

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D. C. 20523
BIBLIOGRAPHIC INPUT SHEET

FOR AID USE ONLY

Batch 97

ARDA

1. SUBJECT CLASSIFICATION	A. PRIMARY	Food production and nutrition	AE10-0000-G584
	B. SECONDARY	Agricultural economics--Bangladesh	

2. TITLE AND SUBTITLE
Rural financial markets in the development of Bangladesh

3. AUTHOR(S)
Adams, D.W.; Nelson, G.O.

4. DOCUMENT DATE 1978	5. NUMBER OF PAGES 32p.	6. ARC NUMBER ARC
--------------------------	----------------------------	----------------------

7. REFERENCE ORGANIZATION NAME AND ADDRESS
Ohio State

8. SUPPLEMENTARY NOTES (*Sponsoring Organization, Publishers, Availability*)
(In Economics and sociology occasional paper no.547)

9. ABSTRACT

10. CONTROL NUMBER PN-AAG-260	11. PRICE OF DOCUMENT
12. DESCRIPTORS Bangladesh Financing aspects	13. PROJECT NUMBER
	14. CONTRACT NUMBER ATD/ta-CA-2
	15. TYPE OF DOCUMENT

2007
PAAG-260

STUDIES IN RURAL FINANCE

AGRICULTURAL FINANCE PROGRAM



Department of Agricultural Economics and Rural Sociology

THE OHIO STATE UNIVERSITY
COLUMBUS, OHIO
43210

Studies in
Rural Finance

Economics and Sociology
Occasional Paper #547

RURAL FINANCIAL MARKETS IN THE
DEVELOPMENT OF BANGLADESH

by

Dale W Adams
and
G. O. Nelson

December 8, 1978

Agricultural Finance Program
Department of Agricultural Economics and Rural Sociology
The Ohio State University
2120 Fyffe Road
Columbus, Ohio 43210

This paper was prepared with resources provided by The Ohio State University Cooperative Agreement on Rural Financial Markets with the Rural Development Office, Development Support Bureau, Agency for International Development (AID). The views expressed do not necessarily reflect those of AID, however.

RURAL FINANCIAL MARKETS IN THE DEVELOPMENT OF BANGLADESH

by

D. W Adams and G. O. Nelson*

Few countries face more obvious rural development problems than Bangladesh. Its per capita income ranks with the world's lowest, and its population density with the highest. A current population of over 84 million will double in 25 years within an area about the size of the state of Iowa. Although primarily an agricultural country, Bangladesh has been forced to increasingly rely on food imports even in normal production years. Cyclones, droughts, floods, low prices on exports, political turmoil, and outflows of trained people add to these problems [9].

It is easy to paint a pessimistic picture of Bangladesh's development prospects. If history is any guide, however, one must be careful not to underestimate growth potential. Only three decades ago, South Korea, Taiwan, and the Peoples' Republic of China were viewed as international "basket cases". These countries are now cited as developmental success stories. Taiwan and South Korea both received substantial amounts of foreign assistance. But, even larger amounts of foreign capital and technical assistance are available to Bangladesh. Furthermore,

* Professor of Agricultural Economics, The Ohio State University, and Ford Foundation Program Officer in Bangladesh, respectively. We appreciate the comments of Cristina David on early drafts of this paper, and the support provided by Ford Foundation and the Agency for International Development.

land and water resources in Bangladesh are superior to those in Korea and many parts of the Peoples' Republic of China; typhoons in Taiwan blow as hard and probably more often than the cyclones in Bangladesh; and population density in many parts of the Peoples' Republic of China is just as intense as in Bangladesh. Accelerated development in Bangladesh will not be easy, but it is clearly not impossible.

If three decades from now Bangladesh is to be cited as a developmental success story, major increases in agricultural output and vast improvements in rural well-being will be necessary. The essentials for this rural development are generally understood: new crop technologies, better water control and management, improved marketing and transportation facilities, land tenure changes, production incentives, more education, stronger local organizations, and physical availability of modern inputs. Major increases in the amounts of formal loans handled by the rural financial markets (RFMs) also will be needed to facilitate expanded production and marketing activities.^{1/} Although not a cure-all for rural development problems, agricultural credit programs are receiving, and will likely continue to receive, an inordinate amount of attention in Bangladesh. In part, this attention will be due to the very small size of the current formal rural financial market; many policymakers recognize

^{1/} Formal RFMs here are defined as commercial banks, postal savings, and cooperatives which provide loans as well as the Bangladesh Krishi Bank.

that these markets must be sharply expanded and strengthened to support development. Policymakers and international aid agencies also recognize that it is relatively easy to augment loan supplies, adjust nominal interest rates, or institute debt moratorium. Other rural development essentials require longer gestation periods, and therefore have less political appeal. The announcement of a new credit program often provides an aura of action for beleaguered policymakers and aid agencies.

