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PN-ABB-812

INSTITUTIONAL CREDIT IN
BANGLADESH AGRICULTURE

June 28, 1988

Robert E. Navin
USAID/Bangladesh

Preface

Institutional credit remains a step-child to non-institutional (informal) credit in Bangladesh agriculture. However, there are strong linkages through the effects on the overall level and allocation of the money supply. This report does not intend to underplay the continuing importance of nonformal agricultural credit, it merely attempts to utilize the extensive and up-to-data data that is available. For those who would like to read further about the informal sector, they might start with documents by Clarence Maloney and by Therese Blanchet.

This report is essentially a distillation of data and ideas culled from the many reports of Robert Nathan Associates and Ohio State University. Their work was funded by the USAID/Bangladesh Rural Finance Project. In particular, I would like to acknowledge the assistance I received from Dr. Zia Ahmed, Dr. Richard Meyer, and Dr. Forrest Cookson. Without their help, this paper would not have been possible. While very little contained in this paper is novel, especially to those whom I just mentioned and to those in the Bangladesh banking sector, any errors or omissions remain fully mine alone.

The impetus for this paper came from Dr. Tom Daves, Chief of Party for the IBRD Agricultural Sector Assessment Team. He insisted that agricultural credit be given emphasized in their analysis. An earlier version of this paper was submitted to the IBRD while I was on loan to the Sector Team.

Since the time when this paper was drafted in August 1987, the Government of Bangladesh (GOB) has had to cope with very bad flooding, and political unrest leading to another Parliamentary election. Unfortunately for the viabilitiy of the financial institutions and the general health of the agricultural economy, a major casualty of these disturbances was institutional credit. Essentially, The progress toward financial viability of the banking system made during FY87 was at least partially negated in FY88. Bangladesh continues to use the banking system as a mechanism of social welfare. Ironically (bust not surprisingly), it remains the relatively wealthy and influential who are able to access and qualify for most of the credit.

I hope that this report will not only encourage people to refer to the more specific literature on agricultural credit cited in this report, but also to effect an improvement of the credit system so as to promote increased agricultural growth.

R.E.N.
June 1988

Institutional Credit in Bangladesh Agriculture

Annex

ACRONYMS

ACD	Agriculture Credit Department
ADBP	Agricultural Development Bank of Pakistan
BB	Bangladesh Bank
BCD	Banking Control Department
BKB	Bangladesh Krishi Bank
BRAC	Bangladesh Rural Advancement Committee
BRDB	Bangladesh Rural Development Board
BSB	Bangladesh Shilpa Bank
BSBL	Bangladesh Samabaya Bank Limited
BSRS	Bangladesh Shilpa Rin Sangstha
BSS	Bittahin Samabay Samity
CEM	Country Economic Memorandum (IBRD annual document)
DFI	Development Finance Institutions
FDBP	Farmers Development Bank of Pakistan
GDP	Gross Domestic Product
GOB	Government of Bangladesh
IBRD	International Bank for Reconstruction and Development
ICD	Industrial Credit Department
IDA	International Development Association (of the IBRD)
IFAD	International Fund for Agricultural Development
IFDC	International Fertilizer Development Center
IFPRI	International Food Policy Research Institute
IRDP	Integrated Rural Development Program

KSS	Krishak Samabay Samity
MSS	Mahila Samabay Samity
NCB	Nationalized Commercial Bank
NGO	Non-Government Organization
RBBUS	Rural Bank and Bank Users Survey
RCGF	Rural Credit Guarantee Fund
RCPD	Rural Credit Project Department
RFEP	Rural Finance Experimental Project
RFP	Rural Finance Project (USAID 1982-87)
SACP	Special Agricultural Credit Program
STW	Shallow Tube-well
UACC	Union Agricultural Credit Committee
UCCA	Upazila Central Cooperative Association
USAID	United States Agency for International Development

INSTITUTIONAL CREDIT IN BANGLADESH AGRICULTURE

I. Overview of the Current Situation

1.01 The Bangladesh banking system in FY87 succeeded in increasing the recovery rate of overdue loans in FY87, but fell far short of its longer term goal of restoring discipline in financial markets. Foremost among the changes in agricultural credit was the President's belated crop loan recovery program that permitted remission of interest payments on small loans. Also, the Rural Finance Project (USAID/Bangladesh Bank) collected some excellent data and offered some inciteful recommendations. While it is encouraging that the GOB has finally taken some measures commensurate with the magnitude of the problem with loan recoveries (ergo the financial viability of the banking system), the challenge remains to institutionalize the short-term reforms so that they become standard operating procedures. A revised goal might be to eliminate the need for crash programs that often either crash themselves, or cause numerous unplanned negative consequences. For example, recovery drives must avoid causing a liquidity crisis and harming rural productivity.

1.02 During FY87, a number of factors counteracted these potentially recessionary forces in rural areas; agricultural prices were high and harvests were at record high levels. Indications are that these anti-recessionary forces may disappear in FY88, as large quantities of foodgrain imports will be arriving in the second half of CY87. Also, if the aman (rice) crop proves to have been severely affected by floods, pests, and/or disease, then the purchasing power in rural areas may well be lowered. By the same token, good harvests of aman, boro (rice), and wheat, might cause the foodgrain price to drop dramatically, depressing rural purchasing power. The cumulative effects of these events would be felt around May 1988 leading us to believe that a recession is quite possible unless sufficient liquidity is assured to rural Bangladesh.

1.03 Until FY86, the GOB had been following a policy of directed lending to priority sectors and activities, low interest refinancing from the Central Bank (raised in October 1983), and a lack of emphasis on loan recovery. Agricultural credit went through a remarkable expansionary period from the late 1970's to the mid 1980's. As a percentage of total outstanding advances (a "stock" as opposed to disbursements that are a "flow"), the agricultural sector received 27 percent in FY86. In FY78, this figure was only 10.5 percent (the manufacturing and wholesale/retail sectors were of course the largest recipients during this period). Bank outstanding advances to agriculture as a percentage of agricultural GDP, were 11.3 percent in FY86, up from 2 percent in FY78. The impetus for this expansion was a three-fold increase in branch banks, occurring principally in the period 1977-1981, followed by a period of expansion of agricultural credit disbursements during 1983-1985. This expansion took place so rapidly that the branch banks and cooperatives did not properly screen the loanees, with the result that dismally low rates of loan recoveries now jeopardize the entire banking system and will continue to do so. The President's personal program in FY87 of interest forgiveness on the repayment of crop loans, as opposed to term loans, succeeded in increasing recoveries among the poorer segments of the population, but his program did not even attempt to address the problem of large loans that are overdue in the agricultural sector, nor the even poorer recovery performance in the industrial sector. Until a way can be found to deal with those politically and financially well connected people who have not repaid these large loans, the survival of the banking system will depend on a life support system of GOB interest subsidies and loan guarantees.

1.04 An acute awareness of this situation was expressed by the Minister of Finance in his June speech announcing the Annual Budget. He stated that the "position of overdue industrial credit is extremely unsatisfactory," and that efforts to recover overdues will "continue unabated." Such rhetoric must be translated into implementation via the political system and non-bureaucratic means if the health of agricultural credit is to be renewed.

II. Summary of Recommendations

2.01 Rural Branch Expansion- Expansion should continue at the slow rate of the past two years, with decisions to establish branches left to the individual banks. The importance of long-term solvency of the banks has not received the attention that it needs. On the other hand, it must be balanced with the social desirability of an expansion into the remaining 50 percent of unions that do not have formal banking institutions, and the importance of promoting competition among banking institutions. Private banking in rural areas should be encouraged, and the Lead Bank in each Upazila should be changed periodically in keeping with the most active bank in each Upazila. The number and location of branch banks and informal credit institutions needs to be reviewed after completion of the proposed IBRD/GOB study of the cooperative system.

2.02 Liquidity in Rural Areas- The GOB should regularly consider the combined effects of monetary policy, programs to recover overdue loans, and expected profits based on prices and crop yields so as to maintain an even expansion of the rural economy. The GOB is now generally able to fend off famine that results from periodic natural calamity. Now the GOB should focus on improving the forecasts and GOB decisions about foodgrain imports so that the foodgrain import levels neither promote famine, nor re-create cyclical disincentives on domestic production. The management of overall liquidity must be part of this process.

2.03 Recoveries- Now that small crop loans have been successfully recovered from the poorer members of society, the GOB must next encourage the banks to collect term loans in rural sectors. Strong sanctions need to be employed against those who are now clearly recalcitrant. Simultaneously, the longer term proposition of educating people about the importance of financially viable financial institutions must be started through political and non-bureaucratic structures. The banks should accelerate their in-house training programs on loan recovery techniques, and change accounting systems and reporting requirements to reflect a common definition of recovery. The GOB must avoid the necessity for crash programs of interest foregiveness. These have a negative impact on bank viability.

2.04 Disbursements- The Passbook System should be continued, but its integrity must be protected. Passbooks should be numbered, extracts of land records should be included in them, and Union Parishad Chairmen should no longer have a say in their allocation, unless they are personally going to guarantee the credit-worthiness of the individuals.

2.05 Savings Mobilization- The banking system should improve borrower selection, loan recovery, and general intermediation (see definition in Section 5.15). New marketing and banking techniques for mobilizing deposits should be explored. Also, the National Savings Schemes should be transferred from the National Savings Directorate to the Bangladesh Bank. If these steps are taken, then savings mobilization can proceed in a steady, less disrupting, and more sustainable fashion than would be the case if the GOB were to just launch a savings mobilization campaign.

2.06 Interest Rates- They should be allowed to increase in accordance with supply and demand considerations. The current 6% penalty on late payments should be incorporated into a revised, all inclusive interest rate for new loans, perhaps as a fee, and returned as a rebate to those borrowers who repay on time. Because a direct implementation of this recommendation is not politically feasible at this time, the GOB should explore ways of hiding effective increases through various techniques of marketing a loan. For example, instead of announcing that the rate of interest is 16 percent per annum, it could be sold as 10 percent per crop cycle.

2.07 Crop Insurance- Work should continue to specify the objectives and implement the Rural Credit Guarantee Fund.

2.08 Responsiveness to Client Needs- Banks should continue to experiment with and adapt four approaches to lending- supervised, tied, targeted, and group lending. Also, perhaps NGOs and public agencies such as the BRDB could be more active in forming and preparing "bankable" groups. But donors and indigenous NGOs should try to limit (if not eliminate) the number of targeted programs, which cause inefficiencies in the overall operation of agricultural lending. The banker/client relationship should be improved. Greater collaborative work will improve the "bank-ability" of the borrower, and thus strengthen the banking system. With greater understanding of farmers' situations, bankers will be better able to screen out risky loans, as well as to selectively reschedule loans of those who truly have encountered an unexpected calamity.

2.09 Legal System- Banks should be allowed to select their own counsel in Certificate cases. District Magistrates should be authorized to appoint temporary servers and clerks to handle the certificate case-load. Other constraints to the increased use of the Certificate procedure should be removed as outlined in numerous evaluations.

2.10 Accounting Procedures- Further adjustment is needed of regulations with respect to loan classfication, eligibility of accrued interest as current income, and the provision of bad debt allowances at the head office, with the objectives of having the accounts reflect the true economic condition of the bank.

2.11 "Management by Directive"- The Bangladesh Bank should renew its efforts to gather political support for its directives so that they have greater acceptance when received. Also, the GOB should reconsider the negative impact of rapid turn-over of the bank directors.

