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Promoting Financial Inclusion for Poverty Reduction with Inclusive Growth: Bazlur Rahman Memorial Lecture

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1.1 I am much gratified to be chosen by Bangladesh Economic Association to deliver the memorial lecture in honor of the very distinguished late journalist Bazlur Rahman renowned for his intrepid professionalism, integrity, dispassionate objectivity and progressive outlook on sociopolitical issues. A rich crop of eminent (and by now senior) journalists in Bangladesh acknowledge debt of gratitude for the guidance and grooming they received from him in their professional careers. His contemporaries and disciples active in fields outside journalism, including politics and academia, fondly remember him as a warm hearted erudite man, keenly observant, principled and fair-minded in analyzing current events and developments. His dispassionate objectivity didn't ever mean passivity or indifference in social issues; he was steadfast in progressive views and convictions about the urgency of righting socio economic wrongs, including deprivation and poverty; partnering in activism with another celebrated progressive, his spouse Ms. Matia Choudhury, now the honorable minister for agriculture.

1.2 The sorrow and sense of loss in the demise of Mr. Bazlur Rahman is still fresh and acute in us, and I believe it will be fitting and appropriate for this memorial lecture to be on an issue at the core of his progressive convictions. *Accordingly my memorial lecture will be on widening and deepening financial*

1 Governor, Bangladesh Bank.

inclusion, an important tool for combating poverty and social deprivation with broad based inclusive growth.

2. Financial Inclusion: definition

2.1 *Financial inclusion is a major dimension of the broader notion of social inclusion (the antithesis of social exclusion), or peoples' opportunity for contributing to and benefiting from social and economic progress*. Poverty related deprivations in health, education and asset ownership are major causes of financial and social exclusion, curtailing or altogether blocking opportunities of employment, income, borrowing and so forth. Physical and mental debilities; discrimination by race, religion, caste, cult or gender; social disruptions from prolonged conflicts and wars are among other main causes of financial and social exclusion. The broad range of causative factors means that financial and social exclusion is likely to be seen in varying degrees in almost all countries, developing or developed; and therefore social and financial inclusion figures prominently in policy agenda even of mature developed countries. *Poverty related deprivations and exclusions are starker and more entrenched in low income developing countries like Bangladesh, with attendant higher urgency of remedial actions.*

2.2 Related to financial and social inclusion is the notion of *inclusive growth*, a growth process participated by and benefiting all population segments. *Inclusive growth stresses on equality of advancement opportunities rather than on equality by redistribution of income*; and is tolerant of 'good inequalities' that are incentives for competitive efficiency, like income differences arising from rewards for innovation, and for superior skills, aptitudes and education. Inclusive growth utilizing the unleashed creative energies of hitherto excluded population segments in growth pursuits is likely to be more broad based and robust, in terms of income and other metrics of well-being including human development, food security, environmental sustainability.

2.3 In daily life we need basic transaction services like accepting our deposits, lending us money for current expenses or for investment, effecting money transfers and settlement of payments. Financial inclusion means access to these basic financial services. Affluent urban individuals and businesses have ready access to these and other more complex financial services from banks and financial institutions, including insurance companies and capital market institutions. Banks and other formal financial institutions do not have many branches or service outlets in rural areas, small sized transactions with the poor being costly and un-remunerative for them. Illiteracy still prevalent among adults in rural areas is also a significant barrier to their accessing financial services from formal institutions. In cities and towns migrant day laborers from rural areas face yet another barrier to accessing institutional financial services in their lack of definitive present address.

Forming mutually owned co-operative societies was an officially supported early initiative in financial inclusion of rural and urban people of modest means in similar occupations. Once formed, these co-operatives focused on advancing interests of existing members, often falling prey to elite capture by more influential members, with little interest in risking dilution of control by expanding membership. In any case, the co-operative movement was not designed to target the poor owning little or nothing in assets.