In the discussion which follows we assess the recent performance of rural financial markets in Bangladesh, and speculate on how this performance might be improved. The discussion opens with a brief overview of the agricultural sector in Bangladesh, and then goes on to outline the role which rural financial markets might play in its development. This is followed by a description of the current structure of RFMs in Bangladesh, and an evaluation of how the system has recently performed. We conclude the discussion by suggesting several policy changes which might improve the future performance of Bangladesh's RFMs.

Recent Agricultural Development

While Bangladesh was part of Pakistan, agriculture was assigned less priority than the industrial sector. It was not until the late 1960's that policymakers focused attention on increasing production in agriculture [4]. This was done mainly by increasing the supply of chemical fertilizers and pesticides, and expanding the number of tubewell or low lift pumps for irrigation in the dry season. Physical inputs and credit were regularly supplied

at concessionary or subsidized rates. The overall production effect of these activities was positive. The increase in agricultural output during the 1960's nearly kept pace with the increase in population growth. The strategy also had negative effects, however, as larger farmers, because of their better access to the credit and modern inputs, benefited considerably more than smaller farmers and the landless.

The modest agricultural productivity gains of the 1960's were severely disrupted during the first half of the 1970's by several catastrophic events. First came the devastating cyclone of November 1970; this was followed by the 1971 Liberation War; a major drought occurred in 1972-73, and serious flooding was experienced in 1974-75. The upheavals in the international economy brought about by the "oil crisis" in 1973-74 further added to Bangladesh's difficulties. Because of the war, the physical infrastructure in the country was severely damaged: markets were thrown into disarray, law and order broke down, inputs and raw materials for agriculture were scarce, and the managerial and entrepreneurial class was depleted through a widespread exodus of refugees.

Bangladesh's First Five Year Plan covering July, 1973 to June, 1978 continued the 1960's strategy of intensifying food-grain production through use of more improved seeds, expanded use of fertilizer, and more irrigation facilities. The supply of agricultural inputs was slow to increase, however. Irrigation

pumps were often in need of spare parts or fuel, and while additional capacity for domestic production of urea came on stream in 1973-74, the added supply was small compared to the farmers' latent demand. New rice and wheat varieties for local conditions were being developed at the Bangladesh Rice Research Institute but were not yet ready for release, and the organizations needed to deliver modern inputs to farmers were disorganized and all too often ineffective. The government attempted to relieve this by extending the multi-purpose, two-tiered cooperative system developed at the Rural Development Academy in Comilla, along with creating several other specialized institutions. Also during this period the currency was overvalued. This worked against agricultural exports. During the 1960's, consumer prices in East Pakistan were quite stable, but in the early 1970's inflation began to accelerate. Inflation rates of almost 40 percent per year were realized in 1973-74 and 1974-75. Since 1970-71, inflation in Bangladesh has averaged about 15 percent per year.

(By 1975, the turmoil resulting from the war began to subside, and gradually the country entered a period of political and economic stabilization.) Law and order was largely restored, and the currency was sharply devalued. Subsidies were reduced on fertilizers and on some irrigation schemes, and stronger efforts also were made to remove the bottlenecks to input supplies. Total chemical fertilizer use in the country increased two and one-half times from 1974-75 to 1977-78, and the number of new

shallow tubewells sunk each year over the same period increased from 893 to 3,452 [20]. Due to favorable weather, the 1975-76 crop year was the best since before Liberation and food prices dropped accordingly. The government began to give more attention to agricultural pricing policy and procurement, and it eventually established prices for rice and wheat which offered stronger production incentives.)

By mid-1978, the production of most major agricultural commodities had approached or surpassed prewar levels. Because of continued population growth, per capita foodgrain output continued to lag behind prewar levels, however, necessitating foodgrain imports to meet minimum calorie requirements. By mid-1978, jute production was not yet back to prewar levels and, since jute and jute products account for more than 75 percent of the total value of exports, this lag in production has had a major impact on the nation.

It appears that agricultural development strategy will continue to focus on expanding foodgrain production with the goal of achieving food self-sufficiency by 1985. Policymakers are increasingly aware, in the face of growing landlessness and shrinking farm size, of the need to pay increased attention to income distribution.^{2/} An indication of this is the 100 Crore

^{2/} A recent study by Jannuzi and Peach [15] indicated that 11 percent of rural households own absolutely no land, another 33 percent own a homestead only, and another 15 percent own a homestead plus acreage of less than 0.5 acres.

Taka Credit Program initiated in 1977 in an attempt to move more credit to the rural poor. In this program, loan collateral requirements were relaxed so that landless tenants could take loans against their future crops, provided they have the backing of the local councilman or their landlords.

