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Local Autonomy versus Central Oversight: A Comparative Analysis of Urban Cooperative Banking Systems in India and Brazil

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Abstract

The paper provides a comparative policy analysis of India's Urban Cooperative Banks (UCBs) and Brazil's Financial Cooperative System, examining their regulatory frameworks and operational effectiveness in promoting financial inclusion and rural economic development. Through the Advocacy Coalition Framework (ACF) lens, we identify two primary stakeholder groups in India's UCB sector: Consumers advocating for stricter regulation and political actors who want to maintain localised control. The paper explores how these coalitions influence policy outcomes, contrasting India's dual regulatory system between state governments and the Reserve Bank of India (RBI) India's Central bank with Brazil's centralised framework overseen by the Central Bank of Brazil (Banco Central do Brazil, BCB) Central Bank of Brazil. Drawing on the Comparative Policy Analysis (CPA) framework, we argue that India's UCB sector could benefit from adopting elements from Brazil's risk-based regulatory approach, comprehensive deposit insurance system, capitalisation and consolidation strategies. While recent reforms in India are promising, we recommend additional policy adjustments inspired by Brazil's model to enhance the stability, efficiency, and competitiveness of India's UCBs while preserving their core principles.

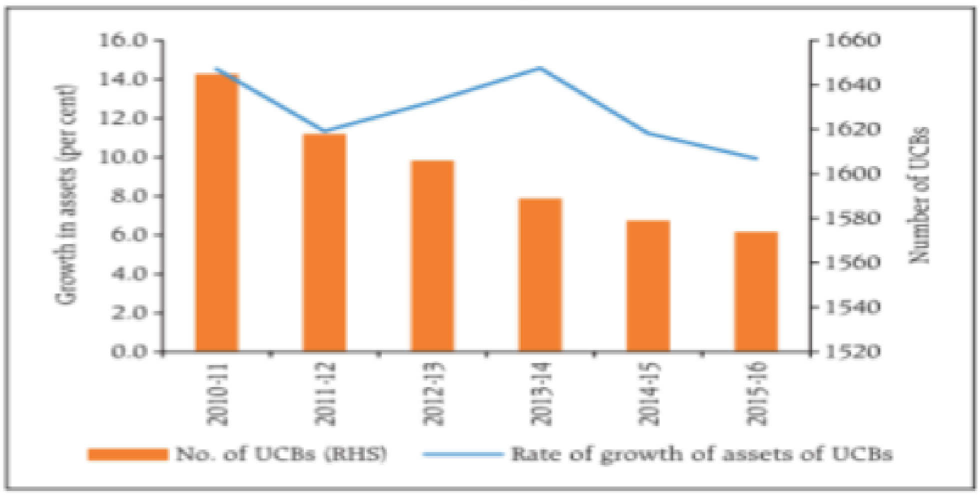
Keywords: *Cooperatives, Urban Cooperative Banks, RBI, BCB, India, Brazil, Policy, Governance*

Introduction of the problem statement:

The Cooperative Banks movement in India emerged in the early 20th Century to respond to rural credit challenges and support agricultural enterprises and rural development (Ministry of Cooperation, 2024). Following the recommendations of the Famine Commission 1901, Rural Agricultural Banks were established through Mutual Credit Associations, emphasising collective lending and group guarantees to create new security mechanisms for farmers (Report of the Indian Famine Commission, 1901).

The history of cooperative banking can be traced back to the Cooperative Societies Act of 1904 (Ministry of Cooperation, 2024). Twelve banks were registered in India within the first 5-6 years from 1904 (see Appendix A). The 1904 Act aimed to encourage the formation of cooperative credit societies in India, primarily to address rural indebtedness and promote thrift among farmers. The act was extensive as it laid out provisions for forming societies, membership eligibility, member liability, profit distribution, shares, audits, inspections, dissolution, and tax exemption. The Act very clearly delegated operational and managerial details to local governments. The 1904 Act was a significant step in developing the cooperative movement in India, laying the groundwork for the future expansion of cooperatives in various sectors of the economy. From 1904 multiple iterations of laws have been brought. By 1911, there were 5,300 societies with memberships exceeding 300,000 (Sapovadia & Patel, 2012). The Cooperative Societies Act of 1912 further enabled cooperatives to provide non-credit services, allowing the formation of federations, and expanding cooperative movement in more sectors such as handloom and artisan industries. More on the development and various committee reports have been discussed further in the paper.

