

Usha Thorat: Financial inclusion and millennium development goals

Speech by Ms Usha Thorat, Deputy Governor of the Reserve Bank of India, at the 4th Program on Human Development and State Finances jointly organised by College of Agricultural Banking, Reserve Bank of India, UNDP and the Planning Commission, at CAB, Pune, 16 January 2006.

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At the outset, I take this opportunity to thank the Planning Commission, the United Nations Development Programme (UNDP) and the College of Agricultural Banking for inviting me to this very relevant program on human development and State finances.

The central theme of the Millennium Development Goals (MDGs) is reduction of poverty in all its forms. The MDGs emphasise human development indicators, especially those relating to women and children, to enable people to live a life of dignity. The role of the State in the achievement of the MDGs through fiscal measures to increase investment in economic and social capital is primary. The financial system can play a role in reinforcing many of the objectives of the MDGs involving savings, livelihood and economic infrastructure apart from providing an efficient payments system. The role of the community based organisations and NGOs has been found to be vital in catalysing local participation to enhance the efficiency and transparency in the delivery of services essential for achievement of human development goals. Thus the State Governments, the formal financial system and community based organisations can be considered as the three pillars in achieving societal transformation. These three pillars perform distinct but mutually reinforcing roles that can have tremendous synergies.

By financial inclusion we mean the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded. It is important to recognise that in the policy framework for development of the formal financial system in India, the need for financial inclusion and covering more and more of the excluded population by the formal financial system has always been consciously emphasised. What has now come to the fore is that even after decades of such emphasis there are large segments of the society outside the financial system. Simultaneously the growth of the NGO and the Self Help Groups has been significant and their linkage with banks has facilitated greater financial inclusion. These groups are mainly of women and the recovery rates are high. There is no subsidy element and the outreach and penetration continues to grow. The coverage is several times that under government sponsored schemes. Where groups have been consciously promoted under government sponsored schemes, the recovery is just 50 per cent as compared to 90 per cent plus recovery under the voluntary movement. Furthermore, there are reports that groups are promoted under the sponsored programmes just to avail of the subsidy. It is, therefore, essential that the strengths of the voluntary NGO/SHG movement are not lost while establishing linkages between this sector and banks in achieving the MDGs. In the context of the overall fiscal constraint faced by most States, the linkages between the formal financial system and the community based organisations can be effectively exploited by the State Governments to meet the challenges of ensuring achievement of the MDGs.

I would like to share with you two recent cases witnessed by me that could be of some interest and relevance. The first relates to women self help groups (SHGs) that I recently visited in Ajmer. The NGO, has catalysed groups that consist of poor Muslim women and trained them in making crochet caps for the nearby dargah. The groups now supply these caps and other items to distant places. Initially the women were neither taken seriously nor supported by their men folk, but after successive drought years when they found that the supplementary income from the women enabled the families to be free from starvation, the SHGs gained credibility and won the support of the men folk. The leaders have become so empowered that they go to Ajmer and even to Jaipur for procurement of yarn and for marketing the produce. In the process of empowerment the women are actively encouraging their children including girls to be regular in school and they have shown active interest in adult literacy classes. They now want to learn how to keep their accounts on the computer. There is much more consciousness on sanitation issues and preventive health care. These women are also prepared to travel as far as Kutch for exchange of experiences with other women SHGs involved with craft production. The SHG is supported by banks and NABARD under the SHG bank linkage programme.

The other case relates to a visit to three villages near Kolhapur where the Zilla Parishad with active involvement of the gram panchayat and banks are building toilets with the entire expenditure of a toilet construction met through bank loans given to individual families through a very simple procedure. The loans are based on assessment of family's cash flow and repayable over four years. The toilets range from the simplest soak pit type to more elaborate ones linked to bio gas units. The procurement of septic tanks and material has been arranged on wholesale basis; locally trained masons are executing the work, with labour inputs from the villagers themselves so as to keep costs and consequently the loan amount low. There is no subsidy element in the financing. While returning from this village, we passed through another village. It was dark and suddenly as the cars headlights hit the road, we saw women from either side of the road getting up hurriedly. This image starkly brought home the meaning of the MDGs for ensuring human dignity.

These cases represent the progress that can be made in achievement of MDGs where there is local leadership, community participation and involvement of the financial sector with the Government playing a facilitating role. What is significant is that in both these cases there is no subsidy or budgetary support. The question is whether these are replicable and can we achieve the desired scale? The answer is yes provided the three pillars, viz., the State government, the formal financial system and the community based organisations work together. Without connecting rural roads, there is very little that can be achieved by the formal financial system or NGOs. Hence it is appropriate that due emphasis is being placed on rural roads and rural connectivity. This has to be an area for priority for state funding.