Development Role of Rural Financial Markets

Policymakers in Bangladesh appear to assign rural financial markets a very narrow developmental role [21, 26]. RFMs are viewed mainly as one-way channels for moving concessionary priced loans to farmers. The general notion behind this is that farmers need more formal loans in order to purchase modern inputs such as fertilizer, pesticides, new seeds, and water control facilities. While this "production facilitating" role is quite important, there are other important roles which RFMs might also play. RFMs may strongly influence asset ownership and income distribution, for example. Only borrowers receive the productive benefits from loan use, realize the "benefits" of loan default, or receive the implied income transfer through negative real rates of interest. (If formal loans are concentrated in the hands of relatively few people, loan benefits will be concentrated. This role becomes very important when large RFM portfolios are involved, default problems are serious, or where real rates of interest are highly negative.)

RFMs may also play a role in influencing household activities which are not directly related to agricultural production. Many households, for example, use additional liquidity provided

by loans to stabilize cash flows and household consumption. These so-called "consumption loans" are often thought to come mainly from informal lenders. In fact, because money is completely fungible, any cash loan affects the amount of liquidity available to the household. Even loans in-kind can be converted to cash through resale of goods borrowed. The additional liquidity provided by loans can be used to augment any of the economic activities in the borrowing household: e.g., consumption, farm investment, nonfarm investment, purchase of consumer durables, and informal lending.

Activities in RFMs can also influence the amount of savings, as well as the forms in which households choose to hold their savings [3]. This is a subtle role which is often overlooked by policymakers. As Bangladesh becomes increasingly monetized and more people are touched by formal financial markets, this role will become more important because of its implications for capital formation. In most low income countries, including Bangladesh, RFMs discourage capital formation by offering nominal rates of interest on deposits which are lower than expected inflation rates. These negative real rates cause households in the long-run to minimize holdings of financial instruments. The wealthier households often shift savings to land, livestock, crop inventories or gold. Poor households are usually unable to accumulate sufficient savings to acquire some of these lumpy assets. Their only alternative may be to hold cash or small

amounts on deposit at negative real returns, or to consume potential surpluses. RFMs may, therefore, affect the form in which assets are held as well as the overall amount saved by rural households.

RFMs in Bangladesh should also play the role of intermediary between households with surplus liquid resources and households and enterprises which lack sufficient liquidity to capitalize on economic opportunities. In many low-income countries formal lenders do a very poor job of carrying out this intermediary function. Many formal lenders do not accept savings deposits, and those that do, often provide savers with very weak incentive to save in financial form. On the lending side, formal RFMs are often badly fragmented. Borrowing costs across formal lenders only provide loans to producers with specific crops or enterprises. Many formal lenders ration loans on the basis of so much per unit of area cropped. Under these fragmented conditions some borrowers receive too much, others too little, and still other credit-worthy individuals are denied access to any formal credit. The resulting inefficiencies in resource allocation under these conditions may be very substantial.

Structure of RFMs in Bangladesh

The current structure of RFMs in Bangladesh is the result of a good deal of evolution interrupted by political intrusions.^{3/}

^{3/} See [2, 8, 20, 28] for further details on the historical background.

Prior to 1900 almost all of the credit in rural areas in East Bengal was provided by informal lenders. Occasional distress credit known as taccavi loans, authorized by the Agricultural Loan Act of 1885, were distributed. These loans, however, have most often been treated by both giver and receiver as relief payments rather than as loans to be repaid. Post Office Savings Banks were also opened in some areas in the late 1880's. In 1904 the British began to introduce village level credit cooperatives in many parts of the subcontinent. These cooperatives were largely aimed at substituting for informal lenders who were thought to exploit the rural poor. By 1947 there were 26,664 rural credit cooperatives scattered around East Bengal. Because of World War II, the Great Famine of 1943, and the effects of partitioning, most of these coops were liquidated by 1957, however. A few surviving credit cooperatives along with other new cooperatives and some post savings facilities provided almost all the formal financial services in rural areas until the late 1950's. Informal lenders continued to provide a very large part of all credit needs in rural areas. A national study completed in 1956 showed that less than 15 percent of the rural borrowers obtained loans from government or cooperative sources [8, 57]. It is very doubtful if this percentage is much higher currently.

As might be expected, the depression of the 1930's, World War II, and the formation of India and a two-part Pakistan

caused extensive turmoil in rural financial markets up through 1947. Loan repayment problems were severe. Many formal debts were restructured or essentially cancelled by political action during this period. In addition, many of the non-Muslim money-lenders left East Bengal as a result of partitioning. This further disrupted informal portions of the RFMs.

