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Financial Inclusion and Developmental Central Banking: The Experience of Bangladesh

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Abstract *The necessity of the developmental goals of a central bank is receiving growing acceptability for which several central banks in developing countries started using financial inclusion to spur economic and social development. In the context of Bangladesh, Bangladesh Bank is mandated by its charter to promote and maintain a high level of output, employment, and real income, fostering growth and development of the country's productive resources along with preserving monetary and financial stability. Bangladesh Bank has remained proactive in its mandated developmental role, with monetary and credit policy stance supporting attainment of the government's inclusive growth and poverty reduction goals. Based on the secondary information, the paper attempts to draw some lessons from Bangladesh experiences that can be extended and generalized with respect to developmental central banking in developing countries. The study found that the policies and measures which have been undertaken so far in Bangladesh in the context of developmental and inclusive banking are in the right directions and have already started creating positive impacts. In the context of Bangladesh there need not be a trade-off between developmental central banking and financial and economic stability. Designing target specific products and strategies for groups like women, farmers, small enterprises, sharecroppers worked tremendously for Bangladesh. It implies that a central bank may bring visible success to the lives of the common people beyond inflation.*

1. Introduction

1.1 Over the years, there has been a notable global change in the theory and practice of central banking. It is well-known that central banks in most countries developed or developing aim to achieve monetary and financial stability, and

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contribute in attaining a country's developmental goals, explicitly or implicitly. Recognizing developing country realities, the necessity of the developmental goals of a central bank itself is receiving growing acceptability. Especially access to finance for low-income households or financial exclusion is hurting economic growth and overall wellbeing, and this realization induces many central banks in developing countries to use financial inclusion to spur economic and social development.

1.2 Bangladesh Bank (BB), a developing country central bank, is engaged in attaining developmental goals by supporting attainment of the inclusive growth and poverty reduction objectives of the government. Besides preserving monetary and financial stability, BB has remained proactive in its developmental role. Especially, in recent years, BB has brought about deeper engagement of the country's financial sector with a social responsibility driven financial inclusion strategy. To promote its developmental goals, BB has upgraded the country's financial market infrastructure by setting up fully automated nationwide online clearing system and hastening automation in banks. Notable initiates have been taken up to ensure appropriate regulatory and supervisory regimes for effective oversight of risk management, internal controls and customer interest protections. Several incentives like refinance lines from BB and limited interest subsidies have been made available to promote lending to the farmers, small enterprises and poor households. More or less all banks that are in operation in the country, local and foreign, private and state-controlled, have come forward in the financial inclusion drive. The paper targets to discuss the initiatives and experience of Bangladesh Bank in regard to its financial inclusion drives and developmental central banking in Bangladesh. Based on the secondary information, the paper attempts to draw some lessons that can be extended and generalized with respect to developmental central banking in developing countries.

2. Financial Inclusion and Developmental Central Banking in Developing World

2.1 There are arguments that central banks should pursue developmental goals actively in developing market (Gray, 2006). The recipe of developmental central banking is dramatically different from the historically dominant theory and practice of central banking, not only in the developing world, but, notably, in the developed countries themselves (Epstein and Grabel, 2007). Advocates of a developmental role for central banks argue that central banks that use a variety of tools such as credit allocation policies, regulated interest rates, direct lending to priority sectors, and so on, can play a more effective role. The evolution in the role of central bankers from pure monetary policy and financial stability to a greater role in propelling and sustaining inclusive economic growth is being driven by several trends. Many central banks in developing economies share this vision and have already pioneered the adoption of methods to support new technologies, increase financial literacy and boost financial inclusion (Baer et. al, 2012). In this connection the most dramatic change and transformation have taken place in the central banking in developing world (Epstein, 2009). Krampf (2012) noted, in developing countries, central banks were much more emphatically 'agents of economic development' than in many richer countries. However, the role of central banking in supporting developmental policies varied from country to country, as a function of an array of complex factors, including inherited economic, financial and industrial conditions and structures.