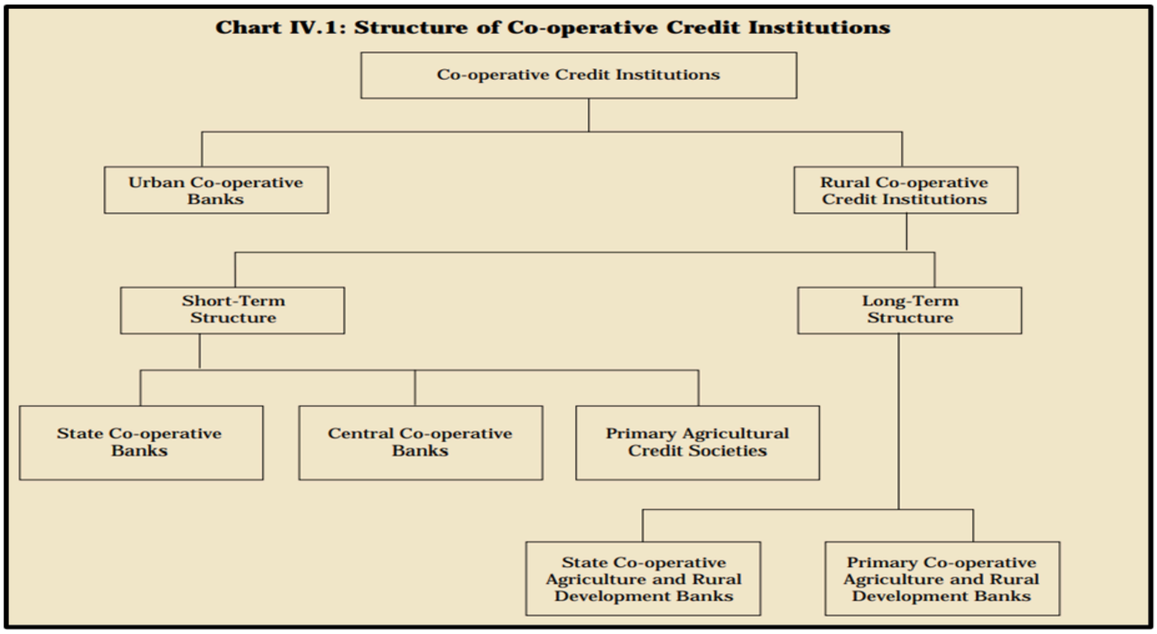
Understanding the functioning of the Cooperative Banks in India, and detailing the structures they operate in becomes essential to understanding the inherent problems of the ecosystem. The potential of these institutions is greatly underutilised in the country (Singh, 2016).



Note: Data for 2015-16 are provisional.
Source: RBI Supervisory Returns and staff calculations

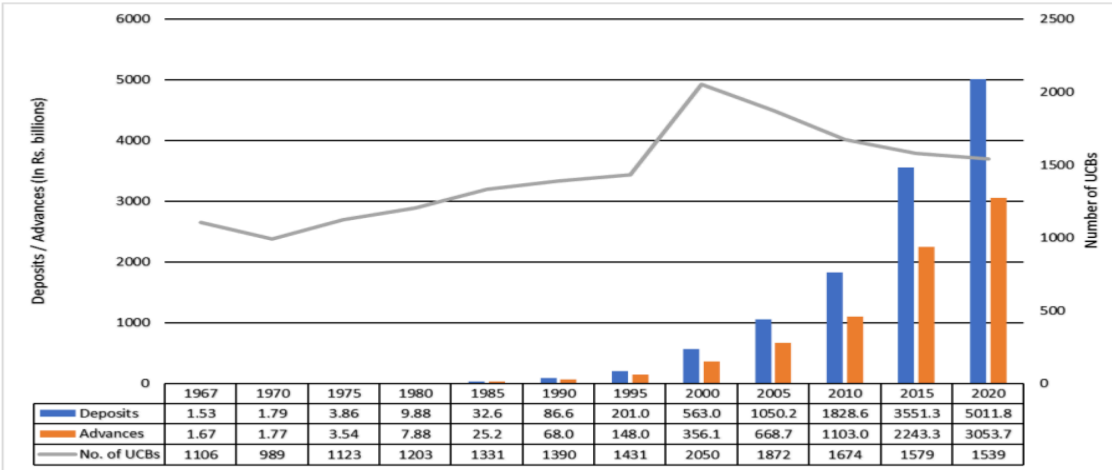
To better understand the landscape, we will be undertaking a comparative study with Brazil's ecosystem of credit cooperatives. Both India and Brazil come with challenges and opportunities within the ecosystem. This paper will examine "How can Indian cooperative banks overcome their structural and operational inefficiencies to enhance financial inclusion and contribute more effectively to rural economic development while competing with commercial banks and adapting to technological advancements in the financial sector?"