In 1948 the East Pakistan Provincial Co-operative Bank was organized. This was followed by gradual liquidation of almost all village based credit cooperatives and their replacement by a three tier system with about 4,000 union based cooperative societies. Although multipurpose in name, most of these societies mainly provided loans. The formal RFM was further supplemented by the formation of an Agricultural Development Finance Corporation in 1951 and the Agricultural Bank of Pakistan in 1957. These two institutions were merged in 1961 to form the Agricultural Development Bank of Pakistan. After the civil war this bank was renamed the Bangladesh Krishi Bank (BKB).

As mentioned earlier, a substantial part of the cooperative system has gone through still another major transformation during the 1970's. A two-tier cooperative system has been developed as part of the Integrated Rural Development Programme (IRDP) [27]. This includes Village Agricultural Cooperative Societies (KSS) and Thana level Cooperative Associations (TCA). Credit allocation and savings mobilization are important parts of these cooperatives' activities. In many areas the KSS and

TCCA's are substituting for the earlier formed, union cooperatives. In other cases the older cooperatives exist along with the new cooperative system.

Shortly after the Civil War which resulted in the independence of Bangladesh, most commercial banks in the country were nationalized [2]. Six state-owned commercial banks emerged from a consolidation of these banks in 1972. These six commercial banks have been strongly encouraged to service rural needs by opening up branches in rural areas, providing loans directly to cooperatives, and also expanding their direct loans to agricultural producers. Overall, the commercial banks and the Bangladesh Krishi Bank (BKB) increased the number of bank branches in the country from a total of 1,148 in December, 1971 to 2,742 in June, 1978 [2]. In mid-1972 only 414 of the bank branches were in rural areas, but this increased sharply to 1,594 by mid-1978.

As can be noted in Table 1, over the past two decades five major channels for formal agricultural credit were used in Bangladesh. The Agricultural Department of the Ministry of Agriculture continued to provide significant amounts of taccavi loans throughout the 1960's. Relatively few taccavi loans were disbursed in the 1970's, however. The BKB and its predecessor agencies have provided roughly one-third of the formal credit supply throughout the 1960-1977 period. The BKB also has provided most of the medium and long-term credit available to

agriculture. The Bangladesh Samabaya Bank (BSB), the Apex Cooperative Bank, and its predecessor agencies have also provided a significant, but declining portion of agricultural credit. IRDP credit activities have largely offset the decline of BSB lending in the past few years. As can be noted in Table 1, commercial banks have become a very important segment of rural financial markets since 1973. This is largely the result of strong government pressure.

Recent Performance

In nominal terms the overall supply of formal agricultural credit in Bangladesh expanded erratically from about 95 million Taka in 1960-61 to about 865 million in 1976-77. The Civil War and substantial amounts of political intrusion caused substantial fluctuations in nominal credit supplies. Very strong inflation pressures since 1970 also have eroded a good deal of the purchasing power of the formal credit supply. As can be noted in Table 1, in 1976-77 total purchasing power of the formal loans disbursed was only three-quarters of the prewar 1969-70 period.

By almost any measure, Bangladesh has a very small amount of formal agricultural credit. In 1976-77 the total new loans amounted to only about \$58 million U.S. In contrast, the Dominican Republic with about 5 million population, approximately half living in rural areas, had the equivalence of over \$140 million U.S. in formal agricultural credit in the same period [17].

TABLE 1: New Disbursements of Agricultural Loans by Various Agencies in Bangladesh 1960-61 to 1976-77

Year ^{1/}	Agric. Dept. Taccavi	Agencies ^{2/}			Commercial Banks	Total in Current Taka	Total in 1960-61 Prices ^{5/} -1960-61 Taka-
		BKB	BSE ^{3/} and Cooperatives	IRDP			
--In Current Million Taka-- ^{4/}							
1960-61	13.5	38.2	43.1			94.8	94.8
1961-62	21.5	40.5	45.7			107.7	104.6
1962-63	29.0	37.7	37.8			104.5	101.5
1963-64	38.5	38.3	35.4			112.2	108.9
1964-65	30.2	36.5	25.6			92.3	87.1
1965-66	17.8	41.6	9.4			68.8	61.4
1966-67	19.0	47.1	23.2			89.3	72.0
1967-68	15.3	65.0	70.1			150.4	121.3
1968-69	25.4	75.8	79.1			180.3	133.7
1969-70	30.0	100.7	173.3			304.0	223.5
1970-71	N/A	69.7	83.5			153.2	106.4
1971-72	N/A	96.4	96.4	15.8		208.6	126.4
1972-73	N/A	179.0	142.5	29.0		350.5	143.3
1973-74	14.6	135.7	77.4	24.6	54.9	307.2	89.3
1974-75	10.0	176.3	94.1	39.3	76.7	396.4	71.6
1975-76	.5	185.2	106.2	45.3	134.5	471.7	91.4
1976-77	.4	388.4	113.3	62.0	301.2	865.3	167.4

Sources: World Bank, "Bangladesh Land and Water Resources Sector Study," Vol. 6, Technical Report No. 19 - Agricultural Credit, Washington, D.C.: World Bank, December 1, 1972, Appendix Table 2.

