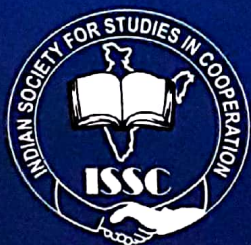
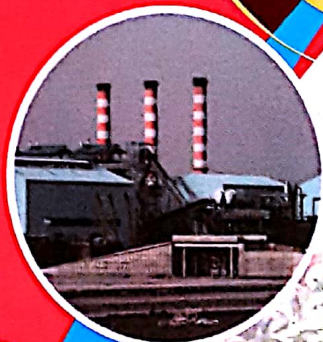


Role of Cooperative Movement in Inclusive Development of India

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**INDIAN SOCIETY FOR STUDIES
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Demonetization and its Impact on Primary Agricultural Credit Societies (PACS) in Kerala

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Abstract

Cooperatives in Kerala are well developed and highly democratic in nature. Due to restrictions imposed after demonetization, PACS were not in a position to lend, mobilize deposits and carry out non-banking businesses. Therefore an attempt was made to pen down the outcome of a seminar held in this respect and a case study. Demonetization has severely affected the rural economy particularly rural development and agricultural activities supported by the PACS and other cooperatives as well. Instead of an average transaction of Rs.1.5/- crores per week, they were forced to restrict their transactions to Rs.24000/- per week. Due to the support extended by the government and the think tank of state cooperative movement, PACS were in a position to manage the shock. Cash sales proceeds in the Consumer store/super markets were used for lending to

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needy members. DCB cheques were issued to borrowers and depositors. Rigorous confidence building measures such as house to house campaign, awareness programmes, and meet the depositors programmes were carried out. As far as long term strategy is concerned, the participants in the seminar stood against the transformation of PACS into business correspondents and favoured maintaining the status-quo which means doing both banking and non-banking business. The case study on Ollukkara Service Cooperative Bank Limited has proved beyond doubt that the super market sale proceeds has helped the poor small loan borrowers for their livelihood and health care, which was also endorsed by the seminar outcome. The authors are of the opinion that a high level committee may be appointed by the federal government to study the exponential growth of PACS in Kerala and to identify the uniqueness and deviations from the law if any, and to suggest a suitable legal entity to sustain the laudable banking and non-banking endeavors.

Background and Justification:

The state of Kerala is entirely different from other states in India. The unique 'Kerala Model of Development' resulted in the highest 'Human Development Index' in the country. Kerala has achieved the highest literacy rate, universal health care, and effective public distribution system ensuring availability of food grains to the downtrodden. The state achieved cent percent financial inclusion. Kerala is known for its significant level of labour migration and depends mainly on repatriation. The state has successfully implemented decentralized democratic governance at all levels. Plantation crops and service sector play a pivotal role in the state economy. However, development in agriculture and industries shows a dismal picture. Cooperatives in Kerala are well developed and highly democratic in nature. In addition to the traditional Credit Cooperatives, Cooperatives are also performing well in the fields of Healthcare, Education, Housing, Labour Contract, Fisheries and Milk, Coir and Consumer. Cooperative Credit structure in Kerala is mainly classified in to two viz., short-term credit structure and long-term credit structure. The three tier Short-Term Cooperative Credit Structure consist of the Kerala State Cooperative Bank (KSCB), 14 District Cooperative Banks (DCB) and the 1587 Primary Agricultural Credit Societies (PACS). Long Term Cooperative Credit Structure consists of Kerala State Cooperative Agriculture and Rural Development Bank (KSCARDB) and the 75 Primary Cooperative Agriculture

and Rural Development Banks. In addition to these, 179 Urban Cooperative Banks, 1122 Employees Credit Cooperatives and 160 Non-Agricultural Credit cooperatives are also in operation.