2.12 BKB, BSBL, and the BRDB Cooperatives- Further reorganization of the BKB into four regional branches should await the results of the implementation of other reforms mentioned in this and other reports. The Joint Review of the Cooperative System in Bangladesh should be given high priority by the GOB.

2.13 General Administration of Rural Branches- Rules and regulations should be changed to enhance the incentives of bank officers to mobilize savings, increase recoveries, and operate more efficiently. While computers could be introduced into rural banking to improve reporting and record-keeping, they should not preceed a steady supply of electricity and the development of appropriate accounting software.

2.14 Institutional Health- Arrangements need to be made to write-off bad debts and prepare for a new start. Current records of known defaulters should be exchanged among financial institutions. Reforms should be instituted that will help avoid past misstakes. The GOB, having decided to have banks serve as banks, and not arms of political patronage or social welfare, should then, and only then, approach the donor community with a request for assistance in re-capitalizing the banks.

III. History, Attitudes, and Credit Needs in the Future

History (Ahmed 1987, pp. 1-6; Alim 1982, pp. 17-23)

3.01 Since ancient times, moneylenders have been prime sources of credit. In the part of the world now defined by Bangladesh, the zamindars followed the Moghul lords in controlling money lending during feudal times. These zamindars, along with Hindu businessmen and Muslim "Kabuliwalas" from the Frontier Provinces of India, were often accused of charging usurious interest rates. The British interceded in 1935 and helped establish the Banking Act of 1936 and the Debit Reconciliation Boards that provided some relief to loanees by trying all moneylending cases. Another form of relief provided by the British Government began in the 1880's. The state provided "Taccavi" loans to farmers, generally after disasters so that they could resume productive activities. These loans were generally viewed as grants from the government.

3.02 In 1904, the Cooperative Credit Societies Act was introduced in part to curb the perceived tyranny of the money lender. The Cooperative societies were formed right down to the village level. For a number of reasons, these early cooperatives did not prosper. First, the net flow of funds tended to go from the village to the central committee. Second, recommendations in a report from the Reserve Bank of India in 1937 as to how to collect overdue cooperative loans were ignored. Third, the Cooperative Societies Law of 1940 (Bengal Act XXI) and its implementation rules of 1942 did not prohibit the granting of loans to members of the management committee, nor the granting of new loans to willful defaulters. Accumulated outstanding overdues of the Cooperative Bank from 1958 to 1971 were 220 million Taka, one third of the total amount loaned. After Independence, the East Pakistan Provincial Cooperative Bank became the Bangladesh Samabaya Bank Limited (BSBL).

3.03 In 1952, the Agricultural Development Finance Cooperative was formed mainly to serve large farmers. In 1958, this became the Agricultural Development Bank of Pakistan (ADBP) with a mandate to also serve small farmers. Given that a land title was required as collateral for a loan, ADBP did not serve the needs of rural poor very well. Also, its purpose was primarily to mobilize rural deposits for investment in urban enterprises by opening branches in major towns.

3.04 Started in Comilla in the 1960's by Aktar Hamid Khan, the Integrated Rural Development Programme (IRDP) set up a grass roots, supervised agricultural credit program which proved very successful. In the 20 Thanas (sub-districts) in which this program functioned between 1968-70, the default rate was only 8.1 percent on 33 million Taka. Many of these cooperatives collapsed after the departure of the charismatic Khan, and Bangladesh has been unable to replicate the system anywhere since.

3.05 Before Independence, there were 12 Pakistani (10 commercial, the ADBP, and the FDBP), 2 Bengali commercial, and 8 foreign banks operating a total of ,191 branches in present-day Bangladesh. The 1971 War and the Awami League's policy of nationalization hurt the banking system in terms of both liquidity and managerial talent. The State Bank of Pakistan in Bangladesh, became the Bangladesh Bank (BB). The 6 newly formed nationalized commercial banks (NCBs) replaced the 12 commercial banks excepting the foreign banks. Two specialized banks, the BKB and Bangladesh Samabaya Bank, Ltd. (BSBL), replaced the ADBP and FDBP respectively.

3.06 All banks, including the BB, were viewed as a means of reallocating resources among various classes and regions, and among economic activities established for the social good of the nation. Despite explicit instructions from the Bangladesh Government (GOB) and the availability of refinance from the BB at 2 to 4 1/2 percent below the bank rate from the BB, the NCBs and the BKB remained reluctant to extend agricultural credit due to the perceived high costs and low returns. In fact, the share of agriculture in total advances increased from only 8.4 percent in 1970 to 8.9 percent in 1976. It was also widely believed that the net flow of funds was out of rural areas. This poor performance of the nationalized banks to reach social objectives, set the stage for more active GOB involvement in banking.

3.07 In 1977, a new President launched the Taka 100 Crore Special Agricultural Credit Program (SACP). The purpose was to increase rural credit from the NCBs and BKB so as to meet food self-sufficiency. The NCBs were forced to open 2 rural branches for each new urban branch, and the GOB provided a guarantee on loans from these banks. The program simplified loan procedures including hypothecation (eg. the use of the future harvest as collateral on a loan) so that land did not have to be used as collateral. The borrowers were selected by the Union Agricultural Credit Committees (UACCs) headed by the Union Parishad Chairman. Since these committee members were not required to guarantee the loans of the people they recommended, there was much abuse of the system. In order to address some of these problems, the Cooperative Societies Ordinance was passed in 1984. Although this law has many shortcomings, it does contain some stiff provisions. For example, loan defaulters are no longer permitted to hold office in the UACCs or in the cooperatives. The enforcement of this regulation, however, may be difficult.

3.08 In 1984, the SACP rules were changed so that credit could be provided based on a farmer's total farming system needs, rather than on just the requirements of individual crops. The GOB loan guarantee was also dropped. A "passbook system" was initiated to prevent people from obtaining multiple loans for the same purpose. In 1987, the GOB offered to waive interest payments on crop loans under 10,000 TK if paid before June 7, 1987 in an effort to improve the recovery rate. Also, the Parliament amended the 1913 Public Demand Recovery Act in July 1987. This Act allows banks to make public that public office holders are delinquent in their payments, and it bars those with such debts to hold elected office. As of this date there were 4 NCBs, 8 domestic private banks, 7 foreign banks, 2 Specialized Development Banks (BKB, and the BSB for industrial loans), and the cooperative banks under BSBL. The Development Finance Institutions (DFIs) are the Bangladesh Shipla Bank (BSB) and the Bangladesh Shilpa Rin Sangstha (BSRS) that lend primarily to industry.

Attitudes Towards Credit Today

3.09 In general, old attitudes towards credit still prevail today; a loan is the result of patronage, and does not necessarily have to be repaid. This is especially true in the case of loans from the government, which are viewed as grants originating from foreign donors who do not expect the grants, by definition, to be repaid. The current government continues to lend credence to this attitude. In the aftermath of flooding in 1984, the government said that the crop loans among those who lost their crops did not have to be repaid. This is similar to the "Taccavi" loans mentioned above. In April, the government decided to forgive overdue interest on outstanding loans to weavers in the handloom industry, and explore the possibility of reduced rate of interest on new credit. Thus, not only are borrowers currently skeptical about the necessity to repay loans, but so is the government.

3.10 In fact, many high ranking government officials believe that by tolerating defaults, particular groups or individuals can be helped in an innocuous way. During the August 1987 floods, the President ordered the banks to extend agricultural credit to the affected farmers. But whereas in the past the GOB forgave the loans, this time the GOB only rescheduled them. This is a positive step in keeping with the advice of USAID's Rural Finance Project (RFP). The RFP has been trying to communicate, among other messages, that persistent defaults cause financial intermediaries to be perceived as transitory rather than permanent. As a result, borrowers will not repay their current loans because they cannot count on future loans, and savers will not trust the banks as safe places to store money.

Credit Needs in the Future

3.11 Agriculture provides 51 percent of the GDP and 80 percent of the jobs in Bangladesh. With an industrial sector still in its infancy, the agricultural sector must remain the engine of economic development. Unlike Indonesia or Thailand where under-utilized lands remain available for cultivation, Bangladesh is limited to essentially improving the intensity of cultivation on currently under-cultivated land. The use of additional units of labor are necessary but not sufficient to meet the challenge. More irrigation, improved seed varieties, and better farming techniques are also required. Capital investment in the form of agricultural credit must be available in larger amounts. This is particularly true because of the lack of privately held savings that could otherwise be used, as was the case in the rapid expansion of irrigated agriculture in the Punjab.

IV. Indicators and Trends

Institutional vs. Non-Institutional Credit

4.01 For the purposes of this paper, we will use the following terminology: "Institutional" sources of credit are categorized as being either "formal" or "informal". A "formal institution" is a bank whose objective is commercial success. "Informal institutions" include cooperatives and the Grameen Bank. "Non-institutional" sources include relatives, neighbors, landlords, merchants, and money lenders ("mohazon").

4.02 During the 1980's, it seems that the role of institutional credit in funding agriculture has been decreasing vis-a-vis non-institutional credit. In FY 1982, the Bangladesh Institute of Development Studies conducted a study in collaboration with IFPRI which showed that only 12.5 percent of farmers borrowed from institutional sources and that the average amounts borrowed were Tk. 382 per household and 373 per hectare. The interest paid on these loans was on the average Tk. 60 per hectare, and about 0.6 percent of the gross value of production. Regular data collection by the International Fertilizer Development Center (IFDC) shows that only about 8 percent comes from formal institutions (IFPRI/BIDS 1985). Thus less than 1 percent of all farmers purchased fertilizer using credit from formal institutions during FY87. The use of institutional credit to finance irrigation equipment has also become alarmingly low during the past two years as the table below illustrates:

Bank Loans Supporting BADC STW Sales
(# units)

Credit	Percent	Of Which Through	Year	Total Sale	Bank
FY84	6988	6612	95		
FY85	7678	6890	90		
FY86	2045	654	32		
FY87 (up to Feb.)	659	230	35		

source: IBRD/Bangladesh Office Memorandum dated 4/25/87.

"Non-institutional" loans tend to be based on an intricate network of reciprocal relationships, allowing repayment both in cash and in kind. Recent studies have shown that women have relied heavily on non-institutional credit due to their particular difficulties with both formal and informal institutions. "Informal institutions," such as the Grameen Bank, recognize the potential of giving credit to women and are beginning to address it. In the meantime, "non-institutional" sources of credit remain attractive because they have low transaction costs, no queues, no forms to fill out, and no bribes of 3-10% to pay. Also, the loans seldom require land as collateral. The disadvantages of non-institutional sources include: interest rates that often exceed 120% per year; no supervision along with the loan; and in case of a genuine crop failure, the loan will not be "written off." Institutional credit at least attempts to address these lacunae.

Direction of Credit Flow

4.03 The Chittagong region, both urban and rural, is the major supplier of funds to other regions. Urban Dhaka is the next largest source of funds with the highest amount of deposits in the country. Rural Rajshahi and Khulna have become major recipients of funds since 1983, followed by rural Dhaka. This situation is a reversal of the net flow of funds to rural areas, which existed prior to 1986. Since that time, urban areas have been the net beneficiaries.

