Duvvuri Subbarao: Financial literacy and financial inclusion are integral to each other

Inaugural remarks by Dr Duvvuri Subbarao, Governor of the Reserve Bank of India, at the India-OECD-World Bank Regional Conference on "Financial education", New Delhi, 4 March 2013.

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RBI partnership with OECD and World Bank

1. RBI is delighted to have this opportunity to partner with two premiere international institutions – the OECD and the World Bank – on this very important conference on financial education.

2. Hearty welcome to all the delegates from around the world and across India.

RBI and financial literacy

3. Why is the Reserve Bank – a central bank, whose core concern is maintaining price stability and supporting growth – in the forefront on a quintessentially development issue like financial literacy?

- Because of 2 reasons
- ***First reason***
- RBI has a wider mandate than a typical central bank.
- Historically RBI has played an important developmental role in the financial sector.
- ***The Lead Bank Scheme*** initiated in 1969 whereby a bank is designated in every district of the country as the lead bank to coordinate the flow of credit from all banks in the district consistent with a district credit plan.
- ***Priority Sector Lending*** – whereby banks are mandated to lend a minimum prescribed portion of their total lending to designated priority sectors.

RBI has provided innovative leadership on financial inclusion initiatives.

The Reserve Bank is in the forefront of financial inclusion and financial literacy campaigns because we believe that a banking regulator, particularly in a large developing economy like India, has a ***unique advantage and opportunity*** as also a ***distinct obligation*** to further these goals.

GOI and RBI work together.

Financial Literacy and Financial Stability

Why is RBI in the forefront? (Second reason)

There is another important reason why central banks, not only in EMDEs, but even in advanced economies, are getting to play a role in financial literacy. This reason stems from the experience of the 2008/09 global financial crisis.

- Many root causes and many proximate causes for the crisis.
- One of the root causes is the lack of understanding of financial matters that led sub-prime borrowers into contracting teaser rate loans.
- It is indeed possible to argue that the sub-prime problem would not have grown to explosive proportions that it did if people had been more financial literate.

- ***Bernanke***: "Helping people better understand how to borrow and save wisely and how to build personal wealth is one of the best things we can do to improve the well-being of families and communities."
- In post-crisis reform measures across all advanced economies, there is a big thrust ***on consumer protection***.
- By far the best and most effective way of protecting consumers is to make them financially literate.
- To summarize, the answer to the question: "***what is the locus standi of a central bank in financial literacy***", the answer is that
  - Part, indeed an important part, of the mandate of a central bank is to preserve financial stability.
  - An essential prerequisite for financial stability is financial literacy.
  - A central bank has a unique leverage in providing financial literacy

What should I say?

4. Struggled here to determine what I should say at this inaugural that will add value to the conference. Given the depth of frontline experience and subject matter expertise that all of you bring to this forum, it will be presumptuous on my part to lay out the agenda for the deliberations over the next 3 days. I feel distinctly inadequate. I will attempt something much less ambitious.

I will give you

(i) The big picture of the challenge of financial inclusion and financial literacy – in general and in India.

(ii) Tell you briefly about the Reserve Bank's accomplishments and challenges in the area of financial inclusion and financial literacy.

(iii) Raise some introspective and important questions that we must be asking ourselves.

Financial inclusion and financial literacy

5. This conference, I know, is on financial education. Nevertheless, you would have found me speaking about financial inclusion and financial literacy together, almost synonymously. That is not confusion. That is deliberate.

- Financial inclusion and financial literacy are integral to each other.
- They are two elements of an integral strategy.
- Financial inclusion provides ***access***

  Financial literacy provides ***awareness***
- Disadvantaged people need both – ***access to and awareness*** of financial services.
- Financial inclusion – supply side

  Financial literacy – demand side

Broader question: why are financial inclusion and financial literacy important?

6. Why are financial inclusion and financial literacy important?

They are important simply because financial inclusion is a necessary condition for sustaining equitable growth. There are few, if any, instances of an economy transiting from an agrarian system to a post-industrial modern society without broad-based financial inclusion.

7. As people having comfortable access to financial services, we all know from personal experience that economic opportunity is strongly intertwined with financial access.

8. ***World Bank – attack on poverty***

- Seminal WDR on Attacking Poverty – 2000/01. Three dimensions of attack on poverty.
  - Creating ***opportunities*** for the poor to improve their lives.
  - ***Empowering*** the poor to demand more responsive state and social institutions.
  - ***Providing the poor*** security – to cope with risks.
- ***Opportunity, empowerment and security.*** Financial inclusion is important on all three dimensions.
- Development experience shows that the poor don't want doles. They don't want hand outs. What they want is opportunity.
- Financial inclusion and financial literacy are essential to give that opportunity. They enfranchise the poor in a very powerful way, and give them security against income shocks.