The Honourable Prime Minister of India has announced demonetization of high value currencies on 8th November 2016 and following it the DCBs and PACS were banned by RBI from exchange of currencies which curtailed them from carrying out their regular activities. Maximum withdrawal limit per week applicable to individuals were made applicable to PACS also. Since then, the PACS were not in a position to mobilize deposits and the depositors are queuing up for withdrawal. This will certainly affect the PACS in the long run. Moreover, the Government of Kerala has announced moratorium for loan repayment due to which payment of loan installments have also stopped. Due to cash crunch, other non-banking businesses have also come to a standstill.

There are many allegations regarding lack of transparency in the working of PACS. Though the Registrar of Cooperative Societies, Kerala have foreseen this problem and issued a circular to PACS in the year 2013 itself for adhering Know Your Customer (KYC) norms, it was not given adequate attention. They were also asked to accept deposits only from the members, but widely overlooked. The PACS with huge deposit base are almost defunct after demonetization. In this circumstances the PACS in Kerala needs a solution to mend themselves and move further to sustain their laudable operations. This is therefore a humble attempt:

1. To understand the problems faced by the PACS in Kerala due to demonetization,
2. To study the mitigation measures taken by the PACS in Kerala and
3. To evolve long term strategies for the smooth functioning of PACS in Kerala.

Required data were collected by administrating a well structured questionnaire in Malayalam from 30 selected participants representing both elected leaders as well as employees of different PACS, from among the 90 participants who have participated in the One day Workshop on Demonetization and its Impact on Primary Agricultural Credit Societies (PACS) in Kerala held on 27th December 2016 at Kerala Agricultural University. Further, the results of brainstorming exercises held on the following themes were also used for this paper:

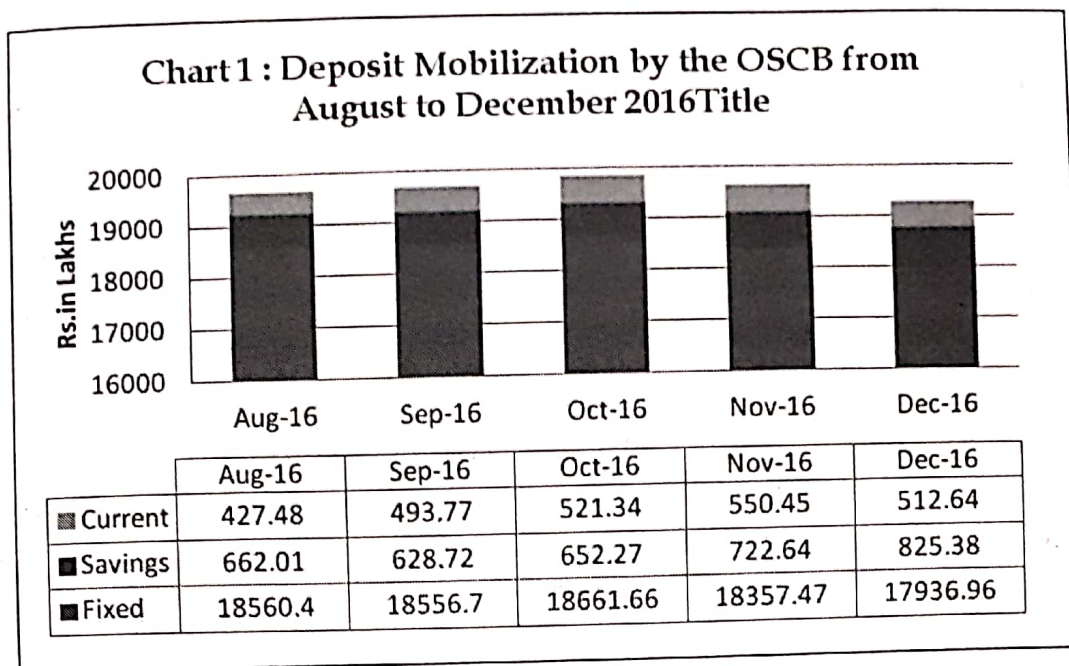
- Demonetization and its impact on PACS,
- Legal Issues impairing the functioning of PACS,
- Need for organizational and structural transformation of PACS

Moreover, a case study was also carried out in one selected PACS by the authors of this paper to substantiate the arguments.

