

Co-operatives in India and the Creation of a New Union Ministry of Co-operation

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Summary

This paper provides an overview of the legal framework within which co-operative societies function in India. It specifically discusses the state of credit and multi-state co-operatives. While regulatory turf issues relating to credit co-operatives seem to be settled with the passage of the Banking Regulation (Amendment) Act, 2020, it is unclear whether the creation of a new Ministry of Co-operation could do the same for multi-state and other co-operatives. The paper also looks at whether such an executive action could tantamount potentially to an infringement of state governments' powers pertaining to the co-operatives sector.

On 6 July 2021, the Indian government amended the Allocation of Business Rules for the 362nd time, since 1950, to create a new Ministry of Cooperation. This is the third time that the National Democratic Alliance (NDA) government (in power since 2014) has created a new ministry. In 2014, the Ministry of Skill Development and Entrepreneurship was created by carving out work areas from the Ministry of Labour; Department of Micro, Small and Medium Enterprises; and Department of Economic Affairs. The Department of Fisheries came into existence in 2019 through the carving out of the Fishery Division from the erstwhile Department of Animal Husbandry, Dairying and Fisheries. The latter department, in turn, had been carved out of the erstwhile Department of Agriculture in 1991. Given that two publicly announced and repeated slogans of the new NDA government were “minimum government and maximum governance” and “co-operative federalism”, creation of more departments/ministries at the Union level on matters that are clearly state-level subjects is a bit paradoxical.

The newly created Ministry of Co-operation is entrusted with the responsibility of strengthening the co-operative movement in the country and deepening its reach up to the grassroots. With an aim to promote a co-operative-based economic development model, the ministry is tasked with creating an appropriate policy, legal and administrative framework to help co-operatives realise their potential. Matters pertaining to the incorporation, regulation and winding up of co-operative societies with objects not confined to one state, including administration of the Multi-State Co-operative Societies Act, 2002 (39 of 2002) fall within the purview of the newly established ministry. Essentially, the ministry will endeavour to develop a general policy in the field of co-operation, and co-ordinate the co-operation activities in all sectors.

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Constitutional Provisions

The Seventh Schedule of the Constitution of India distributes subjects between the Union of India and the states for legislative and executive powers. List 1 of the Schedule contains subjects allotted to the Union of India, List 2 comprises subjects allotted to the states and List 3 is the Concurrent list on which both have jurisdiction.

As regards the subject of co-operatives, the following are the relevant entries in the Seventh Schedule:

- Entry 43 of List 1: incorporation, regulation and winding up of trading corporations but not including co-operative societies
- Entry 32 of List 2: incorporation, regulation and winding up of co-operative societies

Surprisingly, the Seventh Schedule has no explicit reference to multi-state cooperative societies even though legislations on this topic have been around for over a century.

The Constitution (97th Amendment) Act, 2011, sought to address problems related to the management of co-operative societies. The main elements of this constitutional amendment are:

- **Amendment of Article 19 (1) (c) in Part III:** This recognises the fundamental right of the people to form associations, unions or co-operative societies.
- **Insertion of Article 43B in Part IV:** Through this insertion in the Directive Principles of State Policy, the state would 'endeavour to promote voluntary formation, autonomous functioning, democratic control and professional management of co-operative societies.'
- **Insertion of a New Part IX B (Articles 243ZH to 243ZT):** This contains provisions in respect of incorporation, constitution, election, audit, penalties for offences, relating to co-operative societies. In all these matters, the legislature of a state may, by law, make provisions. A notable departure in this regard is Article 243ZR, which deals with Multi-State Co-operative Societies (MSCS) and specifies that for the purposes of the MSCS, any reference to 'legislature of a state', 'state act', or 'state government' will be construed as a reference to 'Parliament', 'Central Act' or 'the Central government'. This preserves the position with respect to the MSCS even prior to the insertion of Part IXB in as much as these societies were already governed by an Act of Parliament, that is, the Multi-State Co-operative Societies Act, 2002. At the time of the Constitutional amendment, the Act was administered by the Department of Agriculture, Cooperation and Farmers Welfare under the auspices of the Ministry of Agriculture and Farmers Welfare, Government of India.

Legislative and Policy Framework

The formation and functioning of co-operatives that operate in one state is governed by state specific laws on co-operative societies. In the case of co-operatives with objects not confined to one state, their matters are governed by the Multi-State Co-operative Societies Act, 2002.

