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In the foreseeable future, we will bring formal financial services to every Indian who wants them: RBI Governor

"In the foreseeable future, we will bring formal financial services to every Indian who wants them. Financial inclusion will be an important element in ensuring access and equity - the necessary building blocks for sustainable growth of our country." Dr. Raghuram G. Rajan said this today while speaking at the National Seminar on Equity, Access and Inclusion organised by National Institute of Rural Development and Panchayat Raj in Hyderabad.

Stating that the imperative for financial inclusion is both, moral as well as one based on economic efficiency, the Governor asked, "After all, should we not give everyone access to the services we all in this room enjoy?" He added that if everyone had the tools and resources to better themselves, it would increase output, growth, and economic prosperity.

In his speech, Governor focussed on three elements of financial inclusion: (a) the broadening of financial services to those people and enterprises who do not have access to financial services sector; (b) the deepening of financial services for those who have minimal financial services; and (c) greater financial literacy and consumer protection so that those who are offered financial products can make appropriate choices.

He described the economic impediments to greater financial inclusion through the acronym IIT: Information, Incentives, and Transaction Costs. Elaborating on these, he said, the banker, especially if he is not from that region, will have difficulty in getting sufficient information to offer financial products to the excluded. As a lender, he may also not have incentive to lend to the excluded as the legal system does not enforce repayment quickly or cheaply. Moreover, the borrower does not have any collateral to pledge; leading the lender to believe that he will find it difficult to get the loan repaid. The third impediment, the Governor said, was transaction costs. Since the size of transactions by the poor, or by micro farmers or enterprises is small, fixed costs in transacting are relatively high. If the time and cost involved in filling up a form and documentation for a client, for instance, is the same for a loan of say ₹ 10,000 and ₹ 10 lakh, a banker who is conscious of the bottom line would naturally focus on the large client.

A moneylender does not suffer any of these impediments. Since there are few more readily available alternatives than the moneylender in underserved areas, he has so many in his clutches. One of the primary motivations for the country to push financial inclusion is to free the excluded from the clutches of the moneylender. The Governor proposed three public policy approaches to overcome this problem: mandates and subventions, transforming institutions, and moving away from credit. He explained each at length with examples. Mandates, the Governor said, are reasonable from a societal perspective but the banks cannot monetise this benefit; only a government can decide to mandate them as those benefits are worth generating. In a similar vein, there may be network benefits from universal access. There are risks emanating from mandates, the Governor said; but given their value, "narrow targeting of mandates to the truly underserved and explicit payment for fulfilling the mandate are necessary so that they are delivered by the most efficient," the Governor stated.

Another approach could be transforming institutions. Learning from the moneylender who is particularly effective because he knows the neighbourhood and its people, and can make a good assessment of who is credit worthy, the Governor stated that local financial institutions, with local control and staffed by knowledgeable local people, could be more effective at providing financial services to the excluded. Similarly, microfinance institutions, small finance banks, credit information bureaus, Aadhaar for individuals and “Udhyog Aadhaar” for small businesses are other institutions that could bring significant changes in credit culture and thus ease flow of credit in underserved areas. Further, digitisation of land records, accompanied by a guarantee of certificates of final ownership by the state government, formal recognition of share cropping agreements, as in the pattas registered by the state government in Andhra Pradesh and Trade-Receivables Discounting Systems (TReDS) which the RBI has licensed, could ease access to credit.

Third approach according to the Governor could be to let credit follow not lead. The government and the RBI are doing this by encouraging easing of payments and remittances, on expanding remunerative savings vehicles, or on providing easy-to-obtain insurance against crop failures. Savings habit, once inculcated, not only allows the customer to handle the burden of repayment better, it may also lead to better credit allocation, the Governor stated. Easy payments and cash out will also make formal savings more attractive. Solutions like strengthening the network of banking correspondents, creating a registry of banking correspondents, giving them the ability to take and give cash on behalf of any bank through the Aadhaar Enabled Payment System and adequately training them in providing financial services would go a long way in reaching financial services to the underserved. Further, with “expanding cash-in-cash-out points through the soon-to-be-launched Postal Payment Bank and telecom affiliated payment banks and making transfers from bank account to bank account easier via mobile through the Unified Payment Interface, we are on the verge of solving the last mile problem,” the Governor affirmed.

The Governor concluded with five issues that arise in managing the process and how the RBI was trying to simplify those: 1) Know your customer requirements 2) Encouraging competition to prevent exploitation 3) Ensuring some flexibility and forgiveness in financial arrangements 4) The need for skilling and support 5) Encouraging financial literacy and ensuring consumer protection.

"The country has come a long way in the process of financial inclusion, but still has a way to go. We are steadily moving from mandates, subsidies, and reliance on the public sector banks for inclusion to creating enabling frameworks that make it attractive for all financial institutions to target the excluded, even while the interests of the excluded are protected through education, competition and regulation," he concluded.

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