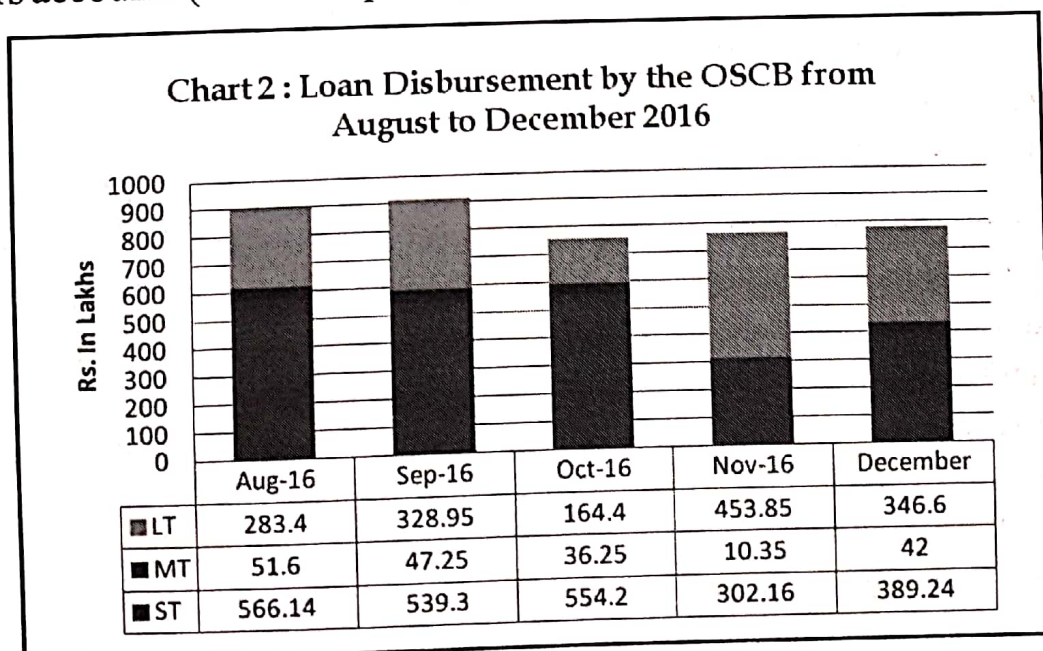
Vignette 1

Impact of Demonetization in the functioning of Ollukkara Service Cooperative Bank

The Ollukkara Service Cooperative Bank Limited No. 544 headquartered at Mannuthy a crossroad settlement in the Thrissur - Palakkad national highway. The bank was established in the year 1946. The area of operation of the bank extends to the entire Ollukkara Panchayat of Thrissur District, Kerala. The bank operates with two branches and a big supermarket. The bank enrolled almost all eligible persons in its jurisdiction as members and the membership stood 27683 as on 31st March 2015. The bank mobilized share capital to the tune of Rs.44.61 lakhs and deposits of Rs.347.60 crores. The bank lent only Rs. 75.28 crores and deposited Rs.317.77 crores in TDCB and other commercial banks. The spread, difference between interest earned and interest paid is adversely affecting the profitability of the bank. However, the service rendered by the super market is remarkable and sale proceeds stood at Rs.100.04 lakhs as on 31st March 2016. The following charts depict the function of Ollukkara Service Cooperative Bank Limited during the demonetization period. The data from August to December 2016 were generated on six important variables namely (1) Deposit Mobilization, (2) Loan Disbursement (3) Recovery Position, (4) Loan Outstanding, (5) Overdue, (6) Purchase and sale of goods in the supermarket.



The bank mobilizes deposits through Fixed Deposits, Recurring Deposits, Monthly Deposit Scheme, Current Deposits, Savings Bank deposits, and other special schemes. For the purpose of this analysis, the authors took only the data related to Fixed Deposits, Current Deposits, and Savings Bank deposits. The above chart clearly indicates the declining trend in the mobilization of deposits except Savings Bank deposits immediately after demonetization. Demonetization clearly affected mobilization of fixed deposits, and made little impact on savings bank accounts. Due to economic slowdown traders accounts (current deposits) showed a declining trend.