Structure of Co-operative Banks in India:



Source: *Developments in Co-operative Banking.* Reserve Bank of India.

Relevance:



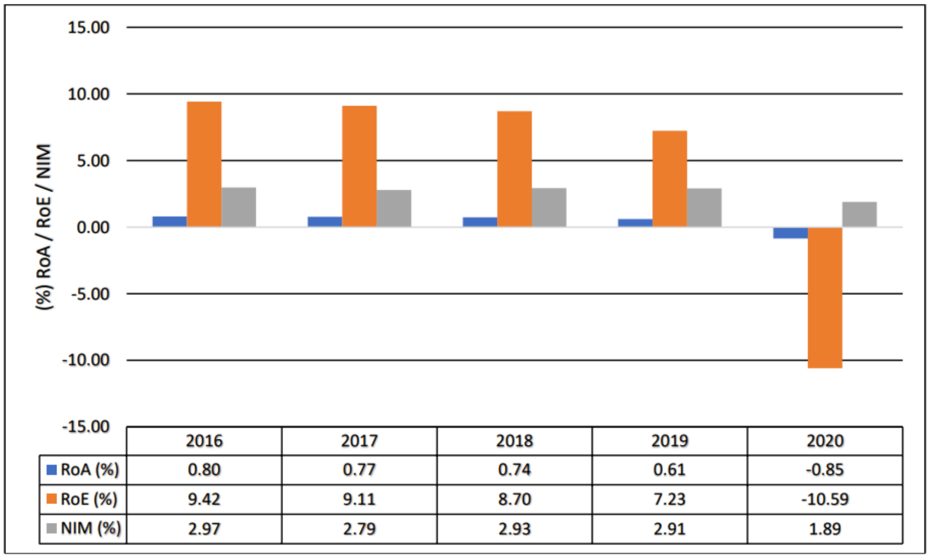
	1967	1970	1975	1980	1985	1990	1995	2000	2005	2010	2015	2020
Deposits	1.53	1.79	3.86	9.88	32.6	86.6	201.0	563.0	1050.2	1828.6	3551.3	5011.8
Advances	1.67	1.77	3.54	7.88	25.2	68.0	148.0	356.1	668.7	1103.0	2243.3	3053.7
No. of UCBs	1106	989	1123	1203	1331	1390	1431	2050	1872	1674	1579	1539

Source: Reserve Bank of India, Report of the expert committee on Urban Cooperative Banks, Growth of UCBs since 1967, Deposits, No. of UCBs, and Advances.

Punjab and Maharashtra Cooperative Bank with 137 branches, 51000 members, and deposits of ₹ 11,617 crores (The Economic Times, 2019). These are just figures for one of the urban cooperative banks in the country. In totality, India has 33 State Cooperative Banks (SCBs), 328 District Central Cooperative Banks (DCCBs) and 88891 Primary Agricultural Credit Societies (PACSs) that are functional in India in 2024. Currently, as per the Ministry of Cooperation (2024), there are over 1500 Urban Cooperative Banks in India, with more than 11000 branches, holding deposits upwards of over ₹ 5.33 Lakh Crore, and loans amounting up to ₹ 3.33 Lakh Crore.

The relevance of these institutions also comes from the objectives they are set up for, i.e., serving the communities they operate in, and providing essential financial services to their members, another crucial aspect of these banks is how they are structured, and committing to their members (Khushi, 2022). Particularly in the case of India a lot of issues associated with these institutions stem from the structures they operate in. The challenges for these institutions arise from their foundational dependence on communities and members, which is central to the cooperative model but at the same time brings in potential governance issues, such as ensuring fair representation of members' interests (Suresh, 2018). The control and ownership structures have led to plenty of scams that have come to light. With the PMC Bank scam, questions have been raised about the regulatory regimes being under state purview and the demand for regulation by RBI (Nayak & Chandiramani, 2022). These banks are often hijacked by state political interests - political appointments to the boards, loan approvals and waiver of large amounts.

In the past decade, we have seen how the Reserve Bank of India (RBI) interventions have been able to turn around the Non-Performing Assets (NPAs) heavy balance sheets of Scheduled Banks to a stable environment today (Subramanian, et al., 2018). The role RBI can play in improving the efficiency and performance of these crucial ground-level institutions by bringing in the necessary structural changes, holding them more accountable, providing essential liquidity support and necessary supervision of their operations. The same level of regulation applicable to other financial institutions such as scheduled banks etc, can help to promote competition and reduce perceived higher risk associated with the lack of access to a liquidity facility.



