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Link between the financial inclusion and Economic Growth: Unconventional Monetary Policy in Bangladesh

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Bangladesh reached a lower middle economy status in FY15 by attaining per capita income of USD $1,314. In the World Bank standard, the graduation to the status of lower-middle income country is ensured if the per capita income stands at $1,045 on an average for three consecutive years. On the basis of this consideration the World Bank has recognized Bangladesh as lower- middle-income country after 44 years of her independence. To reach the upper-income country status, Bangladesh needs to grow at a faster rate with per capita income in between $4,036 to $12, 475.

Bangladesh has been growing on an average six (6) percent over the last 10 to 12 years (Chart-1). Lately, this topic has become the center of attention and many academicians, policymakers, and researchers see that as a trap. They are debating over how to get out from this 6 percent growth trap. To get out from this trap, we also need to increase investment to GDP ratio. Need to create a favorable environment to increase domestic and foreign investment. We need to increase innovative investment in Agriculture, Manufacturing, and Service sectors. Investing in infrastructure development is needed for higher growth. Another tool to reach upper-middle-income countries is boosting up exports sector, increase Foreign Direct Investment (FDI). There is no doubt that all these factors are crucial, and the fiscal policy plays a very significant role in achieving economic growth of any country. However, it is also true that the role of the financial sector and monetary policy filled an important gap in the growth process. This policy note will focus on the link between finance and growth suggest strategies.

Growth theory suggests that to have long-run growth trend we need to increase total factor productivity that is in another word technological development. Innovation plays a significant role in the sustainable development of any country in the world. However, at present Bangladesh has all the favorable conditions to get out from this trap and reach middle-income country status. Bangladesh is lately enjoying the dividend from demographic in terms of higher working-age people. Evidence showed that developed countries in the world such as Japan, China, Vietnam, the Philippines, Thailand enjoyed this opportunity before reaching upper middle-income countries.

Like other developing countries, Bangladesh initiated financial sector reform program during 1990's. The main objectives of the financial sector reform programs were: i) Gradual elimination of credit ceiling to different banks/sectors/areas etc. ii) gradual deregulation of interest rate; iii) gradual removal of restrictions on the entry of new financial institutions (both local/ foreign) into the financial system, and iv) phased withdrawal of restrictions on foreign currency payments.

Chart -1 and 2 show that since 1989 consumption, investment and GDP jumped upward showing the indication of the positive impact of the financial sector reform policies on economic growth.

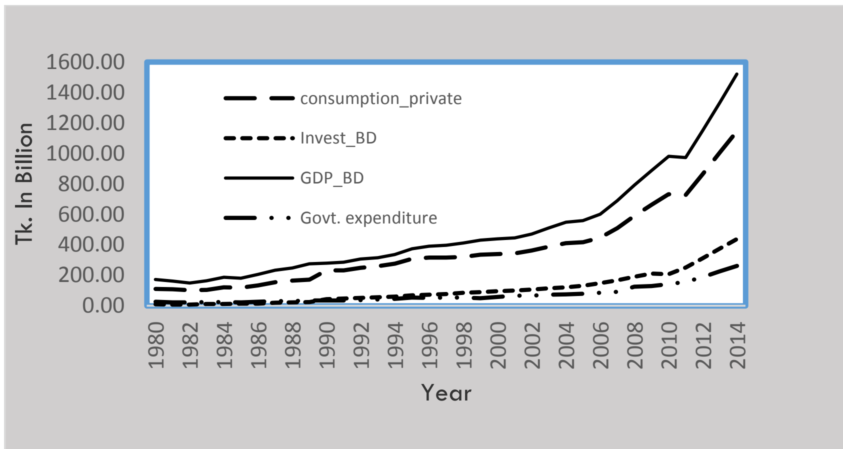


Chart-1: Trends of GDP, Consumption, Investment and Government Expenditure

From the above chart, it is evident that since 2010 consumption, investment and GDP all shows upward trends despite global recession implying the positive impact of massive financial inclusion drives of present Governor and Government.