The bank lends long term, medium term and short term loans to the members and jewel loan to the associate members. Long term loans were

given particularly for purchase of land, purchase or construction of houses, repair and renovation of houses. Medium of term loans were given mainly for purchase of milch animals. Short-term both crop loan and jewel loan were given to member farmers. Major portion of lending portfolio of the bank was for short-term and long term loans. During the demonetization period, though fresh loan applications were low, previously sanctioned loans were disbursed. The borrowers were issued with Thrissur District Cooperative Bank Cheques and they got it encashed with their other banks accounts. Post demonetization period witnessed large number of short-term loan lending. Loss of jobs for labour class forced them to approach cooperative banks for very small amount by pledging their jewels. This crisis was managed by utilizing the proceeds of supermarket sale.

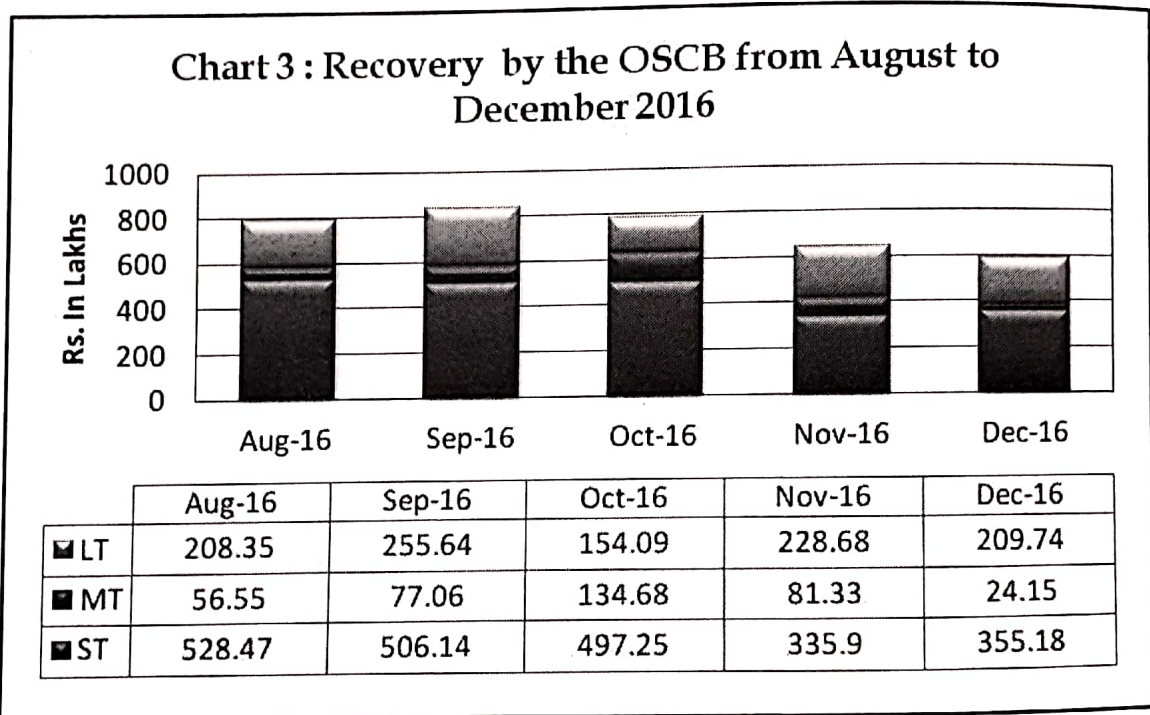


Chart 3 very clearly indicates the decreasing trend in the recovery position of OSCB during the demonetization period. Significant reduction in short-term and medium term loan recovery may be due to the announcement of moratorium by the government of Kerala. Compared to October 2016, recovery of long term loans shows an increasing trend which may be due to increase in long term lending in the month of November 2016 as well as due to conversion of medium term loans in to long term loans.