Financial inclusion by way of the poor's access to small-sized loans for income generating self-employment activities (micro-credit) from microfinance institutions (MFIs) has been extensively employed in Bangladesh as a tool for combating poverty related deprivations, pioneered by Dr Yunus with the Grameen Bank in late nineteen seventies, and by now replicated worldwide. As elsewhere, ill informed, gullible people particularly in rural areas in Bangladesh have at times fallen prey to financial scams of pyramid /Ponzi schemes promising quick high profits, only to lose the investments in inevitable collapse of the schemes. To prevent such deception in MFI activities and to ensure that these are run with integrity and soundness, the Government of Bangladesh (GOB) has established the Micro-credit Regulatory Authority (MRA) chaired by Governor, Bangladesh Bank (BB) to license and supervize MFIs. The MRA being chaired by Governor of BB, the apex financial sector regulator has given a huge boost to credibility of MFIs licensed and supervised by MRA.

Typically, MFI membership commences with opening of deposit accounts with minuscule sums and short spells of group-based learning sessions for new members in basic minimum financial literacy, followed by loan disbursements for income generating self employment pursuits. The deposit, borrowing and repayment transactions with MFIs help micro-credit borrowers prepare themselves for eventually accessing larger loans and other financial services from formal institutions like banks.

2.4 Despite substantial expansion of bank branches and the roles of co-operatives and MFIs, financial inclusion in Bangladesh has much further to go in adequately covering all population segments and all economic activity sectors. About one-fifth to one-fourth of the population still live in extreme poverty, many of them incapable of undertaking micro-credit supported self-employment initiatives due to old age or other debility. With few financial service outlets reaching out to this weakest population segment, accessing whatever modest social safety net payments they are entitled to require them to incur substantial cost in time and travel expenses. Again, not that it is only the poorest that suffer from financial exclusion. MFI borrowers successfully breaking out of extreme poverty and outgrowing eligibility for micro-credit often find themselves in a 'missing middle', still not deemed eligible for larger loans by banks or other formal institutions. Significant market gaps and market failures persist in financing of important growth oriented economic activities like agriculture and SMEs. *These exclusions and gaps are holding down economic growth and poverty reduction; and* **f***inancial inclusion is therefore a high policy priority in Bangladesh for faster, more inclusive growth and poverty reduction***.**

3. Measuring financial inclusion

3.1 As yet without a widely adopted uniform definition, financial inclusion is reckoned in Bangladesh as access to financial services *from entities supervised by official authorities, or from official institutions,* including:

a. Banks and financial institutions supervised by BB,
b. MFIs supervised by the MRA,
c. Credit co-operatives supervised by the Registrar of Co-operative Societies,
d. Insurance companies supervised by Insurance Regulatory Authority,
e. Capital market institutions like investment banks, merchant banks and stock exchanges supervised by the Securities and Exchange Commission (SEC),
f. Post offices of the government offering savings, money transfer and insurance services; National Savings Bureaus issuing government savings instruments.

The clientele of secondary and tertiary financial service providers (like insurance companies, capital market institutions) are also recipients of primary financial services of deposit taking, lending and money transfers. Their double counting needs to be avoided while measuring the extent of financial inclusion.

Deposit services for safekeeping of savings is the stepping stone in accessing credit and other financial services on a continuing basis from banks, financial institutions, MFIs and cooperatives; *the coverage of <u>deposit services</u> (number of deposit accounts /membership in deposit schemes in MFIs, cooperatives, post* *offices as percentage of total population) is therefore taken as a comprehensive primary measure of financial inclusion.*

3.2 *The coverage of credit services across income/occupational/gender groups and across economic activity sectors is another yardstick of financial inclusion,* important from the viewpoint of growth and combating poverty. This measure is more qualitative, expressed in terms of gaps, exclusions and barriers to accessing financial services.

4. Approaches in widening financial inclusion- progress thus far

4.1 Early post-liberation financial inclusion initiatives in Bangladesh comprised:

i. Expansion of bank branches in rural areas (all domestic banks were nationalized in 1971 upon liberation of Bangladesh), and
ii. Promotion of mutually-owned co-operative credit societies offering deposit and credit services to members.

The better-off rural elite benefited from these initiatives, but financial inclusion of the broad masses of illiterate, innumerate rural poor remained limited. As mentioned earlier, the co-operatives tended to fall prey to 'elite capture' by powerful groups uninterested in diluting control by expanding membership; and the co-operative movement actually was not targeted to the poorest population segments owning little or nothing in assets. Rural branches of banks focused mainly on crop loans to farmers, there lending models not geared towards reaching out to the poorer landless illiterate unable to handle the paperwork involved in bank borrowing. The regulated low interest rates on bank lending prevalent up to late nineteen eighties, insufficient to cover the high costs of managing small loans to borrowers in dispersed rural locations, was also a deterrent.