Financial inclusion in India

9. Let me get a little more specific. Take India. Financial inclusion is good for all the stakeholders.

- ***Good for the poor.*** Opportunity to improve their incomes and their quality of life.
- ***Good for the banks.*** Steady low cost savings – ALM.
- ***Good for the government.*** Powerful tool of poverty reduction, it also cuts down leakage.
- ***Good for the economy***, savings of the poor into the formal financial sector.

10. ***Win-win*** for the poor, banks, government and economy. Not just a public good but a merit good.

11. ***India – big picture***

(i) 600,000–100,000 bank branches – just about 10%

(ii) Only 40% of the households have bank accounts

(iii) Financial exclusion is staggering

12. ***What has the RBI done?***

Financial inclusion

- bank led approach
- deregulated bank branch opening
- 25% of new branches in rural areas
- Leveraged on technology to deepen financial inclusion through the BC model
- Delicenced ATMs

- Liberalized the KYC norms for basic banking account without any minimum balance

13. ***Financial literacy***

- RBI prepared a National Strategy on Financial Education catering to all sections of the population in the country.
- ***Simple, comprehensive and inclusive.***
- Since the challenge is to link large number of financially excluded people to the formal financial system, the focus of the Strategy at the base level is to create awareness of basic financial products. For the purpose, the financial literacy efforts is primarily directed towards dissemination of simple messages of financial prudence in vernacular language through large campaigns across the country combined with vigorous roll out of financial inclusion plans by banks, insurance, pension funds and others.
- The strategy is inclusive – active, involves individuals, financial sector regulators, educational institutions, NGOs, financial sector entities, multilateral international players and the Government at both Centre and State.

14. ***Banks and financial literacy***

- We have advised banks that there should be at least one Financial Literacy Centres (FLC) in all the districts (640+) throughout the country. These FLCs are required to conduct outdoor financial literacy camps at least once in a month. Banks have already set up about 650 FLCs till date.
- Further, every rural branch (35000+) is required to conduct a financial literacy camp at least once in a month. Through these camps, we envisage imparting of financial literacy in the form of simple messages like why save with banks, why borrow from banks, why borrow as far as possible for income generating activities, why repay in time, why insure yourself, why save for your retirement etc.
- Starting from April 2012, we have been able to educate about 1 million plus people through these literacy programs.

15. Our strategy on financial inclusion and financial literacy

- Bank led model
- More by moral suasion by asking banks to see their enlightened self-interest, than by regulation
- Let a thousand flowers bloom!

16. FIPs prepared and implemented by banks. Why not a more prescriptive model?

(i) Innovative ideas

(ii) Tailored to their business model

(iii) Ownership of the plan

(iv) India a diverse country. Let a thousand experiments take place.

17. ***Many accomplishments***

- Some of it in numbers
- Some of it in heart-warming stories that we have heard from across the length and breadth of the country
- Villages now having access to banking – 200,000/600,000 through branches + BCs

- Hundreds of millions of people, often illiterate, use smart cards with biometric identification, for bank transactions (Secretary Geithner)
- Tens of millions of people use mobile handheld electronic devices for banking
- 10 million SHGs across the country are credit linked to banks for income enhancing activities
- Villages ask for bank branches as they ask for schools and health centres

  [Neighbouring villages of Jalanga]
- Women voluntarily forming SHGs
- Outreach programmes – more than 50% of participant attendees are women
- EBT – in several states
- Direct cash transfer in 50 districts

18. Challenge for RBI

- Banks see this as an obligation and not an opportunity
- KYC (migrant labour) and UID – simplifying without compromising security
- ***Meaningful financial inclusion (Toilet, Bank a/c)***

New bank licences

19. New bank licences. Strategy for financial inclusion will be an important criticism.

Criticism against RBI: RBI open minded to innovation.

20. ***Introspective but Important Question:***

- Do we know enough about the poor to deepen financial inclusion and further financial literacy?
- Do we understand enough about how the poor manage their finances in order to design products and services that meet their requirements?
- Are we approaching the problem with an open mind or are we too clouded by our stereotype views to understand why the poor behave in such seemingly irrational ways?
- Are we too patronizing in our approach to be dismissive of the concerns and apprehensions of the poor?

  Ela Bhatt [SEWA]: WDR 2000/01: We are poor but so many: “Illiteracy is on the other side of the table”.

Portfolios of the poor

21. Frame these questions in a more concrete fashion.

(i) WB norm for poverty is $2/day.

One of the least understood problems of living on $2/day is that you don’t earn $2 every day. That is the average over time. How do you cope with that?