Agricultural Loans - Types, Terms, and Sizes

4.04 Some reports indicate that only about 50 percent of so-called agricultural credit is distributed to farmers. The other 50 percent is funneled to tea planters, cold storage owners, fish pond operators, and to industries related to agriculture and marketing of agricultural commodities, especially jute and tobacco. Of those loans that reach farmers, only about 50 percent of the money is used for "productive" purposes. The remainder is used for social functions and obligations such as rights of passage. Thus only about 25 percent of the total disbursed amount of agricultural loans is utilized specifically in agriculture (Alim 1982, pg.34).

Individual Loan Size Increasing

4.05 During the past five years, there has been a shift from small to large loans. In terms of the number of loans issued between FY80 and FY84, more than 50 percent of the loans were small, under Taka 2500, while 29 percent were categorized as medium and 13 percent as large (IFDC, 1987, pg.13). But in terms of the value of loans, only 12 percent were small-sized loans, 18 percent were medium, and 70 percent were large. Overall, 69 percent of the loan volume was concentrated in large loans for overdrafts, installments, and other loans. When just two years are compared, we see that large loans in 1979/80 accounted for 41 percent of total loan value. By 1984/84, these loans constituted 89 percent (Gregory 1986, pg.1[illegible]).

4.06 Another example of the size of individual loans can be obtained from records of the BKB, which handled 58% of all agricultural loans during FY86. Loans larger than 10,000 Taka, with the average size being 55,000 Taka, constituted 44% of the total loan volume, but only 4% of all their borrowers received loans of this size. Also, the average rural account's outstanding balance (principal plus interest plus penalty) was Tk. 896 in FY75 and grew to Tk. 5250 in FY86. Some possible equity questions arising from this situation will be mentioned subsequently.

Duration of Loans

4.07 As of June 30, 1985, a rural branch bank's loan portfolio contained, on average, 74 percent agricultural loans of which 40 percent were short term, 20 percent medium term, and 14 percent long term. Only the Sonali Bank and BKB devoted at least a quarter of the total value of their portfolios to short-term agricultural loans, more commonly referred to as "crop loans." Crop loans tend to be for small amounts (less than Tk. 10,[illegible]00), and their repayment rate is higher than for the so-called "term loans" that fund tube-wells and livestock, for example. Many donor projects include term loan components. During the past few years, Table A shows that there has been a shift from crop loans to term loans. This trend raises some concerns about equity and repayment, which the Special Agricultural Credit Program attempted to address in 1978 at a time when the BKB's entire portfolio, for example, consisted of term loans (Cookson 1986).

The Number of Bank Branches

4.08 The GOB has succeeded in encouraging rural branch expansion. At the start of the Special Agricultural Credit Program (SACP) in 1977, there were 2,047 bank branches, of which 1,094 were in rural areas. By the end of February 1987, there were 5,189 branches, 3,472 of them located in rural areas as illustrated in annexed Table B (Ahmed 1987). The number of rural branches by bank were as follows: BKB and the Sonali Bank about 900 branches each; the Janata and Agrani Banks about 540 each; the Rupali Bank 274; and the private banks- Pubali and Uttara together had about 257 (Lu 1986, pg.19). This phenomenal growth is due mostly to the BB policy of authorizing a new urban branch only when two rural branches were also opened. Rural branch banks have increased from 53% to 67% of all branches during this past decade. This increase has allowed greater accessibility of the rural population to the banking system, thus helping to monetize the rural economy (Ahmed, 1987, pg.6).

4.09 The GOB should be lauded for the incredibly fast expansion of rural branch banks, but with some caveats. First, this growth has not been spread evenly in rural areas. Of the 4472 Unions in Bangladesh, over half still do not have formal banking facilities. Second, in theory, village based cooperatives (the Upazila Central Cooperative Association/ Krishak Samabay Samabay (UCCA/KSS)) fill this gap, but their performance has been reported as far from satisfactory (World Bank, 1983, pg.13), and there is some unnecessary overlap among banks and credit-giving cooperatives. Branch expansion should continue, but not at the expense of long term solvency. New branches should be licensed based on the dual objectives of reducing transactions costs to borrowers, while aiming towards an optimal scale of operation for the branches. This is not an easy trade-off to reconcile. Competition among formal banking institutions for rural accounts should be promoted. Also, the command areas of the Lead Banks need to be restructured to improve management, because in some upazilas the Lead Bank is not always the most active bank (Ahmed, 1987, pg. 4). A bank identified as the Lead Bank in an upazila is charged with coordinating crop loans of all the banks, and providing coverage in upazilas where there are no bank branches. We recommend that the GOB continue its current slow expansion of new bank branches, and give preference to increasing the number of Unions which are served by at least one branch.

Mobile Banking

4.10 One way of providing formal institutional banking to these unserved Unions is through mobile banking. The RFP studied the Cox's Bazaar area and came up with an IRR of 20.4% if the scheme was income tax exempt, and 12.5% if taxes were included. The RFP concluded that mobile banking is worth exploring further on a pilot basis in a few easily identifiable locations. These areas should undergo marketing research to assess socio-economic characteristics and the accessability of the area to four-wheel drive vehicles (Nathan Vol. 3, 1985, pg. 74). Mobile banks may reduce not only the transactions costs of both banks and their clients, but may also help break down one of the barriers that prevent more women from traveling to and using formal banking institutions. We recommend that the BB facilitate credit to the NCB/BKB to test mobile banking on a pilot basis in a few purposively selected areas with one caveat: it should simultaneously test a lower cost option- that of using motorcycles and bicycles.

Disbursements

4.11 While the period of greatest growth of branch banks was from 1977-1981, the period of greatest expansion of agricultural credit disbursements was from 1983-1985 as illustrated in annexed Table C. Given the current high rate of overdues, it is easy to conclude that the doubling of annual agricultural disbursements from FY82 to FY84 far exceeded the absorptive capacity of both the institutions and the borrowers. We will leave it to the political historians to decide whether the harm this has caused the banking system is out-weighed by the gains achieved under Martial Law in providing political patronage through the banking system for the establishment of the Upazila system and the return to Parliamentary rule in 1987.

4.12 Table B shows the rapid growth in nominal disbursements from Tk. 1.1 billion in FY77 to a high of Tk. 11.5 billion in FY85. Annual disbursements for FY86 and FY87 dropped to about half of the FY85 level. In real terms, the growth had been a four-fold in just a five year period FY78-FY84 as shown in Table C. Since FY85, disbursements have been curtailed greatly due to BB credit restrictions placed on branches in response to poor loan recovery rates. The provisional figure for this year's disbursements is less than 1 percent higher than last year's, only 55% of the record high figure in FY85, and only 44% in real terms. The cut-backs seem to have been more lenient, however, in the fishery and tea sectors.

4.13 The ratio of agricultural disbursements to agricultural GDP also increased from 0.8% in FY76 to almost 6% in FY84, and then slid to about 2.4% in both FY86 and FY87. Despite this significant increase, the availability of agricultural credit remains quite low compared with that of other countries, especially those whose agricultural sectors contribute as much as 46% of total GDP (Ahmed 1987, pg.8). Usually, capital to output ratios tend to be higher with more progressive agricultural systems, and when the share of GDP is lower. For example the Philippines ratio got up to 25 percent and then fell. (Ahmed, 1987, pg. 8).

Number of Loan Accounts

4.14 The number of rural loan accounts grew from 30,000 in FY75 to 5.5 million in FY86, while the number of urban accounts only doubled. Now almost 85% of the total number of advance accounts (accounts that advance/loan/disburse money) are held in rural branches, although they represent only 27% of the total value of advances. Thus, the GOB has made only slight headway towards SACP's goal of providing rural areas with real access to more resources vis-a-vis urban areas.

Bank Advances and Outstanding Balances

4.15 Table D shows that formal credit outstanding in rural areas increased more than 100 times, from Tk. 290 million in FY75 to about 33 billion in FY87, while urban credit grew only 9 times. As of FY86, outstanding credit to agriculture was 32% of all bank credit, up from only 11% in FY77 (Ahmed, 1987, Table 2). As a percentage of agriculture GDP, outstanding credits have increased from 2.4% in FY77 to 14% in FY86. Note that figures on outstanding advances tend to mask problems of liquidity because they include not only principal, but interest due also. Overdue loans weigh down the banking system right now, and Table D illustrates that liquidity has been shrinking in rural areas.

Recoveries

4.16 While the GOB took important preliminary steps toward restoring discipline in financial markets in late 1986, and initial results were very encouraging, there are indications that major problems remain. Despite magnanimous offers of amnesty on interest payments, recovery levels of overdue loans remain unacceptably high. As Dale Adams and Richard Meyer have noted, rampant loan delinquency and default can tear at the basic fiber of society by encouraging evasion of contracts. High rates of default essentially rob future borrowers of resources that the financial intermediaries would have provided (Meyer 1986, pg. 16; Gregory 1986 pg. 17).

4.17 With the exception of a few specialized programs like that of the Grameen Bank, poor loan recoveries are a long-standing and seemingly endemic problem to the banking system in Bangladesh. The magnitude of the problem is difficult to quantify because of inconsistencies in definitions and reporting requirements. Branch banks and borrowers attach no particular significance to repayment on a due date. Typically, the branch banks keep track of outstanding loans, but not the dates that they are due (Lu 1986, pg. 5). As standard practice, many banks simply roll-over loans on their books, and accrued interest is reported as income. Loan recovery figures, which include loans that have simply been rolled-over, lose much of their significance as a measure of the health of a banking system. The Bangladesh Bank, while not condoning late payments, has made it quite attractive for a bank to use its refinance window at low interest rates.

4.18 In 1984, the ACD/BB introduced a loan recovery recording system known as "ACD-L (1-6)." These forms attempted to be "all things to all people." Thus they collect so much information that the BB has difficulty in processing the data in a timely fashion, even with a computer. This monitoring and information system needs to be reviewed to better handle the trade-off between the timeliness of data, and the amount of data (Nathan 1986, pg. 73). Also, additional effort is needed to discover what are the information requirements of decision-makers, and teach decision-makers what the data can show. Of course, better data does not lead to improved recovery rates until decision-makers enforce such a policy. Led by donors who provide large sums to the banking system, the GOB is beginning to seek out and use information about the performance of the banking system.

4.19 Table D shows the recovery rate of both interest and principal, defined as a percent of amount due, falling rapidly from 48.5% in FY81 to 25.6% in FY86. Preliminary estimates for FY87 indicate that the rate may have climbed to 40.6%, or slightly above the GOB target of 40%. This increase is a direct result of the President's interest remission program for borrowers who had overdue loans valued at less than Tk. 10,000. The program lasted about six months, with the repayment period extended twice, ending finally on June 7, 1987. The recovery rate remains well below that of the early 1980s as illustrated very well in graph form (Meyer and Srinivasan 1987, pg. 30). The extensions favored those people with political clout, for they either were not planning to repay, or they knew that the repayment date was likely to be extended. Thus they benefited from a few more months of free credit. Those who did repay were predominantly the poor who held small sized loans, some of whom resorted to asset depletion or loans from money-lenders to make the payments.

4.20 There is no doubt that the program succeeded in collecting principal that otherwise might not have been repaid. Negatively, the program cost the banks, and ultimately the GOB, a great loss in interest payments. Also, the program has been criticized for perpetuating the belief that there are rewards to those who are delinquent in repaying loans. In addition, the program targeted neither large loans in agriculture, nor industrial loans that have even worse records of repayment. Financial indiscipline among the rich and influential has been growing simultaneous with the period of transition from Martial Law back to civilian rule. All doubts should now be removed, after President Ershad's interest forgiveness program soaked up many of the small loans, that the next target must be the larger loans of the wealthy (Hossain 1986, pg. 6.).