2.2. This new focus of central banks on financial inclusion is observed in the vision of the majority of policy-makers in the developing world. It is because of the fact that access to formal financial sector can economically and socially empower individuals, in particular poor people, allowing them to better integrate into the economy, contribute to the development and protect themselves against economic shocks. However, it is to be mentioned that financial inclusion is not only the process of ensuring access to financial services, it must also be appropriate. Access has to be fair, transparent and cost effective and through mainstream institutional players (Kochhar, 2009). Only opening a bank account is not financial inclusion. Of course, access to bank account and credit facilities could be a short run targets, however, in the long run it is about credit worthiness of the financially included people to attain sustainable developmental goals. For attaining true objectives, supply-side initiatives must complement financial literacy or awareness- the demand side phenomena (Subbaro, 2013).

2.3 In recent years, a group of central bankers has developed their mandates in innovative ways to promote more inclusive and sustainable growth by bringing the promise of financial inclusion of the world's 2.5 billion unbanked population (Baer et. al, 2012). The G-20 has recognized financial inclusion as a key enabler of growth and inclusive financial sector is considered key to attaining the goals contained in the United Nations Millennium Declaration. A number of standard-setting bodies have accepted that the issues relating to financial inclusion need to be incorporated in the international regulatory framework (Blanchard, 2011). The creation of the Alliance for Financial Inclusion (AFI) as a global platform for sharing financial inclusion insights is a clear sign of this new vision. With a shared global agenda (the Maya Declaration - a framework for domestic and collective actions with the aim to bring more of the world's poorest people into the formal financial system.) and strong national targets to bring a positive impact to the lives of the poor, more than 100 AFI member institutions are creating a global momentum for change (Higgins, 2013). These initiatives have offered common grounds for international cooperation on the issue of financial inclusion.

2.3 On the way to attain developmental and financial inclusion goals, several developing countries have pioneered many of the smartest approaches. Even the charter of the central bank of Argentina was changed to incorporate the new approach. In March of 2012, the Argentinean Parliament approved a new charter for the Central Bank of Argentina that embodies some key goals of developmental central banking according to which 'the purpose of the central bank is to promote monetary stability, financial stability, employment and economic development with social equity, within the scope of its powers and under the framework of the policies determined by the national government' (Epstein, 2013). In line with their financial stability mandates, central banks have also focused on ensuring that supply side offerings are protective to the interests of smaller and poorer customers. For instance, in Malaysia, central bank played an active role in promoting financial education and ensuring fair treatment of consumers (Higgins, 2013). In the Philippines, the central bank helped to double the number of access points (banking offices and ATMs) in just over 10 years. In Nigeria, a package of measures relevant to financial inclusion has led to a 7 percent reduction in the number of Nigerians excluded from the banking system in just two years. The enabling regulatory approach by the Central Bank of Kenya, has resulted in mobile financial services being used by 23 million people via a mobile network of more than 90,000 agents; and in Tanzania, 45 percent of the adult population is using mobile financial services through 138,000 agents (GSMA, 2013). These are not isolated cases; other developing and emerging countries are seeing similar financial inclusion successes (Higgins, 2013).

3. Financial Inclusion and Developmental Central Banking-Bangladesh Perspective

3.1 As noted in the publication of BB (2012) on the developmental roles of central banking, the Bangladesh Bank is mandated by its charter to promote and maintain a high level of output, employment, and real income, fostering growth and development of the country's productive resources along with preserving monetary and financial stability. And, BB has remained proactive in its mandated developmental role, with monetary and credit policy stance supporting attainment of the government's inclusive growth and poverty reduction goals based on national aspirations and global visions like the UN MDGs.