M. A. Molla Majid, "Institutional Delivery System of Agricultural Credit in Bangladesh," unpublished paper presented at workshop held in the Bangladesh Bank, Dacca, October 23 to 25, 1978.

Robert R. Nathan Associates, "Bangladesh Bank Agricultural Credit Study Project: Phase II Report," unpublished study submitted to the Bangladesh Bank, March 10, 1978.

^{1/} July 1 to June 30.

^{2/} Bangladesh Krishi Bank (BK); Bangladesh Samabaya Bank (BSB); Integrated Rural Development Program (IRDP); Sonali Bank, Janata Bank, Rupali Bank, Agrani Bank, Rupali Bank, Uttara Bank (Commercial Banks).

^{3/} From 1960-1970 figures include loans made by the cooperative system.

^{4/} From 1960 to 1974 one U.S. dollar was worth about 7 Pakistan Rupees (Taka). Since then 15 Taka have been worth about one U.S. dollar.

^{5/} For 1960-1971 the Consumer Price Index for Pakistan published by The International Monetary Fund, in International Financial Statistics was used. Data for 1972 to 1977 were deflated by the general cost of Living Index for the middle class in Dacca published by the Bangladesh Bank, Statistics Department in Economic Trends [1960-61 = 100, 1969-70 = 136, and 1976-77 = 517].

The Philippines, with roughly half Bangladesh's population, made new formal agricultural loans in the same period for agricultural production which totaled almost \$1,000 million U.S. Bangladesh also ranks very low when the volume of agricultural credit is compared to the value of agricultural output in the country. Over the 1972 to 1977 period the formal credit portfolio was equal to less than 2 percent of the gross national product generated in the agricultural sector.^{4/} Similar figures in the Dominican Republic and the Philippines were around 20 percent throughout this period. The price concessions which Bangladesh gives farmers on fertilizer, pesticides and pumps soften this harsh picture a bit. Nonetheless, it is clear that the amount of formal credit available in rural areas of Bangladesh is relatively small by almost any measure. It is little wonder that informal lenders continue to play such a large role in RFMs when formal credit is so scarce.

Despite the almost complete nationalization of the banking system, it appears that the government has had little success in directing a larger proportion of credit to rural areas. In late 1972 approximately 15 percent of the total value of outstanding balances on loans made by banks in Bangladesh were for agricultural purposes. In late 1976 this had slipped to less

^{4/} In 1972-73 the estimated GNP from agriculture was 26,600 million current taka, while in 1976-77 it was 58,303 million current taka.

than 9 percent.^{5/} The 100 Crore Taka Agricultural Credit Program initiated in early 1977 started to reverse this trend [21].

In addition to the overall supply issue, several other unsatisfactory performance dimensions in RFMs can be readily identified, although not adequately documented. In part, the overall supply of formal rural credit has failed to grow rapidly because of loan repayment problems. Policymakers and aid agencies are slow to push more funds into a credit system which does not retrieve a large part of the money lent. Bangladesh's history of making distress "loans," political intrusions into the repayment process, and the disruption caused by the Independence War caused very serious repayment problems from 1970 to 1973. As can be noted in Table 2, the BKB recovered only 53 percent of the value of its loans which fell due in 1970-71, and only 35 percent of those falling due in 1971-72. Equally serious repayment problems were experienced in the cooperative system. Since 1973 both the BKB and the cooperative system have improved their loan recovery records. The IRDP Cooperatives, however, continue to recover only two-thirds to three-quarters of the total amount they lend. Part of the improved BKB recovery in recent years is the result of repayment of loans which have been overdue for several years. Improved BKB repayment percentages are also likely due to changes in its lending portfolio.

^{5/} Bangladesh Bank, Statistics Department, Quarterly Scheduled Bank Statistics, March 1973, p. 29 and October-December 1976, p. 46.

In 1975-76, more than 35 percent of the value of all loans made by BKB went to tea producers and farmers purchasing livestock. These loans were typically well secured and less risky than loans for rice or jute production. It is still an open question whether formal RFMs can substantially increase loans for production of these commodities typically raised by small farmers and small tenants and also maintain satisfactory repayment records.

As suggested earlier, income distributions can be strongly affected by formal loan allocation. Although difficult to pin down with available data, it appears that relatively little of the funds handled by formal RFMs in Bangladesh have flowed to the rural poor [5]. In 1975-76, for example, the Annual Report of the BKB showed that less than one-quarter of the total value of loans made by the BKB went to farmers who owned less than 3 acres.^{6/} This proportion was down significantly from the one-third lent to this group in 1971-72. It is likely that similar distribution patterns occur on loans made by the various cooperatives. The lament that local elites receive a majority of the loans made by cooperatives can be heard throughout Bangladesh [5, 16].