	2016	2017	2018	2019	2020
RoA (%)	0.80	0.77	0.74	0.61	-0.85
RoE (%)	9.42	9.11	8.70	7.23	-10.59
NIM (%)	2.97	2.79	2.93	2.91	1.89

Source: Reserve Bank of India, Report of the expert committee on Urban Cooperative Banks, Return on Assets (RoA), Return on Equity (RoE), and Net Interest Margin (NIM) of UCBs (2016 to 2020).

Theoretical and Methodological Framework: The paper will employ the Comparative Policy Analysis Framework, based on institutional theory and the Advocacy Coalition Framework, looking into the balance between the current structure of local autonomy and comparing it to the central oversight system in Brazil. The ACF will be useful in understanding how the coalition of actors with varied beliefs influences policy outcomes.

Comparative Analysis

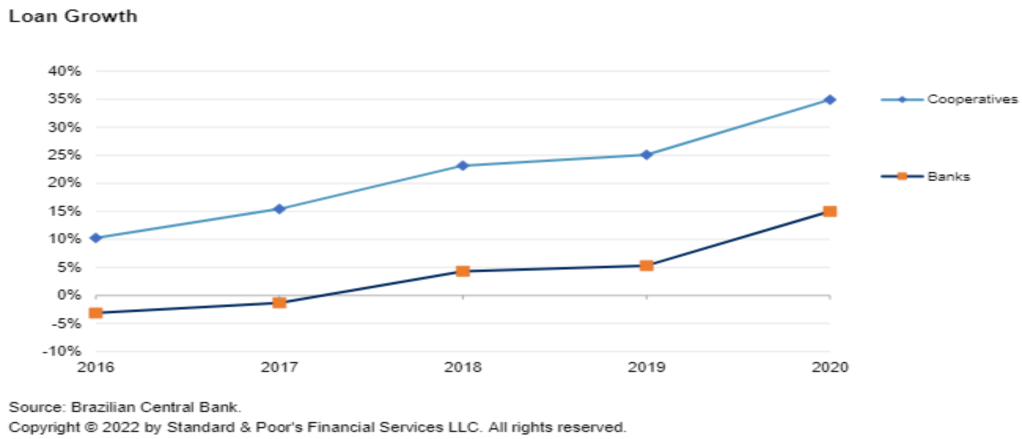
Aspect	India	Brazil
Regulation	Dual (RBI and state governments)	Centralized (CBB)
Governance	Politically influenced boards	Professionalized with audits and controls
Operational Structure	Fragmented, standalone entities	Consolidated three-tier system
Risk Management	Limited deposit insurance; inconsistent frameworks	Robust deposit protection; proportional regulation

1. **Advocacy Coalition Framework,** developed by Paul Sabatier and Jenkins-Smith (1993), is a theoretical framework used to understand the dynamics of policy change and the role of various actors within the "policy subsystem." The Framework will provide a lens through which we can examine the complex policy environment of cooperative banking in India understanding the dual nature of control of cooperative banks where economic, political, and social interests collide. Within the paper, two coalitions have been identified: the consumers (members of the cooperatives) and the politicians. Both the coalitions are looking to protect their interests within the ecosystem.

The consumer coalition comprising account holders (members), borrowers, and advocates for financial inclusion, pushes for stricter regulation of cooperative banks under the purview of the Reserve Bank of India (RBI). This group also has the support of a segment of industry experts who back the demand. The demand from the consumer coalition is also fueled by a series of high-profile scams, regulatory inconsistencies, and the perceived underutilization of cooperative banks' potential for rural development. Consumer groups argue that centralised RBI oversight would enhance transparency, reduce fraud, and improve the overall stability and efficiency of these institutions.

At the same time, political coalition, which includes state-level political actors and certain cooperative bank administrators, resists this change, preferring to maintain the current system of state-based regulation. The demand comes from a desire to advance their political agenda and maintain the benefits of autonomy and local control provided by the existing regulatory structure. This allows for greater political influence over cooperative banks' operations and lending practices.

2. **Comparative Policy Analysis (India and Brazil),** is an approach used to compare and evaluate public policies across different settings, such as countries, regions, or institutions. Building upon the Advocacy Coalition Framework, the comparative policy analysis framework will look into India's cooperative banking sector and Brazil's credit cooperative system offering insights into how the operational and structural improvements can be brought in learning from the Brazilian experience. The comparison will allow us to examine what kinds of structures exist within different institutional contexts. In Brazil, credit cooperatives have seen significant reforms since the 1960s with a move towards a more centralized regulatory framework under the Central Bank of Brazil as they are referred to as institutes of paramount importance part of the National Financial system. Comparing the two systems we will analyse how structural and operational inefficiencies within the Indian system can be worked upon with a shift towards centralised regulation.