4.21 The RFP included a Rural Bank and Bank Users Survey (RBBUS) based on a sample of 6000 loans. It indicates that only 28% of loans are repaid within one year of being due. By the fourth year, this rate rises to 70%, and the remainder will not likely be repaid. Such low recovery rates force the BB to provide net new refinancing for about 50% of all agricultural credit demand in recent years. Basically, a viable financial system with tolerable interest rates is not possible until the recovery rate is raised to at least a level of 90% repayment over 3-4 years.

4.22 The RFP identifies a number of major causes of the poor loan recovery record. 30 percent of loans currently are not being recovered; perhaps as much as 10% are due to bad weather, 3% to the death or departure of the loanee, 7% to false documents, and 10% to bad faith on the part of the borrower. The RFP emphasizes that while the overall socio/political climate sets a general tone for recoveries, the banks cannot and should not use this as an excuse for poor recovery levels.

4.23 Data show that different branches and different banks, presumably having different management, have different recovery rates, but the same general setting. The larger the bank branch (and perhaps the more removed from client contact), the poorer the recovery rate. Also, contrary to conventional wisdom that recoveries increase when disbursements increase, this has not been the case in Bangladesh over the past five years at least. Insofar as this new credit went to those who had not repaid past debts, it seems to be feeding a habit of credit indiscipline. On the other hand, the fall in disbursements in both FY86 and FY87 did not lead to a fall in the recovery rate. During FY86, this can be explained in part by low prices of cash crops including rice and jute, but during FY87, the explanation seems to be more of just a refusal to repay if new loans were not available (World Bank 1987, pg. 10).

4.24 One of the stated intentions of President Ershad's interest remission program was to vigorously pursue defaulters of large loans, and those who did not respond to the amnesty, with firm legal sanctions. So far, there are few indications that Certificate cases have increased. Unless this procedure and other sanctions are followed, people will get the impression that it doesn't pay to repay, even when interest is forgiven.

4.25 We recommend that strong sanctions be pursued against those defaulters who are clearly identifiable now that many others have taken advantage of the amnesty. No doubt these recalcitrants represent a deeply entrenched vested interest group. It will require more than ordinary political will and administrative commitment to affect this group. Simultaneously, we recommend that the more time-consuming process of persuasion through training and education must be started now through political and non-bureaucratic structures (Ahmed 1987, pg. 24). Also, the banks should accelerate their in-house training programs on loan recovery, especially how to reschedule loans to meet borrowers' ability to pay (Nathan Vol.1, 1986, pg. 91). Other recommendations that affect loan recovery are mentioned under other sections such as "Legal," "Passbook and Security," and "General Administration."

Loan Security and the Credit Passbook System

4.26 Loans are backed by some form of collateral, either land or hypothecation typically of crops or equipment. Hypothecation requires that the banks adequately supervise the loan so that the same cow, for example, is not claimed as collateral by more than one person at a time. Also, the number of bank staff is too inadequate to be present at the time crops are harvested or fish sold to insure that the banks receive what is owed to them. Using land as security poses a few problems, least among them being those of legal procedure as mentioned above. Indeed, there are examples of evasion of court action. Outweighing this is the problem of proof of land ownership due to out-dated and incomplete land records. The Credit Passbook has been introduced by some banks to a limited extent as a means of providing a record of credit worthiness.

4.27 There are a number of problems, however. First, the number of borrowers far exceeds the number of passbooks printed. About 1.3 million passbooks have been issued as of June 1987, compared to 5.8 million agricultural loan accounts. Second, the passbooks have not been numbered and thus do not provide a security check against their forgery or theft. Much of the 279 million Taka under the 1982 Weavers Credit was misappropriated via forgeries of passbooks issued by the Handloom Board.

4.28 Third, passbooks do not contain an extract from the land records which would allow for precise identification of rights. There is no way of knowing if several persons in a village are claiming the same piece of land. Liens or other obligations of the passbook holder are not shown. Part of the problem is that Registrar's Offices sometimes refuse to issue non-encumbrance certificates because the land records are so out-dated that they cannot make such a determination in good conscience. The BB has been exploring a substitute procedure in which the Registrar issues a "letter of undertaking" of a search, and the branch bank officers actually visit the land in question (Nathan Vol.3, 1986, pp. 13-134).

4.29 Fourth, the passbook system seems to be subject to influence by rural elites. For FY87, the BB issued instructions which state "Identification of loanees in the passbook by the concerned Union Parishad chairmen would continue to be optional and subject to the discretion of the branch managers." As long as "identification" of potential borrowers is thought by branch managers to be synonymous with endorsement of the credit by political officials, it is not possible to hold branch bank managers fully accountable for their portfolios (Lu 1986, pg. 25).

4.30 We recommend that every effort be made to correct the weaknesses in the passbook system as long as it does not onerously raise transactions costs for farmers. The potential good that can come from the passbook system outweighs the potential harm that it might cause farmers who are already handicapped by the present system of credit allocation. The NCBs/BKB should instruct their branches to make adoption of passbooks one of the criterion for promotion and bonuses of branch officers. All loans, including those of the NCBs, BKB, BSBL, and BRDB should be conditional upon the existence of a passbook. Also, all banks and cooperatives, within a reasonably large area, should be encouraged to exchange lists of borrowers to whom passbooks have been issued (World Bank, 1987, pg.15). Finally, we recommend that rural branch bank managers be insulated to a greater extent from the pressures of Union Parishad chairmen to loan funds to specific activities or individuals.

Savings Mobilization

4.31 The household saving rate in Bangladesh is about 10%, which is low compared with other countries (Nathan Vol.1, 1986, pg. 15). Over the past decade, there do not appear to be signs that this rate has changed. What has changed, however, is the amount that has been funneled into banking institutions. The annual growth in bank deposits has averaged a phenomenal 34 percent during the past decade, but in the past two years, there has been a modest decrease in this growth rate. Total rural deposits have increased 21-fold from Tk. 1 billion in FY76 to Tk.21 billion in FY86 as illustrated in Table E. The deposit/GDP ratio averaged 11.8% for the 1976-80 period, and increased to 16.7% for the 1980-85 period (Nathan Vol. 1, 1986, pg. 16). During the past decade, rural deposits have doubled from 9% to 19% of total deposits, and the average size of a rural branch bank deposit increased from Tk. 931 to Tk. 2840. In urban branches, the average size of deposits remained about four times larger than those in rural branches (Ahmed 1987, Table 5 & 7). In the BKB, 20 percent of the depositors held 84 percent of all deposits.

4.32 Much of the growth in rural deposits can be attributed to the four-fold increase in bank branches, increased disbursements of rural credit, higher interest rates, improved access (roads and communication), and development of the banking habit (Ahmed, 1987, pg. 9 and Khalily 1987). In 1980, rural bank interest rates on savings deposits were increased to roughly 2 percentage points above urban rates. The recent drop in the rate of increase in rural deposits may be due largely to the tightening of bank credit to which people tend to respond by hanging on to their cash.

4.33 In a banking system where savings deposits and repayment of loans fall far short of the cash needed to meet demands for loans, one solution is usually to increase the amount of savings deposits. The most effective policy that the GOB could follow to accomplish this would be to promote increased GDP. Beyond this, banks could mobilize savings in a number of ways, many of which were brought out in a RFP seminar devoted to this topic in April 1987:

1). A strategy should be developed, using new marketing and banking techniques, of how to attract small accounts that are currently stagnant;

2). The bank staff must be motivated through training, recognition, and bonuses;

3). The entire community should be involved in the savings process such as is done in the United Way Campaigns in the U.S., or the Swanirvar programs in Bangladesh;

4). The banks need to make it easy for a client to withdraw the savings;

5). With more than 2800 deposit accounts per branch, computers could vastly speed up the task of keeping the accounts up to date;

6). Many rural people lack confidence in the branch banks. The banks should make sure that the accounts remain confidential and that heirs can gain access easily in case of death of the depositor (a problem of transactions costs);

7). These suggestions, many of which have already been tried, will work only if the banking system and the individuals in it are motivated to implement it (Nathan Vol.3, 1986, pg.146, Alim 1982, pg. 80; Nathan Vol.1, 1986, pg.91).

Despite having identified ways of increasing bank deposits, we must caution the GOB against expanding savings mobilization at this time for two reasons. First, depositors are penalized for saving with banks because the "real" rate of interest is negative, and given the financial status of the banks, it may be difficult to raise the rate on savings deposits. Second, despite the conventional wisdom that individual savings should be placed in banks so that the money will then be provided for use in investments that yield the highest financial return, intermediation is not working all right now in Bangladesh. Banks should concentrate on improving loanee selection and loan recovery. The banking system cannot do everything at once, so priorities must be set (Nathan Vol. 1, 1986, pg. 17).

4.34 We recommend that the banking system concentrate on improving borrower selection and loan recovery, and wait to increase savings mobilization until intermediation has improved. In the meantime, we recommend that new marketing and banking techniques for mobilizing deposits be tested, and that bank officers be trained to attract deposits. We also recommend that responsibility for managing the National Savings Schemes should be transferred from the National Savings Directorate to the Bangladesh Bank, whereupon the BB would coordinate all savings mobilization programs (Nathan Vol. 1, 1986, pg. 90).

Interest Rates

4.35 In 1983, a 4 percent service charge was added to the 12 percent interest rate charged on most agricultural loans as per the recommendations of the joint review by the GOB and the IBRD. Savings accounts without checking facilities now pay 10 percent/year (higher in rural areas), and fixed deposits earn on average 15 percent/year (see CEM 3/10/87 page 34 for a table of all interest rates). The GOB in 1980 set the rates to be paid on rural savings deposits at roughly 2% higher than those for urban savings (Khalily 1987, pg. 1). Nevertheless, the real weighted interest rate paid on deposits was negative five of the years from 1976 through 1984. The administrative costs of processing loans range between 3-6 percent, depending on the volume of lending and the size of loans. These figures are based on reports of the NCBs and the BKB and may reflect an underestimate because their branch banks do not undertake the full range of activities that would be required to attract more customers and to better monitor outstanding loans. The cost of bad debts is equally difficult to measure. The range is estimated to be between 4-6% (Nathan Vol.1, 1986, pg. 39). This current spread between the interest rates on savings and loan funds of about 6% does not cover the cost of operation which requires a spread of about 14 (including a slight profit margin). Thus the current interest rate on agricultural loans should be raised to above 24%.

4.36 Fortunately for the banks, the BB provides funds at a discounted rate of 8.5%. Even so, almost all banks are continuously operating at a loss (see subsequent section "Financial Viability."). Studies have shown that farmers are not overly sensitive to the rate of interest charged, provided credit is available on time, in adequate amounts, and without cumbersome procedures. The interest on their alternative source of credit through money lenders is about 10%/month. The USAID Rural Finance Experimental Project (RFEP) demonstrated that interest rates up to 36% per annum could be charged without adversely affecting the demand for credit or repayment rates. But recovery rates decline when real interest rates increase within the range of -10% to +10%. No matter what the interest rate is that a bank offers, the real cost to the borrower is estimated to be an additional 10-15% of the amount because of the time and expense involved in obtaining a loan. From the saver's perspective, given the current interest rates, it is more beneficial to borrow funds than to save. In effect, a false demand for credit exists in the current banking system due to low interest rates (Nathan Vol. 3, 1986, pg.40, World Bank 1987, pg.150; Cookson 1986, pg.7; World Bank 1983, pg.ii v.1).