(ii) The poor not only have low incomes, but their income is irregular and unpredictable. Their savings are meagre. But, yet they have to cope with loss of employment, illness and death in the family, lumpy expenditure needs for education and for weddings and festivals?

(iii) One stereotype view is “How can the poor save – they have no money”. This is only superficially sensible. The poor should save because like everybody else they have a present and a future. They have little money today, but unless they stumble on a pile of cash tonight, they have little money tomorrow.

(iv) Another stereotype view: The poor’s savings are meagre. They don’t need much financial management techniques. In fact, because the poor have low, irregular and unpredictable incomes, they need sophisticated financial management. $20/day vs $2/day.

(v) ***Portfolios of poor by Daryl Collins, Stuart Rutherford***

- India, Bangladesh and South Africa
- Need sophisticated financial management
- Diaries – fascinating how they cope with everyday finances.
- The truth is that money management is, for the poor, a fundamental and well understood part of everyday life.
- The stereotype view is that the poor are carefree or incompetent. Perish that thought. They are anything but.

(vi) ***Poor economics – Abhijit Banerjee & Esther Duflo***

  (i) Why are the poor simultaneously saving and borrowing at the same time?

  (ii) Why in some countries, the poor actually pay money to save money – i.e. they actually accept (-)ve interest rate

  (iii) Ernakulam – Survey. Dependence on money lenders.

  (iv) Seemingly irrational behaviour tells us a lot about how financial inclusion should be pursued.

22. ***Fortune at the bottom of the pyramid***

Shibboleth or cliché

- Fortune at the bottom of the pyramid is indeed there
- Astounding success of millions of SHGs across the country – a heart warming success story
- Nascent capitalist inside every poor man and poor woman. ***Capitalists without capital*** as Banerjee and Duflo call them.
- The abundance of entrepreneurism among the poor is the least recognized part of our understanding.
- Purely in terms of stated occupations, most income groups in poor countries seem to be more entrepreneurial than their counterparts in the developed world – the poor no less so than others, an observation that inspired Harvard Business School professor Tarun Khanna’s book, ***Billions of Entrepreneurs***.

Financial literacy and inclusion – challenge not unique to developing countries

23. ***Economist*** a couple of weeks ago. Feature on ***“life on the edges of America’s financial mainstream”***.

- In December 2012, the Federal Deposit Insurance Corporation (FDIC) released a survey that found roughly one in 12 American households, or some 17m adults, are “unbanked”, meaning they lack a current or savings account.

- The survey also found that one in every five American households is "underbanked", meaning that they have a bank account but also rely on alternative services – typically, high-cost products such as payday loans, cheque-cashing services, non-bank money orders or pawn shops.
- Not all the unbanked are poor, nor do all poor people lack bank accounts. But the rate of the unbanked among low income households (defined in the FDIC survey as those with an annual income below $15,000) is more than three times the overall rate.

Disturbing questions about financial literacy

24. ***[Economist] – financial literacy***

- Here is a test. Suppose you had $100 in a savings account that paid an interest rate of 2% a year. If you leave the money in the account, how much would you have accumulated after five years: more than $102, exactly $ 102, or less than $102?
- This test is so simple that you suspect there is a catch. There is no catch. But a survey found that only half of Americans aged over 50 gave the correct answer. If so many people are financially challenged, it is hardly surprising that they struggle to deal with financial decisions.

The solution seems obvious: provide more financial education.

But is it possible to teach people to be more financial savvy? A survey by the Federal Reserve Bank of Cleveland reported that: "Unfortunately, we do not find conclusive evidence that, in general, financial education programmes do lead to greater financial knowledge and ultimately to better financial behaviour."

So, is financial education programme a failure? Certainly not. The purpose of education is to teach people to deal with financial decisions more intelligently and with greater sense of confidence.

- make it interesting
- make it instructive
- make it relevant to the age and income group

Summary and conclusion

25. Let me summarize the point that I have been trying to make:

(i) Problems of access and awareness in deepening financial inclusion and spreading financial literacy.

(ii) Problem in poor countries.

Problem also in rich countries.

(iii) Perish stereotype views.

(iv) Easy to attribute it all to sociological and demographic factors. But there is evidence to show that given the same sociological and demographic context, some countries have done better than others. ***So, strategies, policies and commitment do matter.***

(v) More importantly imagination and innovation are required.

(vi) There is no one size fits all. On the contrary, we must let a thousand flowers bloom, let thousands of real life experiments take place. Learn from that collective experience to determine what works, what does not and why?

26. By the end of the conference, we have an improved and shared understanding on the challenge and opportunity of financial inclusion and financial education.

27. All the best for the success of the deliberations.