Demonetization and its Impact on Primary Agricultural Credit Societies

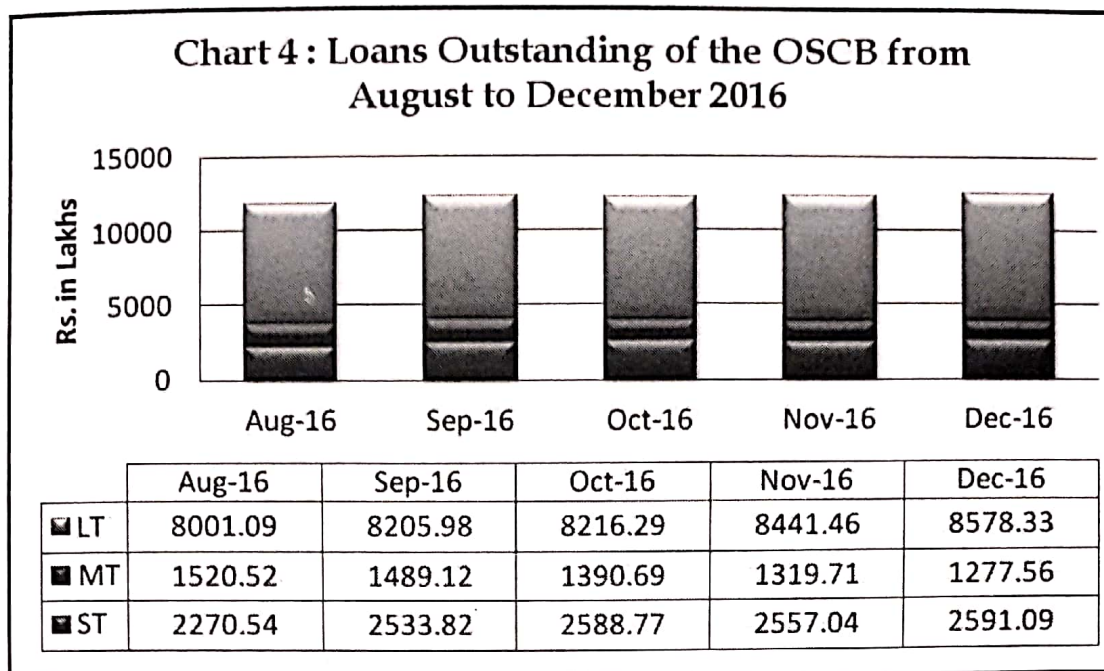


Chart 4 shows the loan outstanding position of OSCB from August to December 2016. Only very limited changes could be witnessed in the outstanding position of Short-term loans. Medium term loans outstanding were declining while long term loans outstanding were increasing. Huge jump in long term loan lending during the month of November 2016 reflects in the loan outstanding position of the bank.