3.2 Bangladesh Bank has been focusing on achieving its inflation targets while providing sufficient space in its monetary program for lending to activities which support broad-based investment and inclusive growth objectives. It has been using both monetary and financial sector policy instruments to achieve these goals. A number of steps have been undertaken over the years to ensure the stability of the financial system. For promoting economic development and economic stability, BB adopted two approaches: *One*, its financial inclusion and developmental finance campaign tries to engage the private financial sector to help reach underserved households and businesses with both banking services and credit to help generate employment, investment and growth. *Two*, it tries to promote financial stability by helping to channel credit away from destabilizing activities and toward productive investments. BB has been working to engage financial sector in its 'social responsibility' and 'financial inclusion' drives to promote financial and economic stability. Society and common customers are receiving due attention to the central bank's initiatives. In response to the BB's initiatives, total CSR expenditure of banks increased by more than eight times in last five years. To ensure improved customer services the 'Customers' Interest Protection Centre' (CIPC) was established in the head office of BB and in its branch offices in March 2012. Since the inception of the CIPC complaints have been coming to this centre everyday through telephones, mobile phones, e-mail and by post too. Recently a new department named 'Financial Integrity and Customer Services Department' has been opened for dealing with the complaints of the customers and clients of Banks and Financial Institutions more quickly and easily. Besides, for the improvement of the standard of customer services the banks have been advised to rationalize the charges, realized from the customers, as far as possible and to display the chart of the deposit and the interest rate as well as the schedule of charges in the suitable and easily noticeable places in the banks and also in their respective web-sites.

3.3. BB proved itself as an advanced organization in the pace of technological development. The implementation of Central Bank Strengthening Project (CBSP) started in late 2003 targeted to achieve the goal of automating its business process. The World Bank considers this project of BB as the most successful one of all projects taken in Bangladesh in recent time. BB has also taken numerous innovative initiatives to build a country-wide modern technology based, efficient and more secured banking system including automated payment systems, online banking system, online CIB service, mobile banking, e-commerce, new services in the Information Technology sector especially outsourcing facility, etc. Installation of National Payment Switch software has opened new windows of e-commerce in Bangladesh. Banking system of the country has responded tremendously to the initiatives of the Bangladesh Bank. Significant response among the banks is observed in adopting ATM, online and SWIFT during recent years. As of end 2009, about 47 percent bank branches were computerized, whereas the figure was around 90 percent as of end 2013 (BIBM, 2014).

3.4 The approach to financial inclusion would vary from country to country. Especially, extensive drive is required in a country like Bangladesh where a big section of population is excluded. In a recent speech of the Governor of Bangladesh Bank, financial inclusion is reckoned in Bangladesh as access to financial services from: one, officially regulated and supervised entities (banks and financial institutions licensed by Bangladesh Bank, MFIs licensed by the Micro-credit Regulatory Authority, registered co-operatives); and two, official entities themselves (post offices offering savings, money transfer and insurance services, national savings bureaus). In terms of above guideline, despite substantial bank branch expansion and increase of membership of MFIs and other institutions, about 25 percent of adult population is still financially excluded. A substantial proportion of the households, especially in rural areas, is still outside the coverage of the formal banking system and is therefore, unable to access mainstream financial products (Choudhury, 2014). BB has undertaken a comprehensive financial inclusion campaign to reach out with financial services to the disadvantaged population of the country. Along with moral suasion, a number of policy measures covering opening of bank branches, deposit and credit products, some of which are very innovative for our banking system, have been taken in this regard. These include: changing of branch opening rules from 5:1 to 1:1 (for opening 1 urban branch, 1 rural branch is to be opened), availability of highest quality banking services to farmers by allowing them to open banks account with minimum initial deposit (BDT 10 only); issuing branch licenses to all SME/Agriculture service centers; easy and effective access to banking services for physically incapable people, hard core poor, unemployed youth, freedom fighters etc.; relaxing conditions of loan repayment and providing fresh facilities to natural calamity affected farmers; mandatory participation in agriculture/rural credit for all banks including PCBs and FCBs; provision of agriculture credit to sharecroppers; formulation and implementation of Agriculture and SME Credit Policies and targets; putting emphasis on financing women entrepreneurs; arranging refinancing schemes for banks; developing ICT solutions (mobile banking, smart card etc.) for inclusive banking; encouraging creative partnership between banks and MFIs; agent banking, policy guidelines for Green Banking and introduction of financial inclusion oriented CSR, School banking, arranging cross country banking road show etc. Because of the remarkable pro-poor initiatives of the central bank, a recent article in China Daily (May 2014) termed the Bangladesh Bank governor as ‘Poor Man’s Governor’.