4.37 We repeat the recommendation in the Financial Sector Review that interest rates for agricultural loans be flexible to allow for changes in market conditions and inflation, among other things. To the extent that these rates continue to be held at levels below that which will cover the costs plus profit margin of an efficiently run bank, then the GOB should reimburse the banks for their loss. Also, to strengthen the incentive of borrowers to repay on schedule, the system of penalty interest charges on overdue loans should be revised. As an experiment, the GOB might try to incorporate the current 6% penalty into a revised "all inclusive" interest rate for new loans, perhaps as a fee, and returned in the form of a rebate to those borrowers who repay on time. Although this system would have to be monitored closely for abuses, it could turn penalties into incentives (World Bank 1987, pg.20). The problem with the above suggestions is that the GOB is not likely to raise interest rates on agricultural loans- not now, and not in the near future. Many officials believe that if interest rates (and recovery rates) are to be increased, it should be in non-agricultural sectors. We agree with the logic behind the advise given above, but it could only be implemented through subterfuge. We recommend that the BB explore ways of creatively marketing loans so that increases in interest rates do not appear so high. For example, interest rates could be quoted as a quarterly or monthly rate, rather than as an annual rate. Fees could also be tacked on outside of the formal interest rate.

V. Viability of Agricultural Credit

Context and Cost of Funds

5.01 The viability of rural credit is only as strong as the overarching financial institutions in Bangladesh. While the recovery performance in the agricultural sector is dismal, it is better than in the industrial sector. The DFIs are unable to be auto-financing, and thus rely on donor support, while complaining often about donor "interference." The GOB was correct in identifying the expansion of agricultural credit as a means of meeting its goal of increased foodgrain production. But rather than establishing an effective policy for expanding agricultural credit for productive uses, the GOB resorted to relaxation of the normal banking practices of full-cost pricing. However, hindsight tells us that perhaps it was not realistic to expect a 4-fold increase in agricultural credit in 10 years, while at the same time having financially viable banking institutes. USAID's Rural Finance Project estimates that the most appropriate interest rate to allow the banking system to be financially self-sufficient is between 24-30%. Of course, the rate of interest on a loan makes absolutely no difference if the loan is not repaid.

Crop Insurance

5.02 Recent estimates indicate that perhaps up to 10 percent of all crop loans run into difficulty because of crop failure. As mentioned in the "History" section of this paper, the Indian and Pakistani administrations used to provide a distress loan known as Taccavi. This loan was administered through a relief department, but the loans were collected by a separate revenue department, which resulted in very low recovery rates. Currently the Ministry of Relief and Rehabilitation provides material assistance in cases of natural disasters, but the loan function has moved over to the now expanded rural branch banking system. When a flood or drought destroys crops, for example, the government occasionally announces that interest payments on the loans will be forgiven. These announcements seem to be based more on the politics of the day than on a careful assessment of the damage and the consequences to the banks of cancelling the interest payments. The GOB has not yet implemented a recommendation of the Banking Commission that the GOB reimburse the banks for the loss.

5.03 At present, the banking system does not have a system to satisfactorly manage loans affected by natural disasters. This results in the banks appearing unreasonable, thus giving their clients the excuse to default completely. By arranging to be fair to disaster victims, the banking system could enhance its credibility. To achieve this, the banks must improve client-bank relationships, and selectively reschedule loans based on an individualistic approach to each client. Currently, however, across-the-board announcements of interest forgiveness by the GOB, and the banks' inability to manage loans on a case by case basis, result in accounting nightmares at the rural bank level.

5.04 We recommend that the proposed Rural Credit Guarantee Fund (RCGF) should have the following approach: First, it should define procedures for the GOB to follow in declaring the extent of any forgiveness program based on natural disaster, and should reimburse the affected banks for most of their resulting losses; Second, RCGF financing should be shared by the GOB, the banks, and since it is a form of crop credit insurance, by the borrowers. Borrower contributions should be mandatory and incorporated into crop loans as a fee. This premium would be small, perhaps only 1 percent, because the GOB and the banks would share the risk; Third, local agricultural officers, BB agents, and local bank officers, should be responsible for identifying which specific borrowers, villages, or unions (ie. the most specific level possible) should benefit from full or partial (such as postponement of debt repayment) amnesties based on field inspections. A vaste literature exists on crop insurance, and before proceeding the GOB should avail itself of it.

Supervised, Tied, and Group Lending

5.05 The GOB needs to continue to experiment with and adapt four approaches to lending so as to improve the viability of the banking system. These are tied, [illegible] supervised, and group lending. Tied loans are those that go directly to a supplier, perhaps through a letter of credit, rather than to the borrower first. For example, a loan for a shallow tube-well (STW) can be paid directly to the distributor of that STW intead of to the borrower. Tying loans in this manner may diminish the diversion of loans from production to consumption. More importantly, this approach should be seen as a way of lowering administrative costs. A bank could provide credit to a fertilizer dealer, for example, who in turn could pass on the credit to fertilizer purchasers. About 2 million farmers could be reached with credit, although only 8000 fertilizer retailers would meet directly with the banks (Islam 1987).

5.06 Supervised credit is the approach that most non-governmental organizations (NGOs) employ, and involves helping the recipients use correctly the inputs that they purchase with the loans. The formal banking sector has shied away from this approach due to its high administrative costs including that of maintaining a staff trained in extension work. The NGOs, in many cases, have kept these administrative costs to a minimum by relying on young, motivated semi-volunteers to do much of the work. The Grameen Bank, for example, makes a point of using recent university graduates to do their field work. The NGOs have shown, however, that the rural poor are willing and able to pay back loans, including the cost of supervision, if that supervision shows them how to use the new inputs wisely.

5.07 Group lending is an approach that allows individuals without sufficient collateral to obtain a loan, and have a group guarantee that the loan will be repaid. Both the Grameen Bank and the Bangladesh Rural Advancement Committee (BRAC) have shown that this approach can work even among the landless and yield repayment rates over 95%. Even so, commercial banks remain reluctant to take on supervised or group lending. Perhaps NGOs or public agencies such as BRDB could be more active in forming and preparing groups so that they will be more 'bankable'. The banks and the GOB should guard against having these entities become a barrier between small farmers and the landless poor. This can be accomplished by making sure that their staffs are well trained and motivated (World Bank 1987, pg. 150).

5.08 <u>Targeted Lending Programs</u> are a favorite method of assistance by local NGO's. Despite their best intentions to help those who are most in need via targeted credit, their efforts occasionally fail, and usually undermine the financial system. Targeted lending usually fails to reach the intended client because where there is a subsidized program, the wealthy and the powerful will not be far away, seeking access to it (Adams 1987). Second, credit is not an input; rather, it should be viewed as a claim on resources that are highly fungible (Adams 1983, pg. 244). Thus, a loan cannot be targeted with any degree of success without prohibitively high administrative costs. Third, targeting seriously undermines the fundamental ability of branch banks to intermediate by essentially telling the banker to whom to give a loan.

5.09 Fourth, too many programs create an administrative nightmare for bankers in terms of different forms to fill out and reports to be filed. Fifth, if a branch banker must deal with a myriad of programs, he/she is unable to keep up with frequent changes made to them. Sixth, when a banker is unable to develop an expertise in a specific sector, shallow tube-wells loans, for example, the branch bank has a higher risk of making a loan that will not be repaid. Seventh, since not all branches handle all programs, borrowers sometimes must go from one bank to another to fulfill their various credit needs. "Full service" money lenders become an attractive alternative to this seeming lack of responsiveness from the banks. Eighth, because of the plethora of programs, it is difficult to verify an applicant's credit history (especially other current loans for other purposes), and it is difficult to evaluate whether the loan has been successfully used as intended, or whether the loan was repaid merely out of funds borrowed from another program (Alim 1982, pg. 37; Lu 1986, pg. 15).

5.10 Contrary to the current recommendations of Ohio State University and others mentioned above, the table below shows that the trend in the number of targeted programs in Bangladesh has increased tremendously.

Number of Targeted Lending Programs in Bangladesh

	FY74	FY78	FY84
Short term	3	5	23
Medium term	6	5	22
Long term	0	4	11
TOTAL	9	15	56

source: R. Nathan, Final Report, Rural Finance Project, Vol. I, Sept. 1986, pg. 76.

5.11 Targeted credit schemes are offered by NGOs (Non-governmental Organizations of which there are more than 400), cooperatives, bi-lateral donors, and the Bangladesh Bank. The BB alone has over 60 specialized credit programs in the rural sector. These programs are crop-specific (eg. tea, jute), activity-specific (eg. irrigation projects), or client specific (eg. women) (Nathan Vol.3, 1986, pg.1). The following table lists some of those programs coordinated by the BB:

Bangladesh Bank Agricultural Credit by Program, FY86

Program	FY86 (in million taka)
Fishing Ponds	35.3
Cold Storage	283.1
Swiss Post-Harvest Project	7.2
ASARRD (FAO/UNDP) Project	3.5
Rural Finance Project (USAID)	450.0
Swanirvar Program	80.0
IFAD Small Farmer	30.0
RD-II (IBRD, CIDA, UNDP)	650.0
N.W. Rural Devel. (ADB, IFAD)	3.0
IDA Credit #1147-D	75.0
Rural Housing	80.0
Banana Plantations	1.1
Rural Transportation	1.9
Shrimp Culture	52.0
Lac/Shellac Culture	0.2
Rower Pump	0.3
Commercial Poultry	0.7
TOTAL	1753.3 (Approx. $57 million)

Source: Figures are mostly estimates based on data from the Bangladesh Bank Annual Report 1985-86.

5.12 The GOB should reduce the number of specialized loan programs. A first step would be to ask donors to refrain from establishing special (targeted) accounts for on-lending; rather, they should put their funds into existing channels of the BB, NCBs, Grameen Bank, cooperatives, etc.

Productivity and Intermediation

5.13 Experience worldwide indicates that if Bangladesh can increase its GDP, then its rate of savings will increase, and the banking system can draw on these savings to finance loans which will further promote growth in productivity. This relationship is more profound than just noting that wealth is positively related to development. If farmers cannot use agricultural credit productively, then they will either not agree to take loans at high interest rates that cover the cost of the loans, or they will default on the loans. Thus, the profitability of credit must be considered from the point of view of the borrower as well as that of the lender. An ideal interest rate structure is one that maximizes the profits of both the totality of banking institutions, as well as those of farmers.

5.14 In other words, the interest rates and repayment schedules should not be so high that only a few people find them profitable. Likewise, the repayment schedules should not be unrealistic. It should be in the banks' interest to make sure that interest rates are affordable and that productive opportunities are promoted. Banks need to both seek out and promote situations in the agricultural sector where: a). Appropriate new technologies are available through the research and extension systems; b). The educational system gives people the skills necessary to understand and use the new technology; c). The physical infrastructure, such as transportation and communication networks, minimize marketing costs; d). Prices are attractive. In short, as Dick Meyer has said, "it is difficult to promote a viable banking system if the borrowers it serves are not healthy."

