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Financial inclusion as a tool for combating poverty- the Bangladesh approach

1. Introduction:

Basic financial services including deposit, payments and credit services are recognized as entitlements of all citizens; particularly in advanced economies (US has a federal law prohibiting discrimination by banks against lower income neighborhoods, and some state laws mandatorily requiring banks to offer basic accounts for low cost banking services, UK have government programs promoting financial inclusion).

Despite substantial bank branch expansion and emergence of microfinance institutions (MFIs), scant access to basic financial services still remains a deprivation suffered by large segments of the poorer rural and urban population in Bangladesh, more hurtful than other deprivations in restricting opportunities of freeing themselves from the poverty trap.

Financial inclusion of the poorest, particularly their access to small-sized credit for income generating self-employment activities (micro-credit) is a major tool in Bangladesh for combating poverty; pioneered by Nobel laureate Dr Yunus in the late nineteen seventies and by now replicated worldwide extensively. The coverage of financial services is still incomplete however, with gaps both at the lowest end and at some patches up the income ladder. Financial inclusion is therefore viewed as a high policy priority in Bangladesh, for more inclusive and more equitable economic growth.

2. Definition and measurement issues in financial inclusion:

With no widely adopted uniform definition, financial inclusion is reckoned in Bangladesh as access to financial services from:

a) 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

b) Official entities themselves (post offices offering savings, money transfer and insurance services, national savings bureaus).

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 including MFIs and cooperatives; *the coverage of deposit services (number of deposit accounts /membership in deposit schemes in MFIs, cooperatives, post offices as percentage of adult population) is therefore a comprehensive primary measure of financial inclusion*.

The coverage of <u>credit services</u> across income/occupational/gender groups of the population and across economic activity sectors is another yardstick of financial inclusion important from the viewpoint of combating deprivation and poverty. This measure is more qualitative, expressed in terms of gaps, exclusions and barriers in access to financial services.

<u>3. Approaches in widening financial inclusion- progress thus far:</u>

Early post-liberation financial inclusion initiatives in Bangladesh comprised:
i) Expansion of rural branches of banks (all of which were nationalized in 1971 after liberation of Bangladesh), and
ii) Promotion of mutually-owned co-operative societies offering financial and other specified services to members.

The better off rural elite benefited from these initiatives, but success in financial inclusion of the broad masses of illiterate, innumerate rural poor remained limited. The co-operatives tended to fall prey to 'elite capture' by powerful local groups uninterested in diluting control by enrolling poorer masses in large numbers. Rural branches of banks focused mainly on crop loans to farmers, their lending models were 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 the late nineteen eighties, not covering the high costs of managing small loans to borrowers in dispersed rural locations, was also a deterrent during that period.

The Grameen Bank and the MFIs brought about a major breakthrough in reaching out to the rural poor. They adopted lending models specifically including imparting necessary minimal literacy and numeracy to aspiring member borrowers; they were also free to realize interest and service charges at rates high enough to recover costs. Their programs also included some gender preference for female borrowers, in the expectation that improvement in their financial standing in the traditionally male dominated families will lead to improved better upbringing and education of their children.

While the number of deposit accounts in banks and memberships in MFIs and co-operatives are growing steadily, the rate of increase has slowed in the recent years, and about 25 percent of the

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 adult population is still to be covered by deposit and other financial services from regulated institutions (table 3.1); quite probably the neediest but hardest to reach. In access to credit, a 'missing middle' has emerged in the recent years 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 too small by banks for their lending, landless sharecroppers not so poor as to be eligible for micro-credit from MFIs are considered ineligible for crop loans by banks, with no collateral for banks to fall back on in events of default. In terms of sectors of economic activity, major areas like agriculture, off-farm rural output activities and environment friendly renewable energy remain underserved by banks and other institutional lenders.

Bangladesh Bank (BB) and the Government of Bangladesh (GOB) have adopted several remedial measures to bridge these gaps in financial inclusion. BB has kept open refinance lines for banks against their loans to Small and Medium Enterprises (SMEs); multilateral development partners such as the IDA and ADB are supplementing BB's refinance programs with their co-financing lines. 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 landless sharecroppers in a group-based special program designed by a major MFI. Further, BB has been urging banks and financial institutions to embrace specific commitment to financial inclusion as a Corporate Social Responsibility (CSR) obligation.

The GOB has been providing from the national annual budgets lending resources to MFIs (through PKSF, an apex financing agency for MFIs) for rural on- and off-farm self-employment micro and SME credit; with some gender bias towards empowerment of women. Financing lines from government budget are available also against loans to rural poor for construction of their basic shelter housing, in a number of schemes titled Grihayan, Ashrayan, Returning Home, and One home-One farm.

4. The way forward:

Although fair progress has thus far been achieved in financial inclusion (cf. table 3.1), much remains to be done in deepen inclusion in several patches where it is still shallow, and in bridging the remaining more recalcitrant gap; needing a new major breakthrough. High costs in management of portfolios of small sized loans to borrowers, rendering many of their possible lower return but lower risk output activities unviable. Advances in information technology now offer a window of opportunity for breakthrough in reducing the costs of managing small loans to borrowers in remote locations; with smart card based / mobile phone based arrangements for disbursement and recovery of loans. Lower costs of loans will enable currently excluded individuals and businesses to undertake new economic activities that generate lower returns but also involve lower risks.

Over the near term BB's policies will focus on leveraging the potential synergies in partnerships between banks, MFIs, and telecom/mobile phone service providers in bridging the remaining gaps in financial inclusion; with due attention to the risk management, consumer protection and systemic stability issues that may arise in these new arrangements. A few such partnership proposals already received are under scrutiny.