CPA enables to identification of variables that have led to differing policy outcomes in these two developing economies such as the degree of political decentralization. The CPA not only provides details of challenges faced by India's cooperative banking sector but also provides potential policy lessons from Brazil's experience of how to maintain a balanced approach. Within this framework, we can further integrate the concept of prudential regulations (Safety of the system) such as liquidity and capital adequacy requirements and non-prudential regulations (enabling or preventive) such as data privacy, consumer protection etc.

Discussing both Frameworks in detail, Advocacy Coalition Framework:

Urban Cooperative Banking (UCB) in India which is set up with the principles of mutual help, democratic decision-making, and open membership have been regarded as the status of institutes of paramount importance. In the initial phases, the UCB gained momentum with the Cooperative Credit Societies Act, of 1904. Within the Act, Canjeevaram (Kanjivaram) was the first cooperative bank to be registered under the Act from the Madras province in October 1904. The findings of the Maclagan Committee of 1914 further established these institutions as of great importance, to serve the lower and middle classes ((Ministry of Cooperation, 2024). The committee believed these banks were more practical than agricultural credit societies. Their recommendations played a crucial role in establishing the urban cooperative credit movement as a distinct entity in India. During the Banking crisis of 1913-14 when 57 joint stock banks failed, people entrusted their savings with the cooperative banks (Sharma, n.d.).

The Maclagan committee captured the same "As a matter of fact, the crisis had a contrary effect, and in most provinces, there was a movement to withdraw deposits from non-cooperatives and place them in cooperative institutions, the distinction between two classes of security being well appreciated and a preference being given to the latter owing partly to the local character and publicity of cooperative institutions but mainly, we think, to the connection of Government with Cooperative movement." The state-led control happened with passing of Government of India Act 1919, wherein the control of these institutions' "cooperation" was passed on from GOI to provincial governments. With then Government of Bombay bringing in the first legislation for State Cooperative Societies Act, "which not only gave the movement its size and shape but was a pacesetter of cooperative activities and stressed the basic concept of thrift, self-help and mutual aid." (Sharma, n.d.) Several committees recognized the importance of urban banks in economic development. The Indian Central Banking Enquiry Committee (1931) mentions how these societies play an important role in offering affordable credit to underserved populations, "The Commission see great opportunity for relief in the matter of cheaper credit in the co-operative credit movement. The primary societies should serve as savings banks for their members and promote thrift." The Mehta-Bhansali Committee (1939), the Co-operative Planning Committee (1946), and the Rural Banking Enquiry Committee (1950) all acknowledged the valuable role of these banks in serving small businesses and middle-class individuals. The Rural Banking Enquiry Committee (1950) mentioned "The cooperative bank, established on a sound basis, can play a vital role in the economic development of rural areas." All committees recommended measures on how to improve the growth and development of these institutions with an essential focus on expanding their reach to smaller towns.

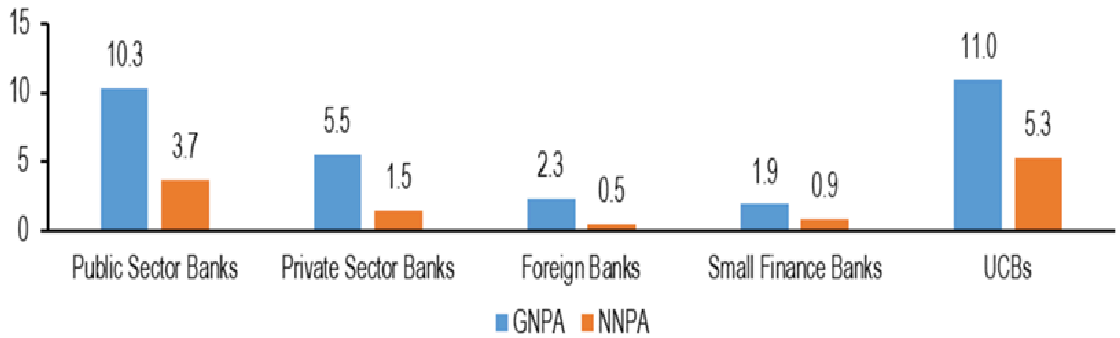
These institutions are of seminal importance as we have read from multiple standing committees reports, post-independence one peculiar issue propped up which was the "dual control system", with RBI overseeing banking functions after their inclusion within the Banking Regulation Act and state governments managing registration, management, audit, and liquidation. Multiple committees were further set, and as per the requirement of those times, they recognised the importance of UCBs in promoting small-scale industries. The Damry Group and the Banking Commission recommended that UCBs finance these industries. The Madhavdas Committee (1979) evaluated the role of UCBs and recommended support from RBI and the government for their establishment in backward areas. The Hate Working Group (1981) sought to align the Cash Reserve ratio (CRR) and Statutory Liquid Ratio (SLR) of UCBs with commercial banks. The Marathe Committee (1992) redefined viability norms and liberalized the sector, while the Madhava Rao Committee (1999) focused on consolidation, control of sickness, and better professional standards. Within all these committee reports one thing that always stood out was the fact that each committee focused on these institutes to have a similar working environment and regulatory regime as scheduled commercial banks.