5.15 In order to be of service to society as a whole, the banking system must be able to handle intermediation. Intermediation is the process by which banks mobilize resources, apply them to the most productive opportunities, and recover these resources for future use during the next cycle (Nathan Vol.1 1986, pg.86). For example, borrowers who are delinquent in their loan payments enjoy the opportunity of recirculating loan funds in their businesses and households. Although the original use of the loan may have earned a high rate of return, subsequent uses by the borrower may not. Potential borrowers, many of whom may have higher rate of return projects, are denied loans because the lenders cannot re-lend unrecovered funds (Meyer, 1986, pg.5). This socially beneficial role of banking breaks down if the banks are unable to identify uses of funds that yield a higher return than they would in the hands of those who originally held them, ie. the BB or private individuals and companies. In Bangladesh right now, the first priority of the banking system seems to be on improving loanee selection and loan recovery (Cookson 1987, pg.17).

Attitudes

5.16 The health of the banking system in Bangladesh is currently more a matter of attitude toward this system than the system itself. The best designed system cannot work if those who implement it are not concerned about the future of the system in particular, and the nation in general (Huda, 1986, pg.5). As mentioned earlier, many people view credit as a dole, particularly if it comes from the government, and even more so if donors are behind it. The poor recovery rates over the past five years exemplify current attitudes (Malony 1986, pg.152).

5.17 Many top policy-makers have been emphasizing short-term political gains at the expense of medium and long term considerations. There is evidence, both in public announcements and in private actions, that they are using the banking system to serve the social objectives of redistributing resources to lower income groups and to themselves. This happened clearly in 1982 in the Rajshahi Division when a military official started a program called "Matir Dak, ("Of the Soil)," in which loans were disbursed, perhaps with the best of social intentions, but with little thought given to ability or willingness to repay them. In 1983, Union Agricultural

Credit Committees (UACCs) were created as part of the SACP to help the banks locate potential loanees. In fact, banks could not make loans to people who did not first appear on the UACC lists. The members of these committees, however, were not required to guarantee these loans, the great majority of which were never repaid. Often they, their families, and their supporters were the greatest abusers. Data on crop loans alone from the BKB through the end of FY86 indicate the nature of the problem:

1). Current and former Union Parishad Chairmen and Members had 16,005 overdue loans, the average amount being equivalent to $478 (three times the annual per capita income in Bangladesh).

2). Current Upazila Chairmen have 150 overdue loans averaging $3677 each (24 times Bangladesh's per capita income) (Ali 1986, pg.22). This example set by the rural elite is not conducive to the collection of loans from others.

5.18 The GOB continues to state officially a commitment to loan recovery. The BB has attempted to implement this policy on a number of occasions by issuing directives. Such directives were superseded on at least two occasions, one in February 1985, and again in February 1986 in directives issued by the President's Office. These directives restricted pursuit of loan recovery certificate cases (Lu 1986, pg. 7; Nathan Vol.1, 1986, pg.62). On April 25, 1987, the President directed the Finance Ministry to examine the possibility of a reduced rate of interest on credit to weavers. The June 5th deadline for repayments of small crop loans with interest exemption resulted in a large increase in repayments (see the "Recoveries" section). But there are no indications that the GOB is following through with its statements to pursue defaulters through the legal system. In June, the Finance Minister announced in his Annual Budget speech that they are exploring "rebates to those borrowers who will repay their loans on schedule." This is a sorry state when rewards must be considered for completion of legally binding loan agreements. More recently during the August 1987 floods, the President ordered the banks to extend agricultural credit to the affected and poor farmers. Fortunately this time, as opposed to times in the recent past, the President did not offer loan foregiveness; rather, he ordered loan rescheduling.

5.19 Attitudes within the banking system are starting to improve. Still, the tendency is for the banks to blame every ill on the politicians, rather than undertake a number of actions that could greatly improve the banking system. For example, while importance is attached to repayments, the timeliness of those repayments does not seem to be of concern. Branch banks keep records of credit outstanding, but they do not have records about what is due or overdue. Bankers must be instilled with the notion that loan collection is an integral part of banking, and it should be done on a regular basis in a systematic fashion. (Lu 1986, pg.5; Cookson 1987).

Corruption

5.20 In a society where potential loanees are mostly poor, illiterate, and unfamiliar with banking procedures, corruption in the form of "baksheesh" is quite common as a way of getting the papers through the system. Fraudulent loans, such as loans to non-existent people, can be reduced if a branch banker was occasionally thrown in to jail as a deterrent by example. Kick-backs to bank staff will be hard to control as long as institutional loans are so much less expensive than the alternative non-institutional loans. Both forms of corruption can be diminished through more policing of the system. The net effect in the short-run would most likely be a decrease in disbursements. Nevertheless, banks must seek ways to combat pervasive corruption so that its effect of raising transactions costs does not drive away clients and integrity can be restored to the system. Top bank managers should provide better training and supervision, reward honesty, and give enthusiastic support to observance of legitimate banking practices (Nathan Vol. 1, 1986, pg.11).

Legal System

5.21 There are two mechanisms for the collection of overdue loans; the civil court system and seizure of assets under the Public Demand Recovery Act. Both systems have been examined in depth by USAID's Rural Finance Project and found to be acceptable. What is not adequate is the implementation of these existing regulations and the establishment of more precise procedures with regard to the identification and policing of overdue loans (Nathan Vol. 3, 1986, pg.113). These systems are misused to collect occasionally a large number of very small loans and a small number of large loans. Also, there is a reluctance to use these collection systems of last resort against those who are politically powerful. More than ordinary political will and administrative commitment are required to change this situation which intimidates bank officials who even contemplate using pressure to collect overdue loans.

5.22 The civil courts are comparatively immune to political pressure, but such litigation is exceedingly slow and costly. Until the present huge number of defaulters is reduced through the Certificates Procedure, the courts will not be able to assume their proper role of resolving these cases, while fully protecting the rights of the accused. Also, lawyers representing the banks are selected by the Ministry of Law and Justice. The banks should be given the right to select their own counsel (Lu 1986, pg.8).

5.23 The Public Demands Recovery Act of 1913, and amended as recently as July 1987, is the basic legal procedure for the recovery of overdue bank loans. This non-court procedure was originally developed for the collection of overdue land taxes/revenues by the British colonial authorities. This procedure permits the value of overdues to be collected by the sale of seized assets by a Certificate Officer. District Magistrates have this title and the power to redelegate the authority to others. But they have been slow in vesting this power in the Upazila Magistrates where it should be. Understaffed, the District Magistrates should be authorized to appoint temporary servers and clerks to handle the certificate case-load. Also, officers of the Grameen Bank, the BKB, and some others have been permitted to become their own Certificate Officers, but as of FY86, no bank has actually done this. This option is being avoided because a coercive collection function would hurt the image of bankers.

5.24 Certificate proceedings, particularly a special expedited procedure that eliminates the accused's right of appeal and hearing, are not ideal. But given the huge number of overdues, these implementation procedures should be pursued. During FY85, there were over 5 million rural borrowers, of which about 1.5 million had overdue loans, yet only 260,000 Certificate Cases have ever been filed, and only 60,000 have ever been settled (Nathan Vol.1, 1986, pg.71). A constraint that should be reviewed is the cost to the banks of pursuing Certificate Cases. They must pay 16 2/3% of the outstanding loan amount as a non-reimbursable fee even if the case is lost.

VI. Institutional Analysis

The Bangladesh Bank

6.01 The Bangladesh Bank is the Central Bank, and among other functions, coordinates and guides all agricultural credit. The BKB handled 58% of the total volume of agricultural credit in FY86, the NCBs 40%, and the cooperatives under BSBL 2%. From these banks, 9% of all credit was channeled through the Bangladesh Rural Development Board (BRDB) cooperative system.

Refinancing and Loan Guarantees

6.02 One of the major functions of the BB is to refinance the banks' loans, and handle loan guarantees from the GOB. Both of these topics are discussed at length in the 1983 Joint Agricultural Credit Review, and thus will only be summarized briefly here. During FY85, an amount equivalent to 69 percent of all formal sector agricultural credit was refinanced by the BB. This is quite high and indicates the importance of such funds for the banks.

6.03 The simultaneous goals of controlling the monetary supply, promoting growth in the rural sector, and providing the correct incentives to savings mobilization are not always complementary. For example, the BB could in theory be used to force rural branch banks to improve their loan recovery rate by restricting refinance to those banks that are out of line. In practice, however, a credit ceiling on branch banks already exists as part of an IMF-sponsored monetary policy. Thus, loan recoveries would only increase if the interest rate on refinancing from the BB were raised to a point where branch banks would find it cheaper to recover loans than to borrow from the BB. This is not feasible in the short run because it would lead to an overall higher cost of capital, and thus a net slow-down in the velocity of money. As a second best solution, the BB should continue its policy during recent years of raising the refinancing rate to promote savings mobilization, while avoiding a de-capitalization of the economy (World Bank 1983, pg.iv; Nathan Vol. 1, 1986, pg.15).

Accounting Procedures

6.04 The BB has been adjusting its regulations with respect to loan classification, the eligibility of accrued interest as current income to the bank, and the provision of bad debt allowances at the Head Office. However, there is room for further improvement. Using the current accrual system of accounting, an outstanding loan and the interest payments are reported as income, and very little consideration is given to bad debts. Thus the more loans a branch employee makes, regardless of whether it is a good or bad loan, improves the "performance" of the bank. The common practice of rolling over bad debts on the books simply conceals a poor recovery rate, and allows the employees to collect year-end bonuses for delivering high income levels (Nathan Vol.3, 1986, pg.44). The final report of the USAID Rural Finance Project (RFP) makes the following recommendatons:

1. Clear guidelines on when loans should be written off need to be established, and a loan loss rate determined. This rate should be

applied to new advances and these funds should be set aside in a reserve fund to protect the depositors' interests.

2. Loans that are clearly in default at the present time, such as loans, should be written off.

3. Clear guidelines need to be established on how to report income and expenses. If income continues to be reported on an accrual basis, then expenses should also be accrued. Income on overdue loans should not be reported as "realized." A separate line item for "deferred" income might be appropriate, depending on whatever new accounting procedure were introduced (Nathan Vol.3, 1986, pg.44). Another negative side of the current procedure, which presents the illusion that 80% of the banks are making profits (in fact, the opposite seems to be true), is that the GOB taxes these "profits." Once the BB changes the accounting procedures, then the GOB should allow bad debts to be tax deductible. Of course, the GOB will then have to adjust to lower revenues originating from banks. Also, the financial statements in the banking system should be prepared as required by the International Accounting Standards Committee (Nathan Vol.1, 1986, pg.55).

"Management by Directive"

6.05 "Management by directive" describes the BB's style of operation, and why BB is unable to resolve many long-standing problems. Directives are almost meaningless if they reflect little understanding of reality, or if they are overruled or superseded by the President's Cabinet. This has happened too often in the past. The BB should renew its efforts to gather political support for its new directives, and test them in the field prior to their formal issuance. In addition, the donors must be somewhat understanding of this problem, especially as some of the directives are at their urging, and a condition to the release of funds. Perhaps the BB and donors should more equally share the responsibility of convincing higher authorities that recommended changes in significant policy are worthy of support.

Appointment of Directors

6.06 Frequent rotation of senior branch bank managers has some advantages such as minimizing corruption as well as boredom. But it also has negative consequences. For example, it limits the development of close relationships with clients that is so necessary in a bank. Long range planning is inhibited, and rapid turnover means that only the rare manager develops a sense of pride in building up a branch that he is soon to leave. According to the Rural Finance Project, between 1980-85, Managing Directors were rotated on average every 1.3 years, and General Managers in 1.8 years.