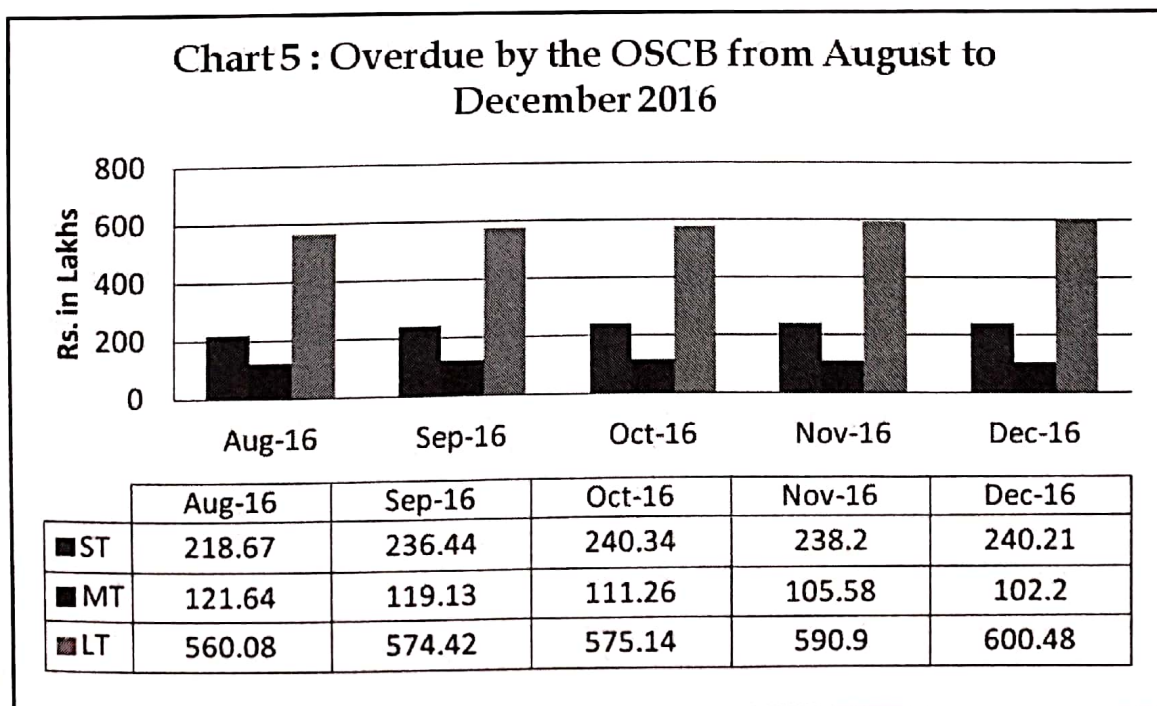
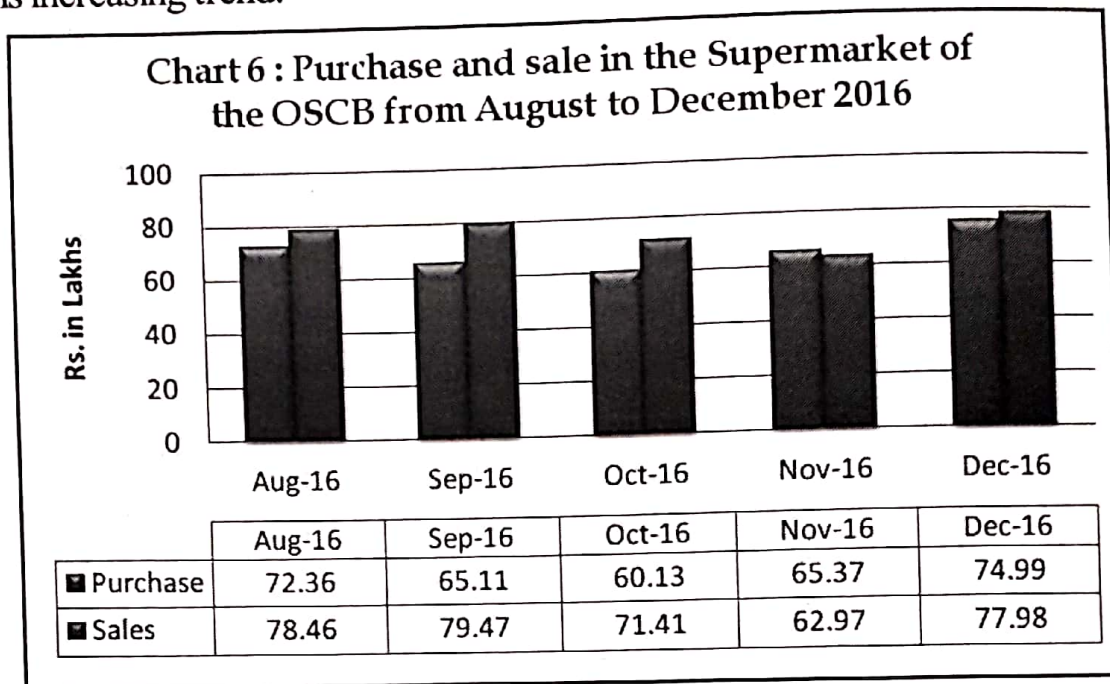


Chart 5 depicts the loan overdue position of OSCB from August to December 2016. With regards to short-term loans there was not much change

in the trend. Overdue position of medium term loans shows a marginal declining trend. Whereas, overdue position of OSCB's long term loans confirms increasing trend.