With a view to promote the all-round development of co-operatives in the country, the National Policy for Co-operatives was notified in 2002. The policy document identified several constraints on the sector, including excessive government control and needless political interference, and regional imbalances in the development of co-operatives.

After a description of the problems, the policy declared that the Indian government, in consultation and collaboration with state governments, enunciates the national policy for co-operatives as –

- Recognition of co-operatives as a distinct economic sector representing community initiatives for harnessing people's creative powers.
- Limited regulation and limited role of government in recognition of the apolitical nature of co-operatives.

State of Co-operatives in India

Co-operatives are an integral part of the rural and informal economy in the country. They are active in sectors such as agriculture, housing, dairy, labour and credit. These, including the state credit co-operatives, function under the administrative control of the Registrar of Co-operative Societies at the respective state departments of co-operation. The MSCS function under the administrative control of the Central Registrar of Co-operative Societies, who was till the recent change at the Department of Agriculture, Cooperation and Farmers Welfare, Ministry of Agriculture and Farmers Welfare.

Credit Co-operatives

The credit co-operative system comprises two broad segments of urban and rural co-operatives. As per the Reserve Bank of India's (RBI) report on Trends and Progress of Banking in India (December 2020), the credit co-operatives sector consists of 1,539 urban and 97,006 rural co-operative banks.

The *urban* co-operative banking system has a single tier to cater to the financial needs of customers - Primary co-operative Banks [also known as Urban Co-operative Banks (UCBs)]. On the other hand, the *rural* system is categorised along long-term and short-term structures, with a multi-tier system.

- The *short-term* co-operative credit structure operates with a three-tier system – Primary Agricultural Credit Societies (PACS) at the village level, Central Cooperative

Banks at the District level (DCCBs) and State Cooperative Banks at the state level. The PACS are not banks, only societies.

- The *long-term* co-operative credit structure comprises the State Co-operative Agriculture and Rural Development Banks and the Primary Co-operative Agriculture and Rural Development Banks.

The banking laws were made applicable to co-operative societies only in 1966 through an amendment to the Banking Regulation Act, 1949. Since then, there is a duality of control over these banks with the banking related functions being regulated by the RBI and management related functions regulated by respective state governments/central government.

In June 2020, the Union Cabinet approved an ordinance to bring urban and multi-state co-operative banks under direct supervision of the RBI. In September 2020, the Banking Regulation (Amendment) Act was passed, incorporating changes enunciated in the Ordinance. These include allowing co-operative banks to issue shares and securities subject to prior approval of the RBI, empowering the RBI to supersede the Board of a multi-state cooperative bank under certain conditions and the Board of a state cooperative after consultation with the state government, sanctioning voluntary amalgamations of the UCBs, under specified conditions, etc.

The financial status of co-operative banks is understood to have triggered changes in the law mentioned above. As per the National Bank for Agriculture and Rural Development, the asset quality of state cooperative banks has deteriorated from 5.4 per cent in 2019 to 6.7 per cent in 2020 (measured by gross non-performing asset [GNPA] per cent). A similar deterioration is observed in the asset quality of DCCBs as well (GNPA percentage rose from 11.9 per cent in 2019 to 12.6 per cent in 2020). As per the RBI's Financial Stability Report (July 2021), the GNPA ratio of the scheduled UCBs stands at a high 10.3 per cent in March 2021 but has declined marginally from 10.4 per cent in September 2020.

The Banking Regulation (Amendment) Act, 2020 seems to have corrected the situation in so far as timely action by the RBI stood hampered due to dual control with state governments. Direct regulation by the RBI may result in more effective regulation of co-operatives in the financial sector. However, to ensure that this works on the ground, the RBI will need to upgrade its supervision capabilities and ramp up this capacity in its various field offices as these banks are present across the length and breadth of the country.

Multi State Cooperative Societies

As per the official portal, there are 1461 MSCS in the country. The maximum number of these are in credit (40 per cent), followed by agro (16.5 per cent), housing (9.5 per cent), multi-purpose (7 per cent) and dairy (6.5 per cent). In terms of regional spread, Maharashtra has the highest number of MSCS (42.5 per cent), followed by Delhi (10.5 per cent), Uttar Pradesh (10 per cent) and Tamil Nadu (8.4 per cent).