Jurisdiction of BCD/ACD/RCPD/ICD

6.07 Conflicting circulars concerning rural credit are occasionally issued by the BB from different departments. The Agricultural Credit Department (ACD) and the Rural Credit Project Department (RCPD) both issue circulars about lending policy. Both the Banking Control Department (BCD) and the ACD issue circulars concerning refinance. Finally, the Industrial Credit Department (ICD) coordinates industrial loans in rural areas. The Joint Agricultural Credit Review in 1983 offered some recommendations that bear high-lighting. The ACD should continue to deal with the national credit programs including cooperatives. The RCPD should continue to manage the IFAD and IDA credit projects as well as develop some new projects, and thought be given to folding them into one department after the termination of IBRD Project (World Bank, 1987, pg.74). In the meantime, these departments should be better coordinated under a common Executive Director (Nathan Vol.3, 1986, pg.6-14, 23).

The BKB and the NCBs

6.08 The BKB and the NCBs accounted for over 98 percent of formal sector agricultural disbursement during FY86, while the BSBL provided the remainder as shown in annexed Table B. However, the BSBL is not the only cooperative system in Bangladesh. The BKB and the NCBs channel about 10 percent of all disbursements through the Bangladesh Rural Development Board (BRDB). The breakdown of disbursements is detailed in Table B in the annex and in the table below:

Rural Operations of the BKB and the NCBs

	# of Branches*	Disburse-ments	Outstanding Dues	% of Recovery FY86 ***
		(in million Taka)		
NCBs:				
Sonali	905	1908	5857	22 percent
Janata	544	253	1956	25
Agrani	544	243	1484	25
Rupali	274	87	796	14
Private:				
Pubali	126**	36	715	14
Uttara	125**	n.a.	145	24
sub-total	2518	2527	10954	22
BKB	929	365	11470	31
BSBL	n.a.	140	1318	15
Total	3453	6317	23752	26

* Figures as of August 31, 1986.

** Total divided equally between these two due to lack of data.

*** Recovered as percent of total due for recovery.

6.09 These figures indicate the relative importance of each bank, and the fact that they all face debt repayment problems. Up to February 1987, 30 additional branches were opened, disbursements increased slightly to 6361 million Taka in FY87, and that the BKB's share of all agricultural loans increased from about 58 percent last year to about 68 percent in FY87.

6.10 The BKB remains the lead institution in rural finance in Bangladesh. The policies and programs of the NCBs are now quite similar. In March 1987, the BKB opened up the Rajshahi Krishi Bank, the first of what will be four regional banks that will all but close the BKB. It seems that an overall improvement in the performance of BKB could have been effected by delegating greater responsibility to its zonal offices without what seems to be a duplication of bureaucracy. We recommend that a decision on reorganization be deferred until other changes recommended herein concerning the NCBs and the BKB are implemented and the results observed.

The BSBL and the BRDB Cooperatives

6.11 The BSBL handles only about 2 percent of formal agricultural credit as the table above indicates. The GOB recognizes that this three-tiered cooperative system, with liabilities exceeding assets by Tk. 500 million, needs reform. The Bangladesh Rural Development Board (BRDB) oversees 448 Upazila Central Cooperative Associations (UCCAs) and 86,857 primary societies. These include the KSS- Krishak (Farmers') Samabay (Cooperative) Samity (Association), the MSS- Mahila (Womens') Samabay Samity, and the BSS- Bittahin (Landless) Samabay Samity . Most of the funding comes from the Sonali Bank, which makes extensive use of the refinance window of the BB and GOB loan guarantees. Despite this extensive network, it only accounts for about 10 percent of all formal agricultural credit, and its recovery rate is also poor. This so-called cooperative system is a far cry from the Comilla cooperatives that truly represented the views of its members. Thus, only about 10 percent of the UCCAs are financially viable. The problems of both of these structures were discussed in detail in the IDA/GOB Agriculture Credit Review in 1983. At the 1986 donor community meeting in Bonn, the GOB agreed that a Joint Review of the Cooperative System in Bangladesh would be undertaken. The Terms of Reference are still being discussed.

The Grameen Bank, BRAC and the Swanirvar Program

6.12 Since much has been written about the Grameen Bank in particular, this report will only mention a few points. The Grameen Bank, BRAC, and the Swanirvar Program use peer pressure to get around the problem of lack of collateral and poor repayment records.

The Grameen Bank's approach also includes the following:
a). Promotion of strong groups through mandatory training and consciousness-raising;
b). Compulsory deposits; c). Extensive supervision of loans;
d). Unhurried expansion; e). Participative decision-making;
f). Decentralization of decision-making; g). Financial discipline;
h). Interest rates of over 21 percent on loans; i). Focus on women, who constituted 76 percent of the membership in 1986.

6.13 The Grameen Bank's very high recovery rate of 98 percent over the past few years has attracted international attention as a possible model. Some of the constraints to the replication of the Grameen model include: a). A staff that is young, idealistic, and motivated by a charismatic leader- an effective combination, but one that is difficult to replicate; b). A portfolio consisting mainly of loans for trading, manufacturing, livestock, and fisheries, with very little for crop production; c). Geographically localized success (operations in 20% of the Unions, total of 254,000 members); d). Funding that is largely dependent upon grants from IFAD and the BB for its Dhaka operations. Even though these issues raise some doubts about the potential for using the Grameen Bank as a model, the NCB/BKB branches should study these approaches, and possibly test them in their own branches (Lu 1986, pp.39-54; Nathan Vol.3, 1986, pp.6,9,12;).

6.14 The Swanirvar (self-reliance) Programme is one of a number of specialized programs that are run by the NCBs and BKB. These other programs will be discussed briefly under the rubric of "Donors and Targeted Credit." Started in 1978 as the "Paddy Husking Loan Scheme," this group lending program targets those who have less than 0.4 acres of cultivable land, or incomes less than Tk. 6,000 per year. Swanirvar now operates in 17 percent of the 448 Upazilas, extending loans of less than Tk. 5,000 each to 400,000 families. The loans are used for such activities as rice trading, small ruminants, the manufacture of puffed rice, and rickshaw manufacture and leasing. To keep this program going, about 3500 volunteers work on a commission basis only.

6.15. While the program has had no small impact on lower income groups, there are a few limitations: First, not all needs can be met with such a small limit on loan size; Second, as is the case with the Grameen Bank, it will be hard to maintain or expand the program without offering more incentives to the volunteers; Third, each group should be required to maintain at least 10 percent of the total amount borrowed as security against the loan; Fourth, cooperatives should follow the same reporting procedures as other credit institutions so that inefficiencies can be avoided. As of June 30th, 1987, 20 percent of the Tk. 555 million disbursed was overdue. Of the total amount disbursed, BKB handled 28%, the private banks 4%, and the the NCBs the balance (B.B. 1985-86, pp.745; Nathan Vol.3, 1986, pp. 97,140).

Access, Equity, and Women

6.16 The SACP attempted to redress one of the major concerns of institutional credit- making it accessible to the rural poor. As discussed above, the 3-fold increase in the number of rural bank branches has facilitated access. To get around a farmer's inability to offer adequate collateral, the SACP allowed bankers to disburse a loan on hypothecation- that is against standing crops, livestock, fish, handicrafts, machinery, and equipment. While well-intended, this added to the high default rate that the banks presently face. Low interest rates were another way of trying to help the poor. However, the main beneficiaries were not the poor, because the subsidy implicit in the low interest rates became concentrated in large loans to relatively wealthy farmers (Cookson 1986, pg.1). Also, the size of individual loans have been increasing since FY76, as have the size of land holdings of the recipients of loans.

6.17 Cooperatives and targeted programs are often thought of as part of the solution to the problem of access and equity. One of the problems with cooperatives has been that over time, they tend to be taken over by the affluent. A satisfactory solution to this has not been found yet. Some of the targeted programs have been quite successful. The Grameen Bank targets women for three principle reasons. First, women are respected in this society as being more thrifty than men. The stereotype of this is the women who holds back some rice from that allotted to a meal so that it can be used when an emergency or an investment opportunity arises. Second, women have a better repayment record than men. Third, women have been neglected by the formal banking system because of such things as the banks' inability to accommodate satisfactorily a women in purdah. Thus there is much untapped potential for steering the savings of women away from the earthen jar and marginally profitable investments, and into the formal banking system.

General Administration of Rural Branch Banks

6.18 If the system of loan delivery is faulty to begin with, then the probability of loan recovery will be quite low. The Rural Finance Project (RFP) observed many branch banks and noted a few characteristics that can be generalized: 1). They are doing the best they can under adverse circumstances; 2). Training, both initial orientation and in-service, is infrequent in quantity and cursory in quality; 3). An atmosphere of frustration, lack of incentives, and lack of motivation pervades the system and threatens not only the quality of the data that is reported, but also the quality of the loans (Ahmed 1987, pg.2).

6.19 According to the RFP recommendations, the banks must be encouraged to "provide for a system of incentives and changes in rules and regulations that would affect the motivation of rural branch bank managers and staff, thereby to increase their efforts to mobilize savings, increase loan recovery rates, sanction productive, high return loans and operate efficient branch banks (Nathan Vol.1, 1986, pg.86). The amount and nature of paperwork that are required of branch banks remain a major constraints to rural banking. Inadequate provisions for bad debt and the accrual system of accounting have led to distortions in bank balance sheets and the incentives of employees. With non-performing loans and uncollected interest charges counted as assets, the banks appear as though they are in better financial health than is really the case. RFP reports recommend that the banks need to increase the bad debt provisions and write off bad loans sooner than they are doing at present. A new reporting system should require that loans are classified by age, and that they be broken down according to principal, interest, and service charges.

6.20 The RFP reports also indicate that of the 160 or so reports that each branch generates, none are computerized, therefore the central banks do not give feedback, and the data is not fed into a central data-bank system. The number of reports submitted is excessive, leaving little time for the staff to analyze that which has been reported or to reconcile the differences in numbers reported at different levels in the banks (Nathan Vol.1, 1986, pp.53, 84).

6.21 To be more responsive to client needs, the RFP again offers numerous suggestins. For example:

a). Other banks may want to follow the example of Agrani Bank and schedule office hours that ae convenient to the client, e.g. 3-7 p.m. for farmers;

b). Confidentiality of client data must be assured;

c). NGOs could be enlisted to be the intermediaries between banks and potential new clients (eg. they could supervise the use of credit so that the borrower actually obtains the potential benefits;

d). BKB and NCBs should try some less conventional programs such as group lending and the Contract Savings and Credit Scheme;

e). Special rooms or procedures should be instituted to provide access to those who are typically disenfranchised- illiterates and Purdanashin women (Nathan Vol.1, 1986, pg.21).

6.21 The BB should give all banks greater autonomy in matters of selection, recruitment, training, compensation, and promotion of branch employees (Nathan Vol. 1, 1986, pg.20). The RFP reports include a number of suggestions in this regard. For example, the reports suggest the following:

a). Employee incentives should be shifted from loan disbursements to loan recoveries, with manages held accountable for bad loans, and given bonuses for high levels of collections;

b). Salaries of NCB and BKB staff should be increased so they can attract and retain competent staff;

c). Banks need to clarify their goals, and then set up incentives and punishments for each level of the organization- from the GM, to the regional banks, to the branch banks, to the loan officer;

d). In order to properly check on potential and current borrowers, the ratio of field workers to borrowers shold not exceed 250, and a supply of bicycles or motorcycles might help relieve the problems of mobility;

e). Training courses that were designed by the RFP for the central and regional offices should be implemented;

f). Branch manages should have authority to reschedule smaller loans which have not previously been rescheduled, but the recommendation should be subject to review at the division level.

