sectoral loan portfolio of the commercial banks. For example in 1975, 48 per cent and 45 per cent of the total disbursement were absorbed by general use and social purposes respectively, compared to five per cent by the industrial sector and the remaining two per cent by "others" and agriculture. In 1988, however, the share of industry reached a level of 29 per cent, commerce 34 per cent, general use and social purposes 28 per cent, and other purposes four per cent. This indicated that the commercial banks' investments' in production and developmental activities are gradually increasing, and their traditional role of lending for consumption purposes is declining. However, the share of the agricultural sector has remained low at about five per cent⁴, and thus the share of the rural sector in general has also remained low.

The share of the agricultural and rural sector has remained low not because of policy gaps. As early as 1974, Nepal Rastra Bank directed the commercial banks to invest at least five per cent of their total deposits in the "small sector," with the aim of increasing the flow of bank credit towards the development of small farmers, industries, and other weak sectors of the economy. Such credit then was known as "Small Sector Supervised Credit" and was renamed the "Priority Sector" in 1976. This programme could not generate enough enthusiasm on the part of commercial banks and they found a way out of this predicament when, in 1978, commercial banks' lending to ADB/N was considered as loans to the priority sector.

In October 1981, the "Priority Sector Credit Scheme" was revamped and renamed the "Intensive Banking Programme" (IBP). The programme stresses area development, financial viability, and constant supervision. Under this programme, special commercial banks' branches/sub-branches, in coordination with line agencies, provide credit facilities for the establishment or extension of priority sector activities within the banks' working area.

Under the IBP, loan approval decisions are to be based on the financial viability and technical feasibility of a project rather than on collateral. The programme is also geared to extend credit on a group guarantee basis to those unable to offer satisfactory collateral. It also aims to extend at least 60 per cent of all agricultural and service loans to low income groups⁵.

Though the commercial banks' outstanding loans to the priority sector increased from NR 12 million in 1976 to 174 million in 1983, this was far below the required target. In 1982, against a target of 10 per cent, the banks lent only three per cent of their deposits to the priority sector⁶. Later on, this ceiling was fixed at a minimum of eight per cent of the disbursable fund which in practice reached 5.1 per cent during the FY 1986/87⁷. This includes the investment under the IDA-financed Cottage and Small Scale Industry(CSI) Project.

4. Ibid, pp 79-80.

5. See Priority Sector Credit (Intensive Banking Programme) Manual, Nepal Rastra Bank, 1981.

6. IDS. *Financial Institution and Economic Development - The Pivotal Role of Nepal Rastra Bank*. Kathmandu, IDS, 1985.

7. HMG, Ministry of Finance, Economic Survey, 1987-88, pp 79-80.