3.5 In regard to the facilitation of agricultural financing in Bangladesh, there are two state owned agricultural lending specialized banks to offer credit services to the agricultural sector. Alongside this, all commercial banks operating in Bangladesh are now extending agricultural credit, directly, through regulated Micro Finance Institutions (MFls) or through intermediaries in value chain. Total disbursements of agricultural credit are on steadily rising trend since 2009. Agricultural credit at concessional interest rate is being extended by banks to farmers for growing of pulse, spices, lentils and oilseeds. Banks get interest subsidy from government through BB against these loans. Local productions of these specialized crops are already contributing significantly towards reduction of import dependence. To support sharecropper farmers, BB launched a refinance scheme worth BDT 5 billion for landless sharecroppers in partnership with BRAC, the largest non-bank MFI in Bangladesh in 2010. Under this scheme, loans were provided to almost 15 million sharecroppers in 14 months till end 2013. Moreover, an ADB assisted crop diversification credit project is extending credit for growing of higher value crops (vegetables, fruits, flowers, spices, oilseeds) in the country’s poverty ridden north-western region. Apart from this, state-owned banks are extending loans to sharecroppers, a sizable number of whom are women farmers. BB exercises close monitoring on the activities and credit volumes in the agricultural sector.

3.6 In a major financial inclusion initiative, banks have opened over 10 million new bank accounts in names of small farmers and other rural and urban people of small means at no charge, with nominal initial deposits as low as Taka ten (about twelve US Cents). These accounts are being used by the account holders for receipt of agricultural input subsidies; social safety net payments etc.; besides use as savings and payments medium. With a view to fostering savings habits and financial literacy among the young, banks have launched ‘School Banking’ initiatives in schools. So far, almost all scheduled banks have opened around seventy thousands accounts for the school students. Besides, a DFID supported financial literacy campaign is underway to create mass awareness of benefits of opening bank accounts and using to best advantage of account holders.

3.7 The central bank issued policy guidelines for green banking in February 2011. According to the guidelines, all operating banks and financial institutions need to take effective measures to conduct environment friendly banking activities in the country. BB’s initiatives have made significant changes in regard to the creation of green governance frameworks in banks. By the time all banks formulated environmental policies and Green Banking Cells; and around three-fourth banks have formulated one or more sector specific environmental policy guideline. Banks have introduced green office guides for their employees and in some banks there are notable initiatives in regard to savings of paper, water and power etc. Bangladesh Bank has also issued a common reporting format to all the commercial banks to report green banking activities including the extent of carbon footprint in a structured way. Banks and financial institutions now regularly submit a quarterly report to Bangladesh Bank on their performance of green banking activities. BB has introduced a refinance line for banks against their loans to environmentally beneficial projects like renewable energy generation, installation of Effluent Treatment Plants and of new energy efficient technologies at a concessional interest rate. The green initiates of Bangladesh Bank were awarded in 2012, when the Governor of the central bank was presented with the title ‘Green Governor’ in the United Nations Climate Change Conference in Doha.

3.8 Considering SME development as one of the important development agenda of the country, BB has initiated a comprehensive policy and programs on SME credit. Accordingly, an indicative yearly target of disbursing SME credit by the banks and financial institutions were fixed for every year since 2010. A new department namely ‘SME and Special Programs Department’ has been established on December 2009 in BB, which is solely responsible for policy formulation, facilitating fund, monitoring and development of entrepreneurship in the SME sector. Besides, a separate inspection department has also been established in BB to effectively monitor this type of credit. BB, with the help of government and different development partners, is now implementing five refinance schemes for banks and financial institutions against their disbursed SME credit. With a view to mainstreaming SME credit, banks and financial institutions are advised to adopt cluster development policy. BB has already taken various initiatives for identifying different clusters around the country and is encouraging all stakeholders for further development of such clusters. As per directives of BB, banks and financial institutions are also coming forward for SME cluster development. Various small-scale manufacturing clusters have already been identified by this time in 20-25 districts of Bangladesh. Light engineering, agricultural machineries, handloom, handicrafts, leather and footwear, small garments are some mentionable clusters in which banks and financial institutions are disbursing SME credit.