6.22 Concerning the overall management of agricultural credit, we emphasize the following recommendations:

a). Department of Agricultural Extension personnel should be trained in and assigned to advise farmers on the importance of credit discipline;

b). Upazila and District authorities should be instructed to help impose sanctions on larger defaulters. Given tht these same authorities are often part of the problem, it will not be easy making this recommendation work. One way is continue emphasizing the importance of tying the release of Upazila Development Grants to progress in loan recovery;

c). The GOB should implement fully their order to disallow defaulters from holding political office;

d). Certificate or other legal proceedings should begin automatically no earlier than 90 days and no later than 150 days from the date of default;

e). Assign life-of-loan responsibilities to specific loan officers.

6.23 The BB is aware of many of these, as well as other deficiencies. In 1986, the BB took the positive step of issuing five management directives to the NCBs and the BKB. They included:

a). Incentives for loan recoveries;

b). Increased presence of senior staff at rural branches;

c). Encouragement to pursue Certificate cases;

d). Improved knowledge of the true loan recovery position;

e). Circulation of defaulter lists among the banks (Nathan Vol. 1, 1986, pg.80). As previously mentioned, "management by circular" is a style that is often ineffective if difficult changes are truly desired.

file: AGRCRED1, IBM format

Table: A

GROWTH OF BANK BRANCHES IN BANGLADESH, 1981-1988
[as at June 30th of each year]

Area\Yr	1981	1982	1983	1984	1985	1986	1987	1988/p
Urban	1,363	1,538	1,553	1,589	1,628	1,668	-	-
Rural	2,839	2,932	3,050	3,228	3,335	3,446	-	-
TOTAL	4,202	4,470	4,603	4,817	4,963	5,114	5,223	5,293

/p Provisional data upto March 1988.
/- Data not available.
Source: Bangladesh Bank, Banking Control Department.

·AGRICULTURAL LOANS ISSUED BY MAJOR CREDIT INSTITUTIONS, BANGLADESH FY1977 – FY1987

[millions of taka]

Source\FY	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
COMMERCIAL BANKS: /a	560.1	845.1	777.1	1,013.0	1,170.3	1,172.6	2,547.9	3,908.9	5,068.1	2,526.7	2,083.2
Short-term agr.[crop] loans /b	496.1	767.1	648.2	874.4	1,038.4	949.8	1,937.7	2,765.5	3,390.3	1,423.5	1,562.6
Other agricultural financing/c	7.2	5.4	5.0	9.5	57.0	113.5	518.3	877.9	1,271.1	726.2	200.4
Fisheries financing	0.1	11.1	37.7	27.0	11.2	10.8	25.3	106.8	78.9	181.9	52.1
Tea prod.& development financing	29.2	35.4	63.3	66.5	27.6	36.3	21.9	35.8	66.7	62.8	60.3
Cold storage for agri.products	27.5	26.1	22.9	35.6	36.1	62.2	44.7	122.9	261.1	132.3	207.8
BANGLADESH KRISHI BANK:	388.4	542.3	741.7	1,420.0	2,097.4	2,710.4	4,008.1	5,924.3	6,147.3	3,650.6	4,419.1 /d
Short-term agr.[crop] loans /b	96.9	186.9	173.2	255.4	730.4	1,099.6	1,383.3	2,163.8	1,573.9	384.8	1,433.2
Other agricultural financing/c	119.9	160.3	268.4	668.6	667.2	926.9	2,051.1	3,149.5	3,422.9	2,003.5	1,056.5
Fisheries financing	0.6	13.7	39.5	47.5	73.7	69.5	56.4	128.6	165.1	103.4	52.2
Tea prod.& development financing	161.8	179.0	247.5	411.7	579.6	563.0	458.6	323.6	841.3	1,008.4	926.8
Cold storage for agri.products	9.2	2.4	13.1	16.8	46.5	51.4	58.7	158.6	144.1	144.5	180.9
BANGLADESH SAMABAYA BANK:	111.8	158.2	201.1	255.8	257.0	174.1	229.5	219.8	283.0	139.9	170.5
Short-term agr.[crop] loans /b	93.6	131.4	165.9	224.5	207.0	137.2	190.1	180.4	229.9	94.6	128.7
Other agricultural financing/c	18.2	26.8	35.2	31.3	50.0	36.9	39.4	39.4	53.1	45.3	41.8
ALL MAJOR CREDIT INSTITUTIONS:	1,060.3	1,545.6	1,719.9	2,688.8	3,524.7	4,057.1	6,785.5	10,053.0	11,498.4	6,317.2	6,672.8
Short-term agr.[crop] loans /b	686.6	1,065.4	987.3	1,354.3	1,975.8	2,166.6	3,511.1	5,109.7	5,194.1	1,902.9	3,124.5
Other agricultural financing/c	145.3	192.5	308.6	729.4	774.2	1,077.3	2,608.8	4,066.8	4,747.1	2,781.0	1,298.7
Fisheries financing	0.7	24.8	77.2	74.5	84.9	80.3	81.7	235.6	244.0	285.3	104.3
Tea prod.& development financing	191.0	214.4	310.8	478.2	607.2	599.3	480.5	359.4	908.0	1,071.2	987.1
Cold storage for agri.products	36.7	28.5	36.0	52.4	62.6	113.6	103.4	281.5	405.2	276.8	388.7
Out of total disbursement: Credits											
Channelled through Coopv.under BRDB	–	108.0	122.0	205.0	256.0	258.0	4,065.0	3,227.0	1,202.0	596.0	480.9
Paddy	–	102.0	112.0	191.0	237.0	245.0	3,932.0	2,895.0	1,202.0	571.0	465.7
—T.Aman	–	33.0	34.0	51.0	71.0	73.0	554.0	965.0	1,202.0	165.0	100.0
—Boro	–	48.0	45.0	85.0	115.0	132.0	1,689.0	965.0	*	331.0	311.8
—Aus/B.Aman	–	21.0	33.0	55.0	51.0	40.0	1,669.0	965.0	*	55.0	53.9
Wheat	–	2.0	4.0	8.0	11.0	9.0	96.0	332.0	*	7.0	4.2
Potato	–	4.0	6.0	6.0	8.0	4.0	37.0	*	*	18.0	11.0

/a Including re-financing provided by the Sonali Bank to co-operatives under BRDB.
/b Crops other than Tea.
/c Including agricultural credit as well as financing for marketing, transport, and agroindustries.
/d Includes Tk 542.8 mill. under Bangladesh Krishi Bank (BKB) and Tk 226.7 mill. under Rajshahi Krishi Unnayan Bank (RKUB) for which breakdown by type of credits is not available.
/* Less than 1.0 million.

Data source: World Bank Mission (for FY77–FY82, & FY87 data); Agr. Credit Dept. of Bangladesh Bank (for FY83–FY86 data).

Table: C

TRENDS IN THE SUPPLY OF AGRICULTURAL CREDIT FROM
INSTITUTIONAL SOURCES, BANGLADESH FY1978—FY1987

Fiscal Years	Amount of credit disbursed	Credit at constant FY78 price/*	Real Value of Credit: Per hectare of total cropped area	Real Value of Credit: Per hectare of HYV land area
	[Mill.Taka]		[Taka]	
1978	1,569	1,569	124	925
1980	2,821	2,221	173	919
1981	3,734	2,630	198	950
1982	4,238	2,632	200	928
1983	6,786	3,945	295	1,294
1984	10,053	5,319	396	1,685
1985	11,498	5,449	401	1,656
1986	6,318	2,747	194	784
1987/p	6,361	2,419	170	664

/* Deflators used to calculate constant prices were computed by using cost of living index (general) for middle class people of Dhaka as prescribed in Bangladesh Bank's publication "Economic Trends", Jan. 1987, pg. 24.

/p Provisional.

Data source: Mahbub Hossain, Fertilizer Pricing Policy and Foodgrain Production Strategy in Bangladesh, Vol.2 Technical Report 1985, pg. 158; Bangladesh Bank, Agricultural Credit Department (July 1987).

Table: D

DISBURSEMENT AND COLLECTION OF AGRICULTURAL CREDITS, BANGLADESH, FY77-FY87
[million taka]

Credits \ Yr.end	FY77	FY82	FY83	FY84	FY85	FY86	FY87/p
A. Scheduled banks' outstanding credits to agriculture etc.	1,305	8,399	13,515	20,774	30,342	35,143	32,719
In percent of:							
B. All bank credit	11.3	19.8	26.9	31.7	34.0	32.2	–
C. Agr. GDP (preceding year)	2.4	6.9	9.9	12.3	14.5	14.1	–

	FY78	FY80	FY82	FY83	FY84	FY85	FY86	FY87/p
D. Outstanding Dues	–	3,422	6,483	8,172	12,402	15,149	23,752	27,077/a
E. Disbursements	1,569	2,821	4,239	6,787	10,053	11,498	6,318	6,361
—Long-Term	314	649	1,187	1,968	2,915	–	–	–
—Short-Term	1,255	2,172	3,052	4,819	7,138	–	–	–
F. Collections	942	1,475	3,143	3,423	5,176	5,839	6,072	10,987/b
G. Collection Rate/*	–	43.1%	48.5%	41.9%	41.7%	38.5%	25.6%	40.6%

/a Excludes FY87 cancelled interest from Ershad's program amounting to Tk. 3.58 million.
/b Cash recovered (principal + some interest).
/p Provisional at end of year (June 30th) figures. /– Not available.
/* Recovery as % of demand for recovery (F/D).
Data source: Bangladesh Bank, Agricultural Credit Department (July 1987); BBS.

Table: E

BANK DEPOSITS/*, BANGLADESH, 1975-86
[end of June balances in million taka]

Year	Rural [RD]	Urban [UD]	Total [TD]	Growth percentage [%] Rural	Urban	Ratio of RD/TD	Average Balance per Branch RD/RB	UD/UB
1975	859	9,323	10,182	–	–	0.08	1.2	11.1
1976	1,063	10,531	11,594	23.7%	13.0%	0.09	1.3	11.1
1977	1,552	12,901	14,453	46.0%	22.5%	0.11	1.4	13.6
1978	2,316	15,161	17,477	49.2%	17.5%	0.13	1.4	12.9
1979	3,540	19,391	22,931	52.8%	27.9%	0.15	1.8	15.3
1980	4,042	24,027	28,069	14.2%	23.9%	0.14	1.6	17.6
1981	5,471	30,291	35,762	35.4%	26.1%	0.15	1.9	19.8
1982	5,938	32,563	38,501	8.5%	7.5%	0.15	2.0	21.2
1983	8,544	42,437	50,981	43.9%	30.3%	0.17	2.8	27.3
1984	12,215	59,369	71,584	43.0%	39.9%	0.17	3.8	37.3
1985	16,159	77,404	93,563	32.3%	30.4%	0.17	4.8	47.5
1986	21,038	89,128	110,166	30.2%	15.1%	0.19	6.1	53.4

/* All scheduled banks. Cooperatives not included. All types of deposits.
Data source: Z. Ahmed, Rural Finance Project, Aug. 1987 draft report; Bangladesh Bank Bulletin various issues.