Another important element in financial markets is the term structure of the loan portfolio. Until recently, the BKB was the primary source for medium and long-term formal loans in

^{6/} In 1967-68 the average farm in Bangladesh had only 3.1 acres.

TABLE 2: Loan Repayments To The Bangladesh Krishi Bank 1970-77

Year	Loan Transactions During Year			Total Overdue
	Due	Repaid	Recovery Percentage	
	----- (Thousand Taka) -----		%	(Thousand Taka)
1970-71	N/A	N/A	53	171,226
1971-72	84,158	29,164	35	226,220
1972-73	99,386	67,238	68	258,368
1973-74	161,259	118,991	74	300,636
1974-75	228,313	199,963	88	328,987
1975-76	280,187	274,795	98	326,026
1976-77	317,483	297,362	94	337,866

Source: Bangladesh Krishi Bank, Annual Reports, various issues 1971-72 to 1976-77.

rural areas. Most agricultural loans in Bangladesh have terms of less than 12 months and many are for only a single cropping season of 4-6 months. In 1971-72 the Annual Report of the BKB showed that about two-thirds of the total value of its loan portfolio was in medium and long-term loans. By 1975-76 medium and long-term loans made up only 40 percent of BKB's loan portfolio, and long-term loans made up only one percent. Commercial banks and cooperatives have even shorter average term structures on their agricultural loans. Not only is formal agricultural credit scarce in Bangladesh, but it is also very short-term for a country which needs large amounts of investment in farm level land and water improvement facilities.

A few countries like Japan, Taiwan and South Korea have been quite successful in mobilizing savings through RFMs [23]. Unfortunately, it is difficult to document the amount of voluntary savings deposits which originate in rural areas in Bangladesh [3]. The sketchy information which is available suggests that Bangladesh has not been very successful in this regard. At the end of 1976 only 11 percent of the deposits in the entire banking sector were in rural branches of the banking system.^{7/} At the end of 1976 the BKB only had savings and fixed deposits which amounted to one-third of the total new loans it made during 1976-77. The cooperative system had an even

^{7/} Interestingly enough, however, these rural branches had deposits at the end of 1976 which were three-and-a-half times as large as the outstanding balances on loans made by these same rural branches.

lower savings-deposit-to-loan ratio. As suggested earlier, formal RFMs in Bangladesh largely view themselves as retail outlets for money provided by the Central Bank.^{8/}

Formal RFMs in Bangladesh also appear to be imposing relatively high user costs on some actual as well as potential users of deposit and loan services. In the early 1960's, Shahjahan conducted a study which reported on borrowing costs incurred by various classes of borrowers in Bangladesh who received loans from the Agricultural Development Bank of Pakistan [30]. During the period of the study the Bank charged borrowers a uniform 7 percent nominal interest rate on all loans. In addition to interest payment, however, many borrowers were required to pay application fees, filing fees, loan registration fees, and also visit the bank a number of times to negotiate the loan. For new and small borrowers these additional loan transactions made up a large part of total borrowing costs. On an annualized basis, small borrowers were found to incur borrowing costs, as a percent of total amounts borrowed, which were similar to "high" interest rates charged by informal lenders [1].

The expansion of financial facilities into new areas in Bangladesh during the past few years has undoubtedly reduced the time and travel expenses involved for many rural people to

^{8/} Information in this paragraph was drawn from various issues of the Bangladesh Bank Bulletin.

use formal financial services [2, 32]. Some banks have also reduced the number of bank visits required by borrowers and or reduced borrower paperwork. A few banks have also used mobile banking facilities to bring financial services closer to users. Despite these improvements, new and small borrowers still complain about the time, effort, and expense associated with getting small loans.

In summary, several laudatory aspects of RFMs in Bangladesh can be noted. Most importantly, the rapid expansion of financial outlets in rural areas is a very important step forward. Also, the increasing flexibility and willingness of policymakers to discuss and experiment with RFM programs and policies is a very hopeful sign [6, 7, 10, 21, 24, 25, 29]. Despite these bright spots, the performance of RFMs in Bangladesh appears to suffer in many of the same ways which can be noted in all too many other low-income countries. With significant amounts of inflation and relatively inflexible nominal interest rates, Bangladesh has not been able to maintain the purchasing power of its formal agricultural credit portfolio. Despite nationalization of most banks, relatively little of the formal credit in the country is going to agriculture and the rural poor [26]. Repayment performance, while improving, still is unsatisfactory. It is also obvious that the average term structure of agricultural loans must be lengthened substantially if rural financial needs are to be more adequately met. It also is apparent that RFMs in Bangladesh are mobilizing

too few savings and also imposing too many loan and deposit transaction costs on rural poor.