The SHG movement in India has enabled social and economic inclusion of women. The SHG-bank linkage movement where SHGs are linked to banks in a gradual way - initially through savings and later through loan products - has been able to ensure financial inclusion to a certain extent. However, there is a need to increase their credit absorptive capacity as a large number of SHGs linked to the banking system are utilising the credit only for consumption purposes. They have to migrate to employment generating activities so as to be able to fully reap the benefits of economic freedom. Nevertheless, the SHGs and in many cases SHG federations have played a pivotal role in the creation of social capital and empowerment. There are hundreds of examples where the SHGs have worked with NGOs and Government agencies to bring drinking water to their villages, conduct regular health camps, organise adult literacy camps and generally improve the social status of members. For example, the SHG Federations active in Tamil Nadu have been able to provide life insurance products through an internally administered scheme. In Kerala, the Kutumbashree model set up by the Government covers a variety of financial services as also health insurance. The Friends of Women's World Banking (FWWB) have started a Social Security Project in association with micro finance agencies/NGOs and insurance companies to provide life insurance to lakhs of persons and non life insurance products like livestock insurance and health insurance. Other innovative products like hut insurance, food security, pension scheme, etc., too have been launched. Since the SHG Federations/NGOs or, the MFIs provide the gateway to a large number of families and absorb administrative costs both in insuring and in claim settlement, such schemes have been able to keep the premium to the minimum. In Orissa there are reports about an NGO working amongst disabled women living in abject poverty. Their intervention has resulted in finding a united voice for these women, getting the necessary certificates and thus getting facilities due to them and also bank finance for economic activities.

Apart from the SHG bank linkage, the experience of the formal banking system partnering with micro finance organisations set up as societies, cooperatives, trusts and NBFCs including Section 25 companies has also been extremely encouraging. These tend to be on a larger scale with services ranging from health, education, marketing apart from savings, loans and insurance. These linkages have also grown without government intervention and have proved to be efficient. In both models, the challenge is in reducing transaction cost so as to keep the services affordable while covering costs and thereby ensuring increase in outreach and sustainability.

The formal financial system has to recognise the huge business potential coming from the unmet demand for financial services from those who normally tend to be excluded. The focus on financial inclusion comes from the recognition that financial inclusion has several externalities which can be exploited to the mutual advantage of those excluded, the banking system and society at large. Banks need to understand the market and develop products suited to the clientele. They need to develop data sets to evolve risk assessment models for proper rating and pricing. Financial inclusion has to be viewed as a business strategy for growth and banks need to position themselves accordingly. Further improvements in rural connectivity, through roads, power and telecom, can ensure greater penetration

by the financial system into remote areas and provide safe and efficient financial services to large segments of the financially excluded. Use of IT, apart from speeding up transaction time and reducing cost, facilitates building automatic safeguards by ensuring on-line identification, authorisation, monitoring, transparency and accountability and in turn enables banks to deal with much larger numbers with minimum risk. The State governments will need to ensure such rural connectivity and also facilitate capacity building to use IT in a big way.

Let me now proceed to highlight some of the recent initiatives that RBI has taken to promote financial inclusion

i. As a proactive measure, the RBI in its Annual Policy Statement for the year 2005-06, while recognising the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, urged banks to review their existing practices to align them with the objective of financial inclusion. In the Mid Term Review of the Policy (2005-06), the RBI exhorted the banks, with a view to achieving greater financial inclusion, to make available a *basic banking* 'no frills' account either with nil or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population. The nature and number of transactions in such accounts would be restricted and made known to customers in advance in a transparent manner. All banks have been urged to give wide publicity to the facility of such 'no frills' account. A number of banks have since come out with schemes for such 'no frills' account facility.

ii. Further, in order to ensure that persons belonging to low income group both in urban and rural areas do not face difficulty in opening the bank accounts due to the procedural hassles, the KYC procedure for opening accounts has been simplified for those persons with balances not exceeding rupees fifty thousand (Rs. 50,000) and credits in the accounts not exceeding rupees one lakh (Rs.1,00,000) in a year.

iii. RRBs have been specifically advised to allow limited overdraft facilities in 'no frills' accounts without any collateral or linkage to any purpose. The idea is that provision of such overdraft facility provides a ready source of funding to the account holder who is thereby induced to open such accounts. From the bank's point of view, the offering of a "no frills" account should represent the beginning of a sustainable relationship that will be mutually beneficial. Looking at the numbers involved, there is no doubt that banks should look at technology based solutions and low cost delivery mechanisms that will reduce transaction cost of such services with the volumes required to make such a model sustainable.

iv. For all borrowers where the principal amount is less than Rs 25000, banks have been asked to offer a one time settlement scheme. As there are large number of such very small NPAs with banks, offer of such an OTS is expected to restore borrowing relationship with the formal system and thereby obviate the need to go back to the informal system. Banks, however need to give wide publicity to the scheme at their rural and semi urban branches. In case where the loans are under government sponsored schemes the State Level Bankers' Committee (SLBC) is expected to evolve a suitable policy.