Post-1991 reforms, there was a shift in how UCBs were regulated. Following the recommendations of the Marathe Committee, which advocated for a liberalized regime, including new bank licensing, branch licensing, and expanded area of operation. RBI implemented these recommendations, resulting in a substantial increase in UCBs and their branch networks. Then another working group was set up under the chairmanship of Shri. Uday

M. Chitale to review the audit systems of UCBs. The working group recommended that UCBs with deposits over Rs. 25 crores be audited by chartered accountants to ensure professionalism. However, most states did not implement this recommendation.

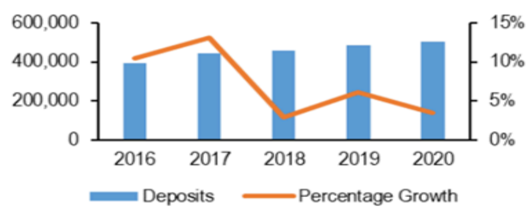
RBI then granted more autonomy, including the ability to finance direct agricultural operations, deregulate interest rates, and install ATMs without RBI approval. The RBI's move from an excessively controlled regime to a thoroughly liberalized one reflects its broader policy stance on the financial sector. But the State governments, as co-regulators, have been slow to implement similar reforms, with Andhra Pradesh being an exception. The mismatch in the regulatory environment, led to the issue of duality of control of UCBs as both financial institutions and vehicles for social and rural development, creating an environment where economic, political, and social interests collide. This further led to a duality of control between the RBI and state governments, leading to governance issues, inefficient management, financial weaknesses, and technological gaps. We can see in the charts below, how the duality of control over the years has led to operational inefficiency in these institutions which has led to growth in NPAs, low profitability, mergers of underperforming UCBs etc.

Figure 3: Asset quality across banks (in percentage)



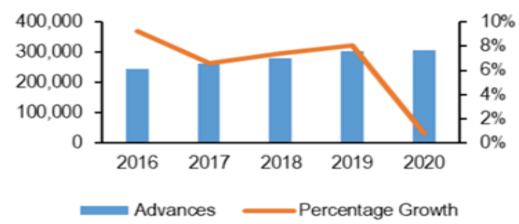
Sources: Report of the Expert Committee on Urban Co-operative Banks; PRS.

Figure 1: Growth in deposits of UCBs (in Rs crore)



Source: Report of the Expert Committee on Urban Co-operative Banks; PRS.

Figure 2: Growth in advances of UCBs (in Rs crore)



Source: Report of the Expert Committee on Urban Co-operative Banks; PRS.

This issue of structural and operational inefficiency peaked around 2019 – 2020, this is evident in the way scams have propped in the UCB ecosystem, just the data from 2018 - 2019 shows there were a total of 1886 Cooperative banks, of which 1500 are urban cooperatives. As we can see from the image below, the number of scams and the amounts have increased manyfold, more than $1 billion, impacting the members and depositors alike.

Financial Year	Number of Frauds	Amount involved (In Rs crore)
2018-19	1,285	703.75
2019-20	719	6,839.18
2020-21	438	1,985.79
2021-22	729	536.59
2022-23	964	791.4
Total:	4,135	10,856.70

Source: RBI and NABARD.

The conditioning has led to two opposing coalitions coming into being with the intent to protect their interests. The first coalition, comprising consumers (UCB members), account holders, and advocates for financial inclusion, pushes for stricter regulation under the Reserve Bank of India (RBI). The particular group is supported by industry experts, who have raised concerns over high-profile scams, regulatory inconsistencies, and the perceived underutilization of UCBs. They argue that centralised oversight would enhance transparency, reduce fraud, and improve the overall stability and efficiency of these institutions.

Then there is the second coalition consisting of state-level political actors and certain UCB administrators, who resist this change, preferring to maintain the current system of state-based regulation. This particular group has their own vested political interests in maintaining control over the day-to-day functioning of these institutes. This also stems from influencing voter behaviour near and around elections using these institutes (Khelkar, 2023).

They benefit from the autonomy and local control because of the existing regulatory structure, which allows for greater political influence over UCBs' operations and lending practices.

