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Political limits to financial inclusion

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- Financial inclusion is being crippled by the affliction of political correctness
- Initiatives to draw the excluded into the financial system are being neutralised by stifling conditions
- The reform of the coop banks presents a tough challenge as both governance and efficiency issues need to be addressed

THE inclusion of all sections of society in the financial system has become one of the central planks of financial policy in developed as well as developing countries in recent years. In India, there has been a concerted effort to promote the inclusion of our uniquely termed "weaker sections" into that system. The government even appointed a Committee on Financial Inclusion to "study the pattern of exclusion from access to financial services and...to suggest a strategy to extend financial services to vulnerable groups."

A key initiative for promoting financial inclusion is the Reserve Bank of India's well designed "no frills account". This requires bankers, particularly their rural branches, to seek out people with no bank accounts and open these for them even if there is no deposit balance in those accounts. In theory such accounts are linked to automatically available lines of credit of Rs 3,000. A good start has been made in this effort with Pondicherry being the first state to announce 100% financial inclusion while numerous districts in various parts of the country have joined the race to become fully inclusive in this way.

The design of the "no frills" accounts conforms well with the research findings of the author's organisation, amongst others, that the daily financial lives of low income families are characterised by the regular accumulation of savings, of the order of Rs 10 to Rs 200, and the occasional need to borrow amounts of Rs 500 to Rs 3,000 to overcome occasional shortfalls in income.

In practice, in most places where the no frills account has been opened by rural banks, its efficacy as a measure of financial inclusion is handicapped by lack of access as well as lack of information. First, if a bank branch is located 10-15 km away from the account holder's location it is hardly economical for her to travel to the branch to deposit even Rs 50. Any gain from this exercise would have already been neutralised by the loss of half a day's wages in addition to the transport cost of Rs 10. Second, bankers wary of loan waivers hardly ever inform the account holders of the line of credit that could potentially save them from further indebtedness to the local moneylender. Small wonder therefore that rural bankers report minimal activity in the no frills bank accounts.

Another initiative propagated by the RBI is that of business correspondents (BCs) who are supposed to be appointed by banks as their agents to carry small banking transactions to the doorsteps of the people. A well functioning network of BCs would, in theory, eliminate the costly trip to the branch and result in no frills accounts becoming operational, leading to practical financial inclusion. But, in politically correct India, any additional cost to the low income account holder resulting from such a service is deemed to be unfair, so the RBI circular expressly forbids banks from charging directly for it. In effect, this means that the banks must cover the cost of the BC out of the 4% margin they earn from their normal banking activities. Nowhere in the world are doorstep financial services paid for by such a small margin and the result is that in the over two years since the RBI circular on the subject was issued, there has not been any substantial roll-out of the BC service.

In addition, in order to stimulate the growth of financial services to the excluded sections of the population, both the regional rural banks (RRBs) and the district and state cooperative banks that operate mainly in rural areas, have become the subject of expensive reform programmes with borrowing from the Asian Development Bank and the World Bank. The RRBs have been extensively amalgamated to obtain larger banks at the state level. The theory is that these larger banks would have stronger management and access to economies of scale. Yet, trends in the financial performance of RRBs over the past few years show a steady improvement even before the start of the amalgamation process. At the same time, it is well known that larger banks chase larger business and the financial inclusion agenda is likely to be of declining interest to the RRBs as growth and competition with commercial banks becomes an increasingly important driver.

Cooperative banks, on the other hand, have always been highly malleable entities controlled by local politicians while being presented to the public as people's institutions. The reform of the cooperative banks, therefore, presents a formidable challenge as both governance and efficiency issues need to be addressed. Without successful reform their effective contribution to financial inclusion will inevitably be limited.

The proposal to reform the cooperative banks is yet another example of politically correct action that, in practice, is unlikely to advance the financial inclusion agenda. It is apparent that for real financial inclusion to take place, the bold initiatives of the RBI will need to be freed from the present stifling conditions. Unfortunately, the advent of the loan waiver shows that this will take a degree of political will presently in short supply.

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