v. In urban areas, credit cards enable households to manage to get their credit needs met by the banking system, with not only the ability to make purchases on credit but also facility to draw cash against card. In the rural areas, there are no points of sale or outlets where plastic cards can be used. Banks have been recently advised by RBI to provide a General purpose Credit Card (GCC) facility at their rural and semi urban branches. The credit facility extended under the Scheme will be in the nature of revolving credit. The GCC-holder will be entitled to draw cash from the specified branch of bank up to the limit sanctioned. Banks would have flexibility in fixing the limit based on the assessment of income and cash flow of the entire household. However, the total credit facility under GCC for an individual should not exceed Rs.25,000. Interest rate on the facility may be charged as considered appropriate and reasonable. The borrowers would be eligible for availment of the credit facilities provided under GCC, as per their requirement, without any insistence on security and the purpose or end-use of the credit. Fifty per cent of credit outstanding under GCC up to Rs.25,000 will be eligible for being treated as indirect agricultural financing coming under the ambit of priority sector lending norms. The eligibility criteria will be subject to review. It is not necessary that GCC should be linked to purchases and GCC may not necessarily be in the form of a card. GCC can be issued in the form of a Pass Book, if the holder of GCC desires to operate cash withdrawals from bank branches. It is expected that banks will come out with their own schemes to popularise this product amongst the rural clientele.

vi. A major recommendation made by the Internal Group set up by RBI on micro finance (Khan Committee), currently under consideration, is to permit banks to use micro finance institutions as business facilitators and correspondents to enable banks to increase their outreach and ensure greater financial inclusion. This recommendation which will lead to provision of micro-finance services at the doorstep of the customer, can make substantial change in the availability of comprehensive financial services in rural areas and to the poor and the disadvantaged in both, rural and in urban areas.

Banks need to view these recent measures as an opportunity to provide timely and adequate financial services and increase their share in a rapidly growing market. In case of GCC or overdrafts in 'no frills' accounts, the interest rates can be appropriately fixed while building in incentives for prompt payment.

Financial inclusion has several benefits. Establishment of an account relationship can pave the way to the customer availing of a variety of savings products, loan products for consumption livelihood and housing. The account can be used for making small value remittances at low cost and making purchases on credit. The same banking account can also be used by State Governments to provide social security services like health and calamity insurance under various schemes for the disadvantaged. It is often felt that some contribution should be made by the beneficiary so that he has some stake. However, the deterrent is that the cost of collection of the premium that can be more than the premium itself. If however it is collected through a no frills account, the cost is practically nil. From the bank's point of view, having such social security cover makes the financing of such persons less risky and hence can be covered by the loan component. Reduced risk means more flow of funds at better rates. Furthermore there is a complete audit trail and transparency. In other words the single gateway of a banking account can be used for several purposes and represents a win-win situation. The Employment Guarantee Scheme being rolled out in 200 districts in the country which would bring in large number of people through their savings accounts into the banking system is another opportunity to promote financial inclusion in its fullest sense.

I would now like to focus on the role of the State governments. While there is no alternative to raising revenue through taxes and user charges so as to have the resource base to undertake huge investment in physical and social capital, it is possible, even in the present milieu to give focused attention to a few areas.

- Firstly, there are many programmes where the central assistance is not drawn down due to the inability on the part of States to provide matching contribution and such allocations often lapse. It could be considered whether contribution from the beneficiary (supported by a loan from a bank) can be blended with the State's contribution to achieve the amount required to use the Central assistance. Banks can tie up with community based organisations having a good track record to provide the comfort of knowledge of the borrower.
- Secondly, States can leverage on the provision of guarantees. There is a recent instance where the State housing board has partnered with a bank for housing schemes for families below poverty line (BPL) in urban areas where the housing board provides a first loss guarantee to the extent of 10 per cent of the loan amount. The housing board identifies the beneficiaries and helps in recovery. The title is passed only on completion of loan repayment. In addition to making available the housing loan, health insurance cover is also provided with either the premium being fully or partly provided by the State Government. There could be calamity or accident cover as well. Like I mentioned earlier, such insurance reduces the risk of the loan asset and can lead to more flow of funds and better pricing.
- Thirdly, in urban areas, there is considerable scope for better pricing of services. It is common knowledge that the poor end up paying more for various public goods, such as, water, power, sanitation. Efficient provision of services, with minimum leakages, and their comparative pricing is critical. Formulation of schemes that have a viable pricing policy will enable the involvement of the financial system to ensure that adequate funds are available for such infrastructure projects.

This initiative of the Planning Commission in conducting this programme in collaboration with the United Nations Development Programme and the College of Agricultural Banking is indeed a very welcome one to build synergy through mutuality and convergence of the efforts of all the major stakeholders in the progress towards achievement of MDGs.

I find that your time here has been structured well with presentations by a number of eminent persons on various aspects having a critical bearing on human development, such as, public health, livelihood, government and group work as well as experience sharing ending up with an interesting quiz. I wish you a fruitful week ahead.