The major non-banking activities of OSCB were *Margin Free Society Supermarket* and distribution of fertilizers and cooking gas. For the purpose of this study, only the purchase and sale in the supermarket was considered. Though there was a setback immediately after demonization, in the month of December, it regained its transaction. Purchases were made by issuing cheques to the suppliers and sale proceeds in cash around Rs.2.5 lakhs per day were used for lending to the borrowers of small amount.

The above analysis reveals the OSCB's business operations for three months of pre-demonetization and two crucial months of post-demonetization period. The indicators chosen for the study shows undesirable trend. Deposit Mobilization, Loan Disbursement and Recovery have decreased, Loan Outstanding and Overdue have increased, and Purchase and sale of goods in the supermarket was restored within a month after demonetization. However, the bank was in a position to serve the poor agricultural and other workers by lending small amount of money as personal loans or on pledging their small quantity of gold ornaments. Other loans were given in the form of cheques and bank transfers. Considering the crisis, the suppliers of goods to the super markets accepted cheques and bank transfers. The cash sale proceeds of super markets acted as a shock absorber. In this regard, the steps taken by the government of Kerala to built the confidence of members and depositors needs a special

mention. The cooperative leaders were continuously meeting the members and depositors to sustain the long standing bondage, which prevented the panic among the stakeholders.

Demonetization and its Impact on PACS:

An open ended question was raised among the respondents and the findings were brought under four categories namely (i) trading activities affected, (ii) Mobilization and repayment of deposits affected, (iii) lending and recovery affected and (iv) trust of the people affected. For the first three variables 80% (24/30) of the respondents opined that the demonetization adversely affected their business. Interestingly 90 % (27/30) of the respondents expressed that the trust of the members and the community has not vanished. That is the uniqueness of Kerala and the loyalty towards cooperative sector.

The seminar came up with the following observation:

1. Demonetization has severely affected the rural economy particularly rural development and agricultural activities supported by the PACS and other cooperatives as well. Instead of an average transaction of Rs.1.5/- crores per week, they were forced to restrict their transaction to Rs.24000/- per week.
2. Though the PACS in Kerala are subjected to statutory audit, blaming them for not adhering to KYC norms has shattered the public confidence which will have long run impact.
3. Honoring the demand from the depositors, lending to agriculture and other purposes could not be done and the liquidity crisis created by this has pushed the cooperative sector to an economic slowdown.

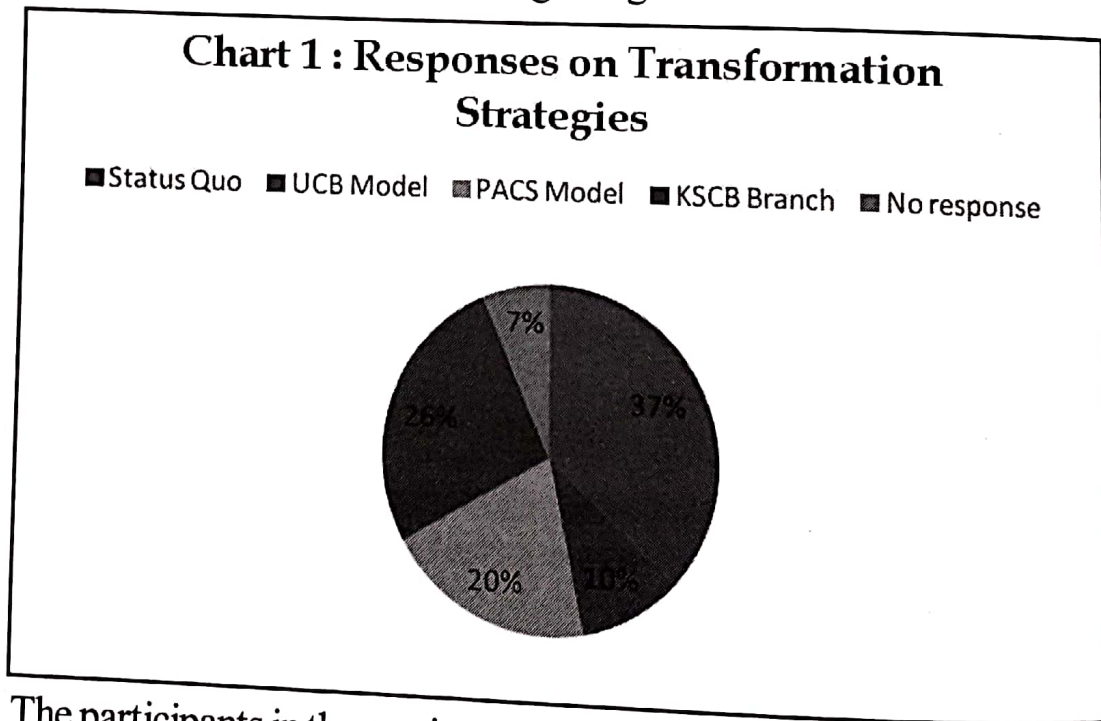
Mitigation Measures taken by the PACS and the Government of Kerala:

1. Opening of mirror accounts in DCBs was suggested as a solution, but many PACSs have not opted for it, fearing flow of funds and customers to DCBs in the long run.
2. Government of Kerala has declared moratorium for agricultural loans which further deteriorated the liquidity position of PACS.
3. Sale proceeds in cash in the Consumer store/super market was used for lending to needy members.

4. DCB cheques were issued to borrowers and depositors.
5. Rigorous confidence building measures such as house to house campaign, awareness programmes, and meet with the depositors were carried out.

Long Term Strategies for the Smooth Functioning of PACS in Kerala:

Considering the developments which took place in the short-term cooperative credit movement in Kerala, a question was raised among the respondents with five options namely (i) would like to maintain the status-quo which means doing banking and non-banking operations both with members and non-members (ii) transform like an Urban Cooperative Bank by working as pure Cooperative Banks adhering the entry point norms (iii) just to run as a traditional PACS and serving mainly the member farmers (iv) would like to be a branch of proposed Kerala Cooperative Bank (v) no opinion/response. The results are depicted in chart I, which clearly shows the disturbed mindset of respondents and lack of collective bargaining.



The participants in the seminar stood against the transformation of PACS in to business correspondents and for maintaining the status quo. PACS should strengthen the existing resource base and identify new sources of funds. In this context the government of Kerala can take initiative by announcing a package from the “plan funds”. Urgent measures to be taken to bring back public confidence. Thrift fund should be made compulsory to members and thereby ensuring continuous deposit mobilization. Depositors may be issued with *Cash*

Certificates with the government guarantee. Thrift deposits need to be made as compulsory for the members of Self-help groups. Cooperative may be associated fully with local development. Parallel currency may be introduced by the local PACS. PACS should strive for digitizing their operations. Tax concessions for cooperatives should be continued. A common network platform should be evolved for facilitating cashless transaction in the state connecting all PACS, DCBs and KSCB. Effective diversification both in the banking and non-banking activities will cooperativise the rural economy.

Conclusion:

Demonetization in India has severally affected the cooperative movement particularly the PACS in Kerala. In the short run, they failed to lend, mobilize deposits, lost confidence, but maintained their non-banking businesses particularly supermarket sale. They managed to withstand the unexpected shock and slowly regaining their status. They feel the necessity of overhauling the system without losing their current business and unique identity. Considering the strong penetration of PACS in the rural economy, significant growth in their deposit base, diversified lending portfolio, significant move towards cooperativisation of local economy, the authors are of the opinion that the state cooperative movement especially the STCCS needs a special treatment. A high level committee may be appointed by the federal government to study the exponential growth of PACS in Kerala and to identify the uniqueness and deviations from the law if any, and to suggest a suitable legal entity to sustain the laudable banking and non-banking endeavors.

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