The pro-reform group leverages the support of the public following scandals and the RBI's regulatory authority while facing constraints from constitutional limitations and political resistance. On the other hand, the status quo coalition utilizes local political networks and established community relationships but faces increasing public scrutiny and pressure for modernization. The debate centres around balancing local autonomy with necessary oversight, professionalizing management, reducing political interference, and modernizing banking practices. Through the Advocacy Coalition Framework, we can better understand the need for a compromise between these coalitions, leading to a model that addresses both stability concerns and local development needs in the UCB sector. In the next section, we will discuss the multiple amendments that have been brought for the functioning of UCBs and also within the Multi-State Cooperative Societies Act and I will also be comparing the Indian ecosystem with the Brazilian framework.

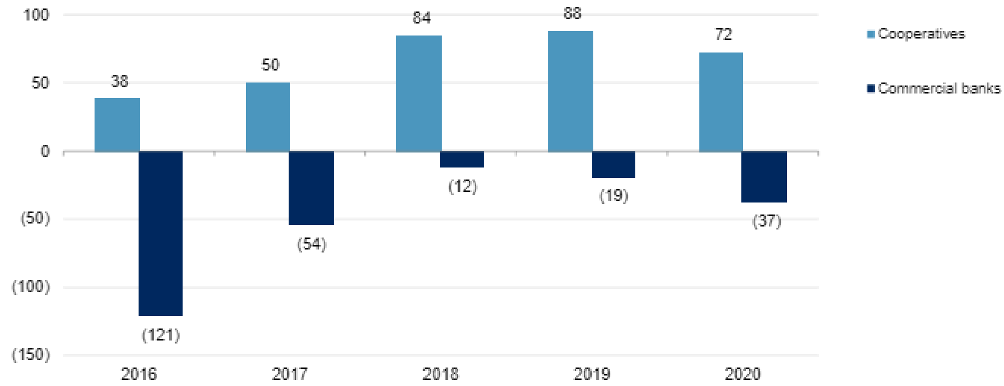
Comparative Policy Analysis Framework:

The cooperative banking systems in India and Brazil, while sharing a common goal of financial inclusion, showcase significant differences when it comes to regulatory frameworks and operational structures. From a speech by Mr Swaminathan J, Deputy Governor of the Reserve Bank of India in 2024. He affirmed how important it is for Cooperative banks to establish essential trust as they not only raise money from their members but also take deposits from the public. “Therefore, the governance mechanisms and practices within banks should give paramount importance to safeguarding depositors' interests and upholding their trust.” (Swaminathan J, 2024).

Following the Punjab and Maharashtra Cooperative (PMC) Bank crisis in 2019, which eroded the trust of members and consumers in the cooperative banking institutions. India's urban cooperative banking system has undergone significant reforms since then. Amendments were made to the Banking Regulation Act and the introduction of the Multi-State Cooperative Societies (Amendment) Bill, 2022. The BR (Amendment) Act, 2020 tried to address the issue of duality of control, by expanding the regulatory approach of the Reserve Bank of India. These reforms have expanded RBI's control over cooperative banks' management, capital, audit, and liquidation processes, introducing measures such as the Cooperative Election Authority, concurrent audits for larger cooperatives, and empowering RBI to reconstitute boards and remove chairmen.

In contrast to the Indian system, the Brazilian system established in 1902 and significantly restructured post-1990, operates under a single regulatory authority – the Central Bank of Brazil (BCB).

Variation In The Number Of Cities Served By Banks Or Cooperatives



Source: Brazilian Central Bank.

The approach in Brazil is more streamlined and integrated. In the Brazilian system, there are provisions already in place for a multi-layered auditing system, a well-established deposit protection scheme or FGCoop, and a proportional regulatory framework based on size and risk. Considering the Financial ecosystem in general, a risk-based approach maintains a balance for businesses to thrive and also at the same time keeps a necessary check and balance in the powers of these institutions of imminent importance.

Both countries have a commonality when it comes to competing with traditional banks and fintech companies. The Brazilian system, they are trying to overcome these challenges by putting in place necessary provisions like deposit insurance, tax exemptions for growth, and clear resolution mechanisms for failing cooperatives. With the recent reforms in the Indian system, addressing long-standing issues in governance and oversight, other concerns have propped up about balancing increased regulation with cooperative principles and the potential strain on RBI's supervisory capacity. These arguments are presented as a counter to including regulation of UCBs within the framework of RBI.

