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Financial policy for the poor: Financial inclusion and microdebt

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

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FINANCIAL INCLUSION: CHANGING CONTOURS

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<u>OUTLINE</u>

I. Origin and Concept

II. Globalisation

III. New Directions

IV. Demonetisation

V. Issues

I. ORIGIN AND CONCEPT

1. Mohammed Yunus started a unique package for the poor, of which community development banking on a non-profit basis was a component.

2. In 2003, Kofi Annan of UN called for 'inclusive financial sector' that ensures access to the many excluded to financial services, namely, saving, credit or insurance.

3. In India, access to credit to replace money-lender was part of central bank's (RBI) duties for decades. Banks were also nationalised after Independence primarily to extend credit to rural areas.

4. In 2005 the focus of RBI changed from extending credit to poor, to financial services to the poor. This is the origin of 'financial inclusion' (FI) in India. 'Zero' balance account and banking correspondence introduced. Elections in India provided an inspiration. Through a process of collective thinking and several initiatives over 18 months, the concept was formalized in Monetary Policy Statement of April 2006.

5. The objective of FI was safe keeping of savings, reducing or making financial transactions free and extending credit for consumption smoothening. (To bridge seasonal income and regular constant expenditure).

6. Experiment with Dharavi slum that moblised savings from poor; pilot project of Direct Benefit Transfer with the help of IDRBT (Institute of Development and Research in Banking Technology); and Pondicherry survey provided solid base for way forward.

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I. ORIGIN AND CONCEPT

Continued

7) Government also takes the initiative and includes emphasis on credit in the concept of FI.

8) For RBI, MFIs become additional instruments for flow of credit to poor, but most of them at that time were non profit. (Mohammed Yunus said: For profit MFI is no different from money-lender).

9) Some MFIs become profit oriented. Backlash against such MFIs for unethical practices for recovery.

10) Government of AP intervenes. RBI changes the regulation.

II. GLOBALISATION

1. In G-20 agenda for the meeting of heads of Governments in November 2008, Financial Inclusion was put on the agenda. Possibly, this was meant to moderate popular resistance to the proposed large bailout of the banks due to global financial crisis.

2. G20 Financial Action Plan was the result. Multi-lateral institutions like UN and World Bank picked up the message.

3. Central banks joined the chorus possibly to atone for the sins of the past that caused the crisis.

4. INDIA continued with emphasis on financial inclusion and also financial literacy. Experiment with financial counselling started earlier was not successful.

5. The Direct Benefit Transfer became popular public policy tool.

6. Public sector banks had comparative advantage in this work, and got high profile.

III. NEW DIRECTIONS

1. Globally, FI becomes part of public policy and central bank virtually becomes partner with the Government to pursue FI.

2. The objectives of FIs expanded from credit to poor to alleviation of poverty. The coverage of FIs was extended beyond individuals to include small businesses and even medium-term enterprises. In addition, financial market instruments were also added to FI.

3. Some benefits of FIs were also recognised. These are stable retail deposit base, lending stability to the financial system; enhancement of monetary transmission to the banking system; and monitoring of suspicious financial transactions.

4. Extensive use of non-banks for FIs was encouraged.

5. Different countries had different packages for FI.

6. In INDIA, FI became a massive movement by the Government and the RBI, jointly.

7. New institutions like small banks, payment banks, postal bank, licensed by RBI to serve FI.

8. The new government in 2014 gives a very high profile for FI and its linkages with government programme. It also uses FI as a means for government to connect with individuals through banking system. Direct Benefit Transfers (from government to beneficiary) gains momentum and adds to financial inclusion.

IV. DEMONETISATION

1. Conceptually demonetisation is, simple instant replacement of old currency with new currency. It is usually done when the currency is debased or to eliminate counterfeit currency. However, as a by-product of the process, information on holder of cash is available to the public authorities through the banks where notes are exchanged.

2. On November 8, 2016, demonetisation was announced as a fight against black money and corruption. The announcement was made by the Prime Minister.

3. Demonetisation covered a very large part of the currency in circulation. Hence, replacement of the currency across the counter was not possible. So, those who had cash and did not have an account had to get the account opened. Further, many accounts became active. Thus, demonetisation, in a way, accelerated financial inclusion.

4. Since cash went into the banks and there was no cash for transactions in the economic system, some digitalisation was inevitable. Digitalisation was a result of delay in handing over new currency notes in exchange for old notes. It was not on account of demonetisation itself.

5. Technological progress and institutional arrangements for accelerated digitalisation – which commenced over 10 years ago enabled accelerated digitalisation under the compulsions of the process of demonetisation.

6. At a broader level, demonetisation involved huge pain and disruption, perhaps temporary, and yet there was a massive support among the people. Overall, the impression is that short-term pain has been incurred but medium-term gains are expected.

7. Overall, costs and benefits of digitalisation are yet unclear. The link to financial inclusion is through digitilisation, which was incidental to demonetisation.

V. ISSUES

1. There are several dimensions to inclusions, namely, social inclusion, political inclusion, economic inclusion and financial inclusion. There is scope for financial inclusion to cover the gaps and, to some extent, help economic inclusion.

2. Should expansion of credit be an important component of financial inclusion? Credit always has element of risk and excess leverage. US housing bubble was in a way a government sponsored financial inclusion program.

3. Central bank's independence and reputation may be at stake if it goes beyond a limit in terms of participating in social and developmental objectives. However, it has full freedom to operate within its jurisdiction such as payments system and regulation.

4. There may be exploitation of asymmetry of information if sophisticated financial instruments are included in the FI program.

5. Will separate institutional arrangements result in perpetuating two systems or two types of banks – one for the poor and one for the others. Should the coverage of FI be restricted to individuals?

6. In conclusion, the issues of financial inclusion are specific to individual countries and hence there can be no global standard.