4.2 Grameen Bank and the MFIs brought about a major breakthrough in reaching out to the rural poor. Their lending models specifically included imparting of necessary minimal literacy and numeracy to aspiring member borrowers; they have also been unrestricted in realizing interest and service charges at rates covering their higher costs. Their programs were designed with some degree of gender bias favoring women, in the presumption that women's enhanced financial standing and stature in the traditionally male dominated families will lead to better upbringing and education of their children.

Besides extending micro-credit, many MFIs in Bangladesh are collaborating with insurance companies in extending microinsurance to the poor, offering modest covers such as *credit life insurance* ('debt dies with debtor'*), health and accident insurance (*for sicknesses and injuries requiring hospitalization etc*), and property insurance (*usually for livestock bought with MFI loans) at affordable rates of premium. Typically the MFIs act as partner agents of the insurance companies, collecting microinsurance premia on their behalf, most often by deduction at source while disbursing micro-credit loans. Regular published data on microinsurance in Bangladesh are as yet unavailable; a February 2007 survey posted in CGAP's *microfinance gateway* (www.microfinancegateway.org) reported 10 insurance companies in partnership with 61 MFIs, offering differente microinsurance products in 81 schemes, with cumulative premium collection of over Taka 11.2 billion from about 4.5 million clients.

Some empirical studies, employing differing methodologies and covering differing time spans, dispute the poverty reduction impact of micro-credit claimed by its protagonists. Episodes of borrower distress from rigorous micro-credit repayment disciplines, in many cases compounded further by multiple MFIs lending to the same borrower, occasionally do appear in newspapers. It is easy to see that self-employment initiatives financed by micro-credit are far from being risk free for borrowers and lenders, ill-chosen initiatives and lax loan sanction and management disciplines can and do land lenders and borrowers occasionally in difficulties, requiring prompt but appropriately flexible corrective responses. Such difficulties do not negate the reality that financial inclusion by way of micro-credit indeed unlocks opportunities for the despondent poor to lift themselves out of poverty, unleashing in them the optimism and creative energies necessary to retry and get over occasional setbacks.

Another criticism that micro-credit does not help the poorest of the poor is not tenable because micro-credit is intended only for those who can use it in income generating activities. Those unable to do so because of old age or other infirmity need to be supported by outright transfers from the social safety net (the traditional safety net offered by extended families exists no longer, the extended families breaking up into smaller ones), and here financial inclusion helps recipients by eliminating or reducing costs they face in accessing the safety net payments.

Social innovations promoting financial inclusion like micro-credit and the programs designed to bridge market failures and gaps in agricultural and SME financing help spawn diverse cycles of other innovations by entrepreneurs in the real sector, fostering broad-based inclusive growth in the true sense. For instance, SME financing has helped innovative entrepreneurs in small light engineering workshops in Bangladesh to develop and expand into a huge network producing plant/machinery spares (and sometimes plants/machines in entirety) of all descriptions for the manufacturing, transportation, construction and agricultural sectors, at fractions of import costs. In early nineteen eighties the emerging apparels export sector had scant access to foreign exchange for their import of inputs. The innovation of back-to-back usance LCs for input imports against export LCs from buyers got around the problem, unleashing decades of sustained growth.

Table 3.1 Status of Financial Inclusion in Bangladesh

Year	Adult Population* (millions)	Population per bank branch (millions)	Number of bank deposit A/Cs (millions)	Deposit A/Cs as % of adult population	Number of members in MFIs (millions)	MFI members as % of adult population	Number of members in cooperatives (millions)	Cooperative members as % of adult population	Financial Inclusion** as % of adult population
1999	73.16	18669	27.30	37.32					
2000	75.16	18347	28.40	37.79					
2001	77.18	19886	30.10	39.00			7.65	9.91	
2002	79.59	20753	30.90	38.82			7.67	9.64	
2003	80.80	21406	31.30	38.73	14.63	18.11	7.57	9.37	66.21
2004	82.25	21443	31.60	38.42	14.40	17.51	7.76	9.43	65.36
2005	83.80	21420	33.10	39.50	18.82	22.46	7.92	9.45	71.41
2006	84.60	21171	34.50	40.78	22.89	26.95	8.03	9.45	77.33
2007	84.95	20920	35.70	42.02	20.83	24.52	8.22	9.68	76.22
2008	85.78	20566	37.60	43.83	20.90	24.36	8.44	9.84	78.04

Source: Scheduled Bank Statistics, Bangladesh Bank and Statistical Year Book of Bangladesh, BBS

* Adult population is defined by BBS as population 15 years and above

** Financial Inclusion is measured here as

(No. of bank deposit A/Cs + No. of MFI members + No. of members in cooperatives)/Adult population*100.