Other notable differences include how Brazil's more developed capital sourcing options, including the issuance of "Letra Financeira" subordinated debt instruments, compared to India's newly introduced ability for cooperatives to issue various types of shares and bonds with RBI approval. The subordinated debt instruments help cooperatives to raise capital without diluting member ownership or control. These instruments also come with longer maturity periods providing stable long-term funding. Though the RBI has liberalised raising capital provisions for cooperatives for redemption there’s a challenge, as members who subscribe cannot demand payment against the surrender of shares and capital cannot be withdrawn without RBI permission.

A learning for India from the Brazilian model could be to emphasise consolidation and federation of smaller cooperatives to increase competitiveness to address fragmentation in its sector. They have a three-tier structure which allows for economies of scale and improved competitiveness. This also allows smaller cooperatives to benefit from sophisticated systems and expertise. In India, the fragmentation is higher with many small, standalone entities. A discussion paper published by the Department of Banking Operations and Development (DBOD) and the Department of Economic and Policy Research (DEPR) under RBI in 2013, discussed the potential for larger multi-state UCBs to convert into commercial banks, citing concerns about their ability to compete effectively under more stringent regulatory frameworks while acknowledging that such conversions could enhance business opportunities and reduce systemic risk. “These banks, freed from dual control and with more avenues to raise capital, could extend banking services in the regions characterised by poor banking outreach.” However, the paper also highlighted that such conversions could negatively impact the cooperative sector's market share and pose challenges to the cooperative principles that underlie UCBs.

While both systems recognise cooperatives as crucial for financial inclusion, especially in rural and semi-urban areas, their approaches differ. Brazil has a more established system with specific support mechanisms such as tax exemptions designed to support cooperative growth and the provision of affordable banking services. While India's reforms aim to strengthen the sector while maintaining its cooperative nature. Adopting the element of Brazil's risk-based, proportional regulatory framework and comprehensive deposit protection scheme can further enhance stability and efficiency in India's cooperative banking sector.

Discussion:

Key Takeaways, from Brazil's experience with India is the importance of consolidating smaller cooperatives to achieve economies of scale and enhance competitiveness. India could reduce the fragmentation of its cooperative sector, possibly making it more adaptive and capable of competing with commercial banks and fintech companies. Having a risk-based approach can help the regulator to strike a balance between maintaining cooperative values and ensuring financial stability. Prudential regulations such as liquidity and capital adequacy requirements can play an important role in maintaining the financial health of cooperatives, while non-prudential regulations can help ensure consumer trust and security. Both these regulations are important to address the concerns of all stakeholders ensuring cooperative banking retains the true nature of their existence.

In conclusion, India's reforms are moving in the right direction, with essential reforms being brought through the Banking Regulation Act, 2020 and the Multi-State Cooperative Societies (Amendment) Bill, 2022. Along with that RBI is proactive in restructuring the banks in distress with a new board or evaluating any other options be it a merger or an acquisition to be implemented. Managing relevant stakeholders equally becomes important as these banks are largely led by members and the customers they serve mainly belong to low or middle-income households, protecting them and their resources is essential. A large amount of work still needs to be done towards better operational efficiencies of these banks so that they can better work in the competitive environment with scheduled banks and fintech organisations. Learning from Brazil's centralized yet cooperative-friendly approach as discussed above could provide valuable insights, having such provisions in place can go a long way to strengthen these banks and promote the agenda with which they are set up.

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Appendices:

Appendix A:

Year	Name of the registered Cooperative Across India
1904	Rajahauli Village Bank, Jorhat, Jorhat Cooperative Town Bank Charigaon Village Bank, Jorhat, Assam Tirur Primary Agricultural Cooperative Bank Ltd., Tamil Nadu
1905	Agriculture Service Cooperative Society Ltd., Devgaon, Piparia, MP Bains Cooperative Thrift & Credit Society Ltd., Punjab Bilipada Service Cooperative Society Ltd., Orissa Government of India, Sectt. Cooperative Thrift & Credit Society Kanginhal Vyvasaya Seva Sahakari Bank Ltd., Karnataka Kasabe Tadvale Cooperative MultiPurpose Society, Maharashtra Premier Urban Credit Society of Calcutta, West Bengal
1907	Chittoor Cooperative Town Bank, Andhra Pradesh
1909	Rohika Union of Cooperative Credit Societies Ltd., Bihar

List of Abbreviations

- BCB: Central Bank of Brazil (Banco Central do Brasil)
- CRR: Cash Reserve Ratio
- DCCBs: District Central Cooperative Banks
- DEPR: Department of Economic and Policy Research
- DBOD: Department of Banking Operations and Development
- GOI: Government of India

- NPAs: Non-Performing Assets
- PACSs: Primary Agricultural Credit Societies
- RBI: Reserve Bank of India
- SCBs: State Cooperative Banks
- SLR: Statutory Liquid Ratio
- UCBs: Urban Cooperative Banks