As mentioned earlier, till the amendment of the Allocation of Business Rules, the MSCS functioned under the administrative control of the Central Registrar of Co-operative Societies, under the auspices of the Ministry of Agriculture and Farmers Welfare. Since one of the stated objectives of the newly established Ministry of Co-operation includes the administration of the Multi-State Co-operative Societies Act 2002, it would appear that the administrative control of the MSCS will now shift from the current ministry to the new ministry. It is unclear what the purpose of such a shift is or the potential advantages of such an act could possibly be.

Several instances of suspect irregularities and fraud in multi-state co-operatives have come to light in the recent past. Between 2010 and 2014, an entity known as the Sahara Group floated four societies under the Multi-State Co-operative Societies Act and garnered deposits from close to 40 million depositors. In August 2020, the Central Registrar of Co-operative Societies wrote to the Ministry of Corporate Affairs to initiate a probe by the Serious Fraud Investigation Office into investments made by the Sahara Group's entities. The Group has been in the news for a decade or so for enforcement actions to be taken against the Group's entities by the regulatory agencies of the financial sector, namely, the Securities and Exchange Board of India and the RBI. More recently, the chief executive of a large multi-state fertiliser co-operative society called the Indian Farmers Fertiliser Cooperative was called by the Central Bureau of Investigation for investigation on graft charges. In all such instances pertaining to multi-state co-operatives (including non-financial sector societies), a serious risk to depositors' money is inevitable.

The investigations into these issues are scattered across agencies. With limited authority to oversee or direct these efforts, the setting up of a new Ministry of Co-operation is unlikely to emerge as a solution to this problem.

Concerns

The 97th Amendment, in its statement of objects and reasons,² sought to achieve the objectives of autonomous and democratic functioning of co-operatives, ensure accountability of management to stakeholders, and provide deterrence for violation of the law. This constitutional amendment in 2011 was an earlier attempt by the Parliament/Union government to bring about "reforms" in the co-operatives sector. Although the Parliament had no powers to legislate on the co-operatives sector per the Seventh Schedule, the 97th Amendment was an attempt to do the same.

Importantly, the Press Information Bureau (PIB) release³ on the creation of the Ministry of Cooperation states that "this ministry will provide a separate administrative, legal, policy framework for strengthening the co-operative movement in the country". If one were to take a cue from the PIB release as to what the primary objective of the ministry is the legality of such an exercise will have to be seen in the context of the treatment by the Gujarat High Court of the 97th Amendment itself.

² The 97th Amendment, Statement of Objects and Reasons, 11 November 2009, <https://legislative.gov.in/sites/default/files/SOR97.pdf>.

³ Cabinet Secretariat, "Modi Government Creates a new Ministry of Co-operation", Press Information Bureau, 6 July 2021, <https://pib.gov.in/PressReleasePage.aspx?PRID=1733225>.

The Gujarat High Court in *Rajendra N Shah vs Union of India & Anr*,⁴ by a judgment dated 22 April 2013, struck down the 97th Amendment as being beyond the competence of the Parliament to enact. The High Court found that the various provisions of Part IX B created fetters on the unbridled powers of the states to enact law and thereby regulate co-operative societies.

By this logic, any policy or legal framework as proposed to be enacted/promulgated by the new Ministry of Co-operation may suffer from the same legal infirmities as the constitutional amendment, if not more.

The decision of the Gujarat High Court has recently been upheld by the Supreme Court. On 20 July 2021, the Supreme Court held that the parliament could not have introduced a law regulating co-operative societies within states and Union territories under the 97th Amendment of 2011 without first getting it ratified by half of the state legislatures. However, by a 2:1 majority, the Supreme Court held that the amendment act will be valid and operational with regard to multi-state co-operative societies. The minority judgment has opined that the amendment cannot apply to multistate co-operative societies either by applying the principle of severability.

On the face of it, given the limited information there is on the exact nature of activities to be undertaken by the newly established Ministry of Co-operation, this executive act seems to be achingly close to state government territory on the regulation of co-operatives.

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⁴ Writ Petition (PIL) No 166 of 2012, *Rajendra N Shah versus Union of India & ANR*, https://www.livelaw.in/pdf_upload/wppil1662012gjh240215512012304220420131-396247.pdf.