Post offices and government savings bureaus not included as these offer no credit services

4.3 The number of deposit accounts in banks and the number of members in MFIs and co-operatives are growing steadily, but the rate of increase has slowed in recent years. About 25 percent of the adult population is still to be covered by deposit and other financial services from regulated institutions (table 3.1), quite probably the hardest to reach. In access to credit, a ‘missing middle’ persists between the poorest served by MFIs, and the relatively better off served by banks. Small businesses outgrowing eligibility for micro-credit from MFIs often find themselves considered still too small by banks for their lending; sharecroppers not so poor as to be eligible for micro-credit from MFIs are deemed ineligible for crop loans by banks, with little or no collateral to fall back upon in events of default. In terms of sectors of economic activity, important areas like agriculture, off-farm rural output activities and environment friendly renewable energy remain underserved by banks and other institutional lenders.

4.4 BB and the GOB have adopted several remedial and promotional measures to bridge the gaps in, and to deepen financial inclusion. In SME financing, BB has made available refinance lines for banks against their agricultural and Small and Medium Enterprise (SME) lending; multilateral development partners such as the IDA and ADB are supplementing BB's refinance lines with their co-financing. Besides, BB is allowing banks to open SME service booth in areas with no branch banking coverage of their own.

The agricultural credit program announced by BB for FY 10 enjoins all banks to engage in lending for a comprehensive range of on- and off-farm rural economic activities, with refinance lines available to them from BB in case of need. A Taka 2.0 billion refinance line has been introduced in FY 10 against bank loans for environment friendly investments in solar energy, biogas plants and effluent treatment plants. In FY 10 BB has also introduced a first ever Taka 5.00 billion refinancing line against loans to sharecroppers in a group-based special program designed by a major MFI.

In issuing new branch licenses to banks, BB has been following a policy of requiring at least one in every five new branches to be in rural locations; with a view to pushing forward banking services physically closer to the rural population.

BB has also been exhorting banks and financial institutions to embrace fostering financial inclusion as a Corporate Social Responsibility (CSR) obligation. To mitigate risks in agricultural production (and hence also in agricultural financing), introduction of crop insurance has been included in GOB's Food Policy agenda. Introduction of a scheme of partial guarantee for mitigating SME lending risks likewise merits consideration.

A Challenge Fund in the ongoing DFID supported BB initiative for automation of the payments system in Bangladesh, the Remittance and Payments Partnership (RPP) project, is promoting innovations of faster and cheaper remittance and money transfer services; broadening and deepening financial inclusion particularly of rural recipients of remittances from family members working elsewhere within or outside the country. Partial grant support incentives from the Challenge Fund has already spawned a number of new IT based remittance delivery processes that are superior in speed and affordability for users. The soon to commence online automated clearing and settlement of cheques and electronic fund transfers by the Bangladesh Automated Clearing House (BACH) will hopefully trigger innovation of yet other new service packages custom tailored to needs of specific client segments, further widening and deepening financial inclusion.

4.5 GOB has been providing lending resources from annual national budgets for micro-credit (through PKSF) and for SMEs (through the SME Foundation) with some gender bias towards empowerment of women. Financing lines from government budget have also been made available against loans to rural poor for their basic shelter housing in a number of schemes titled Grihayan, Ashrayan, Returning Home, and One home-One farm.

The Post Office Department of the government has been actively engaging with banks, mobile telephone companies, and other external and internal remittance intermediaries to offer faster remittance and money order delivery to recipients.

4.6 Lately the government has embarked on a program of delivery of fertilizer and irrigation fuel subsidies for agriculture directly to individual farmers. To make this a success, Bangladesh Bank has asked state owned agricultural and commercial banks to ensure that their rural branches open bank accounts with deposits as low as Taka 10 in the names of farmers against identity cards/papers issued by Agriculture Department. Over three million new bank accounts have already been opened; privately owned banks are also encouraged to open bank accounts of farmers in their branches in rural areas. Direct delivery of government subsidy into the bank accounts of individual farmers will be a huge leap forward in extending and deepening financial inclusion.