Future Policy Strategies

Major increases in the amounts of funds handled by, and the coverage of, formal RFMs will be needed to support significant rural development in Bangladesh. It is clear, however, that the current poor performance of RFMs in Bangladesh cannot be resolved through any simple solution. In large part, financial intermediation follows rather than leads development. In part, RFMs are struggling because of the limited amounts of financial transactions in a terribly poor country. Despite the obvious limitations which current low incomes place on RFM growth, we feel that several policy changes might lead to substantially improved RFM performance in the near future. A brief outline of these suggestions follow.

Most importantly, policymakers in Bangladesh should expect RFMs to play a more comprehensive development role than being simple retail outlets for central bank money. In the medium to long-run, restricting RFMs to this limited role will be anti-developmental; availability of concessionary priced funds from the central bank give lenders little incentive to mobilize voluntary private savings. In a country like Bangladesh, government and industrial firms contribute a relatively small part to overall capital in the society. The key savings-consumption decisions are made by millions of households, most of which

are located in rural areas. Policymakers must be very careful and creative in designing policies which provide very strong incentives for these primary producers of capital to defer consumption. RFMs should play an important role in providing some of those incentives as well as inexpensive deposit opportunities for savers.

On the loan side, policymakers should be more concerned about how formal lending activities affect income and asset ownership distribution [6, 31]. Concessionary interest rates on loans are no bargain for the rural poor if they do not get loans, or if formal lenders force the poor to incur substantial loan transaction costs. Also, the poor are not better off if the well-to-do are the ones doing most of the defaulting on formal loans in rural areas.

Policymakers in Bangladesh should also be more concerned with defragmenting rural financial markets. While some geographic concentration is desirable by lenders, it appears that too much emphasis is currently being placed on segmenting borrowers. Resources would be more efficiently allocated if formal lenders extended loans to any eligible borrower who could reasonably be expected to repay the loan, and who is located in the lender's service area. Loans to small nonfarm business firms in rural areas may, in fact, result in more additional income for rural poor than loans to small farmers [19].

If RFMs are to play a more comprehensive role in Bangladesh's development, significant policy changes will be necessary. Flexible interest rates could play a pivotal role in these changes. It is becoming increasingly apparent in most low-income countries that negative real rates of interest are intimately associated with many of the maladies which plague RFMs. The purchasing power of credit portfolios are eroded by negative real interest rates, and formal lenders have little incentive to lend to agriculture or small rural borrowers when interest rates are low. Lenders can expect to realize larger economic surpluses by lending to less risky nonagricultural enterprises and also concentrating on large loans where lender costs per unit of money lent is minimized. Administrative fiat from the capital city do little to alter the lenders' perceptions of these economic realities.

Low, and especially negative, real rates of interest also cripple the ability of RFMs to mobilize significant amounts of voluntary private savings. This further limits the ability of RFMs to increase loan supplies through deposit expansion. One might also argue that it will be difficult to improve loan repayment records in Bangladesh until "government money" makes up a much smaller portion of loanable funds. It is much less socially acceptable to abscond with loans if local private savings make up a significant part of monies lent. It will also

be easier for RFMs to provide more financial services which are less costly for users in rural areas if the volume of savings and loans are sharply expanded. More flexible interest rate policies could allow this to happen more quickly.

REFERENCES

1. Adams, Dale W and G. I. Nehman, "Borrowing Costs for Agricultural Loans in Low Income Countries," Journal of Development Studies, Vol. 15, No. 2, January 1979.
2. Ahsan, A. S. M. Fakhrul, "Recent Performance of Rural Financial Markets in Bangladesh - Nationalized Commercial Banks," Unpublished paper presented at Workshop held in the Bangladesh Bank, Dacca, October 23-25, 1978, 11 pp.
3. Alangir, Mohiuddin, "Rural Savings and Investment in Developing Countries: Some Conceptual and Empirical Issues," The Bangladesh Development Studies, Vol. 4, No. 1, January 1976, pp. 1-48.
4. Alangir, Mohiuddin, "Some Aspects of Bangladesh Agriculture: Review of Performance and Evaluation of Policies," The Bangladesh Development Studies, Vol. 3, No. 3, July 1975, pp. 261-300.
5. Blair, Harry W., "Rural Development, Class Structure and Bureaucracy in Bangladesh," World Development, Vol. 6, No. 1, pp. 65-82.
6. Choudhury, Omar, "Critical Rates of Interest for Institutional Lending to Agricultural Sector in Bangladesh," Unpublished paper presented at Workshop held in the Bangladesh Bank, Dacca, October 23-25, 1978, 28 pp.
7. Church, Phillip E. and Gary D. Adams, "Experimental Approaches to Rural Credit in Bangladesh," Unpublished paper presented at Workshop held in Bangladesh Bank, Dacca, October 23-25, 1978.
8. Dacca University Socio-Economic Survey Board, Report on The Survey of Rural Credit and Rural Unemployment in East Pakistan, 1956, Dacca: Dacca University Socio-Economic Survey Board, no date but about 1958, 205 pp.