3.9 For mainstreaming women in economic activities, BB has taken a number of initiatives to ensure women entrepreneurs to have access to financial facilities on simple terms and conditions. To ensure loan facility for the women entrepreneurs, at least 15 percent of total BB refinance fund for SME sector has been allocated for them at a reduced interest rate. Banks and financial institutions may sanction loan up to BDT 2.5 million to women entrepreneurs without collateral but against only personal guarantee under refinance facilities provided by BB. In order to include a large number of micro women entrepreneurs in the SME credit facilities, a policy of group based lending of up to BDT 50 thousand or above has been initiated. The share of women entrepreneurs in total SME loan disbursement has been increasing consistently.

3.10 In order to bring the vast unbanked/under-banked population under the umbrella of formal financial service BB has taken steps to introduce bank-led mobile financial services (MFS). Disbursement of inward foreign remittance and domestic fund; payment of utility bills, salary, allowances, pension; buying and selling of goods and services; balance inquiry; tax payment; Government subsidy payment and payment of the benefits of social safety nets can easily and quickly be provided through mobile financial services. To make MFS service more effective, 'Guidelines for Mobile Financial Services' was issued in September 2012. By the time over 50 percent banks were permitted to offer MFS services that are offering different mobile services through 240 thousand bank-agents countrywide. MFS has created an opportunity of fast and cost-effective transaction even to the remotest corner of the village as well as it has given access to modern banking services to the rural poor including the social safety net beneficiaries. Following recent issuance of agent banking guidelines, BB expects that there would be greater access to banking services in under-served areas with the scaling up of various pilot initiatives in 2014. This would complement the growth of mobile banking services where currently by end 2013, 13 million accounts were already in use.

4. Concluding Remarks

4.1 The social responsibility driven financial inclusion campaign launched by BB serves to keep productive sector away from involvement in speculative financing that eventually leads to asset price bubbles creation. Central bank's developmental role, therefore, act as an in-built stabilizer of the financial system. The policies and measures which have been undertaken so far in Bangladesh in the context of developmental and inclusive banking are in the right directions and have already started creating positive impacts. The banking services of the country have started reaching to the low-income groups and to the remote Bangladesh. Rural deposits and advances of the country increased from less than 13 percent and 8 percent in 2010 to above 18 percent and 10 percent respectively by the end of 2013. In between 2009 and 2013, SME financing increased by over three times which now constitute around 30 percent of total loans and advances of banks. Following a tremendous rate of growth, the users of the mobile banking services in the country exceeded 15 million.

4.2 Today, central bankers in the emerging and developing world have established a roadmap to create an innovative and enabling environment for financial inclusion through cooperation and shared experiences. Obviously, one size does not fit all, and goals and tools should be tailored to fit specific national needs and resource limitations; however, country initiatives and experiences offer valuable lessons in reshaping the approach of central banking to attain developmental goals. In the context of Bangladesh experience, it is proven that there need not be a trade-off between developmental central banking and financial & economic stability. It is also to be noted that the developmental goals of BB has been consistent with its capacity to implement and monitor the programs.

4.3 A central bank may bring visible success to the lives of the common people beyond inflation. Thus, central banks is required to develop broader expertise beyond an understanding of inflation to the understanding on issues related to employment, distribution, green technology, poverty and development. The central bank leadership is expected to focus on issues related to broader economic concerns and cooperate with others in the government and broader economy. Based on the experience of Bangladesh Bank, it can be stated that a central bank can develop explicit developmental goals, make them public and then report on their degree of success.

4.4 Designing target specific products and strategies for groups like women, farmers, small enterprises, sharecroppers worked tremendously for Bangladesh. These underserved groups are getting visible benefits and improving their living standards. Direct involvement of the central bank through refinancing brings positive results, as observed in the case of the country. Bangladesh is a very good example of channeling banking eservices to the low-income rural people in response to the central bank's initiative.

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