Very recently, Bangladesh Bank organized a cross country banking sector road show led by the Governor and other senior management members. In this road show commercial and specialized banks came forward to connect and interact with the general population, providing information and receiving user feedback about their lending, deposit, remittance and payments service packages, and building up in the general population literacy on financial services and awareness against money laundering and illegal hundi channels in remittance delivery. This major new campaign-mode drive in widening and deepening financial inclusion will be repeated, appropriately refined, in other regions of the country.

5. The way forward

5.1 We thus see that progress attained thus far in financial inclusion is quite fair, with deposit services from regulated entities available to more than three fourth of the adult population (cf. table 3.1). However, as already mentioned, much still remains to be done in deepening access to credit and other financial services in several shallow patches, and in bridging the remaining more recalcitrant gap. High costs of managing portfolios of small-sized loans to borrowers in dispersed locations mean high interest rate/service charge burdens on the borrowers, rendering their use of micro-credit for low risk but low return output activities unviable. Advances in information technology offer windows of opportunity for breakthrough in reducing the costs of managing small loans to borrowers in remote locations, with smart card /mobile-phone based arrangements for disbursement and recovery of loans. Full advantage need to be reaped from these new windows of opportunity. The number of mobile phone subscribers is expanding fast in Bangladesh, already covering more than half the adult population (cf. tables 4.1, 3.1). Lower borrowing costs made possible by IT based remote delivery and recovery of loans will enable many currently excluded individuals and businesses to borrow for output activities that generate low returns but also involve low risks.

5.2 BB's policies are currently focusing on leveraging the potential synergies in innovative cost-saving partnerships between banks, MFIs, and telecom/mobile phone service providers in bridging the remaining gaps in financial inclusion,

Table 4.1 : Growth trends and teledensity of mobile and fixed phone

	2004	2005	2006	2007	2008	2009
Mobile phone subscribers (millions)	4.15	9.27	20.8	34.38	43.7	46.69
Fixed phone subscribers (millions)	0.83	0.87	1.02	1.19	1.28	1.44
Total subscribers (millions)	4.98	10.14	21.82	35.57	44.98	48.13
Growth rate of mobile phone subscribers	...	123.37	124.38	65.29	277.11	6.84
Growth rate of fixed phone subscribers	...	4.82	17.24	16.67	7.56	12.50
Total growth rate	...	103.61	115.19	63.02	26.45	7.00
Teledensity (in percent)	3.62	7.25	15.39	24.71	27.91	32.09

Commission (BTRC); Figures areend June

with due attention to the risk management, consumer protection and systemic stability issues likely to arise in the new arrangements. Some of such partnership proposals have already been approved and operational. A number of GOB owned public utilities are collecting utility bills from users through mobile phone based arrangements, saving the bill payers travel costs to and queuing up time in traditional crowded receipt booths. Similar cost saving IT based remote delivery arrangements are possible for numerous government payments in small amounts like social safety net allowances for the eligible poor, pension payments for retirees, salary subvention payments for teachers in privately run schools, subsidies for farmers and so forth. Well-designed IT based arrangements of this kind for these payments will prevent leakage or wrongful delivery of benefits, besides deepening financial inclusion.

5.3 To conclude, financial inclusion combats poverty by unblocking advancement opportunities for the disadvantaged poor, thereby fostering social inclusion and inclusive socioeconomic growth. In Bangladesh, following bank branch based, co-operatives based and MFI based phases of major expansion, we are pinning hopes and efforts on IT based cost-saving innovations for another phase of major breakthrough in closing the remaining gaps and shallow patches in financial inclusion.

The tasks of promoting financial inclusion and poverty eradication may never be seen as completed once for all; natural or man made disasters quite often can and do push the affected population sections into hardship and exclusion. Also, poverty is a relative rather than absolute notion in perception. Regardless of however much affluent a society is, extremes of inequality will always be seen as constraining social and financial inclusion of the less advantaged population sections. This is why social and financial inclusion figures prominently in social charters/ social policy agenda even in mature developed economies.