9. Faaland, Just and J. R. Parkison, Bangladesh: The Test Case of Development, (Dacca: University Press, 1976).
10. Gangopadhyay, A. K., "Interest Rate Policy for the Rural Sector," Unpublished paper presented at Workshop held in Bangladesh Bank, October 23-25, 1978, 4 pp.
11. IBRD, "Bangladesh Agricultural Credit Review," Unpublished report by World Bank, Washington, D.C., June 1, 1974.
12. IBRD, "Bangladesh: Current Economic Situation and Development Policy Issues," Unpublished report by World Bank, Washington, D.C., May 19, 1977.
13. IBRD, "Bangladesh Land and Water Resources Sector Study," Vol. 6, Rural Development Institutions, Technical Report No. 19, Agricultural Credit, Unpublished Reports by World Bank, Washington, D.C., December 1, 1972.
14. Jannuzi, F. Tomasson and James T. Peach, "Report on the Hierarchy of Interests in Land in Bangladesh," Unpublished report prepared for the Agency for International Development, Washington, D.C., September 1977, 92 pp.
15. Khan, Ali Akhtar, "Rural Credit Programme of Agricultural Cooperative Federation," Bangladesh Academy for Rural Development, Comilla, Bangladesh, November 1971.
16. Ladman, Jerry R. and Dale W Adams, "The Rural Poor and the Recent Performance of Formal Rural Financial Markets in the Dominican Republic," Canadian Journal of Agricultural Economics, Vol. 26, No. 1, February 1978, pp. 43-50.
17. Meyer, Richard L., "Financing Rural Nonfarm Enterprises in Low Income Countries," Unpublished paper presented at Workshop held in Bangladesh Bank, Dacca, October 23-25, 1978, 19 pp.
18. Ministry of Agriculture and Forests, Planning and Evaluation Sector, "Development Statistics of Bangladesh Agriculture," Series No. 2, July 1978, Dacca, Bangladesh.

19. Molla, M A. Majid, "Institutional Delivery System of Agricultural Credit in Bangladesh," Unpublished paper presented at Workshop held in the Bangladesh Bank, Dacca, October 23-25, 1978, 26 pp.
20. Ong, Marcia L. and others, "Voluntary Rural Savings Capacities in Taiwan, 1960-1970," American Journal of Agricultural Economics, Vol. 58, No. 3, August 1976, pp. 578-582.
21. Rahim, A. M. A., "A Note on the Applicability of a High Interest Rate Structure in Bangladesh," Bangladesh Bank Bulletin, Vol. 5, November 1973.
22. Rahim, A. M. A., "The Concept of Credit Programming and Credit Allocation in Bangladesh," Journal of the Institute of Bankers (Bangladesh), no date, circa 1975, pp. 22-30.
23. Rahim, A. M. A., "The Performance of the Banking System, 1971-77," Journal of the Institute of Bankers Bangladesh, Vol. 6, December 1977, pp. 23-59.
24. Rahman, Khandker Mahmudur, "Providing Credit Facilities to Small Farmers with Special Reference to the Integrated Rural Development Program," Unpublished paper presented at Workshop held in Bangladesh Bank, Dacca, October 23-25, 1975, 30 pp.
25. Safdar, S. A., "Development of Cooperatives in Indo-Bangladesh Subcontinent: A Chronology of Events 1875 to 1976," Unpublished paper, Bangladesh Jatiya Samabaya Bank Ltd., Dacca, Bangladesh, 1976, 37 pp.
26. Saha, Jadab Chandra, "A Case of Differential Interest Rates for Rural Poor," Unpublished paper presented at Workshop held in the Bangladesh Bank, Dacca, October 23-25, 1978, 13 pp.
27. Shahjahan, Mirza, Agricultural Finance in East Pakistan (Dacca: Asiatic Press, 1968).

28. Vogel, Robert C., "Subsidized Interest Rates and the Rationing of Agricultural Credit in Developing Countries," Unpublished paper presented at Workshop held in Bangladesh Bank, Dacca, October 23-25, 1978, 14 pp.
29. Yunus, Muhammad, "Bhumiheini Samiti (Landless Association) and Mohila Samiti (Women's Association) in Jobra and Other Villages," Unpublished paper presented at Workshop held in the Bangladesh Bank, Dacca, October 23-25, 1978, 28 pp.