Like other developing countries Bangladesh initiated a financial inclusion drive to include unserved, and underserved poor people in the financial system since 2010. Bangladesh Bank directed monetary and financial policies towards financing of productivity and sustainability enhancing output initiatives. Bangladesh Bank has adopted motivational initiative by arranging road shows, fair, campaign and CSR initiatives; Technology driven initiatives is taken by **d**igitization/modernization of the payment system.

P**olicy level support has been given on c**oncessional refinance against agricultural, SME and green financing; Area cluster based support packages for MSME; Rural bank branch expansion;Off branch agent-based financial services delivery using MFIs and mobile phone/Smart card based banking; No- frill accounts for farmers and other disadvantaged people.; Bangladesh Bank made it mandatory for all commercial banks domestic and foreign to disburse at least 2 % percent of their total loan and advances, which is 5 % for newly licensed banks in Bangladesh.

BB has taken on board all banks and financial institutions in Bangladesh in a countrywide inclusive financing promotion campaign. BB has set up a Taka 2 billion revolving refinance scheme to support lenders to green financing initiatives. Under this system, banks can claim refinance facility from BB at the bank rate (5%) against their direct finance at 9% for green products and 11% in case of funding through MFI linkage. Bangladesh Bank has taken an innovative re-financing scheme of Tk. 5.0 billion revolving fund with BRAC in 2009-10 at 10 percent interest (flat rate) for the neglected sharecroppers who are marginal farmers and have hardly any formal access to finance.

Under the Credit Program for Sharecroppers starting from FY 2009-10, Tk. 13.28 billion has been disbursed to 863,000 sharecroppers up to June 2014. The BRAC has been operating this program in 250 upazillas of 48 districts across the country. During the past five years Bangladesh Bank has brought 13.5 million people under banking service which includes farmers, hardcore poor population, unemployed young men/women, freedom fighters, beneficiaries of social security program, small life insurance policyholders, schools students, garments workers, city cleaning staffs, street children, etc. Other than farmers' Tk. 10 account, 3.6 million accounts have been opened to distribute financial aid to different social security program beneficiaries, unemployed young men/women, hardcore poor, freedom fighters, destitute beneficiaries under Hindu Welfare Trust, small life insurance policy holders and school students. 47 banks have launched school banking schemes reaching out to young school students. Up to December 31, 2013, a total of 2,86,479 students have opened accounts with savings of Tk. 3.04 billion. As a result, income per capita increased which in turn increased consumption, investment and GDP, and this help us to uphold real GDP growth up during the financial crisis (Chart-5).

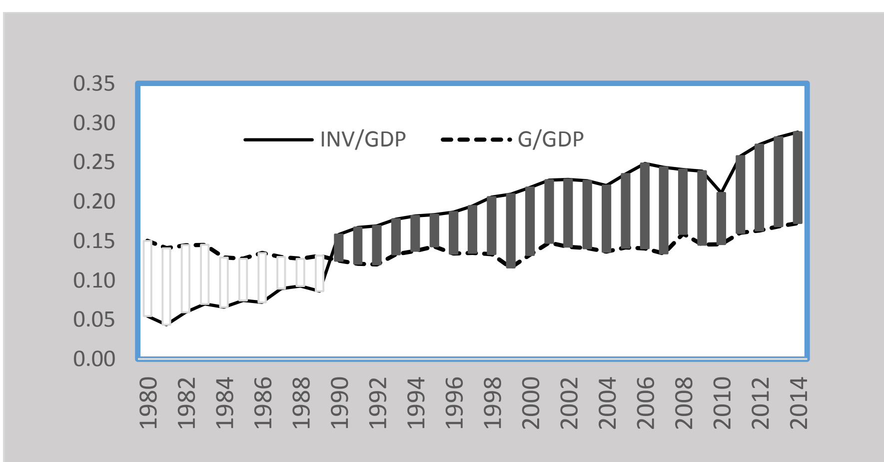
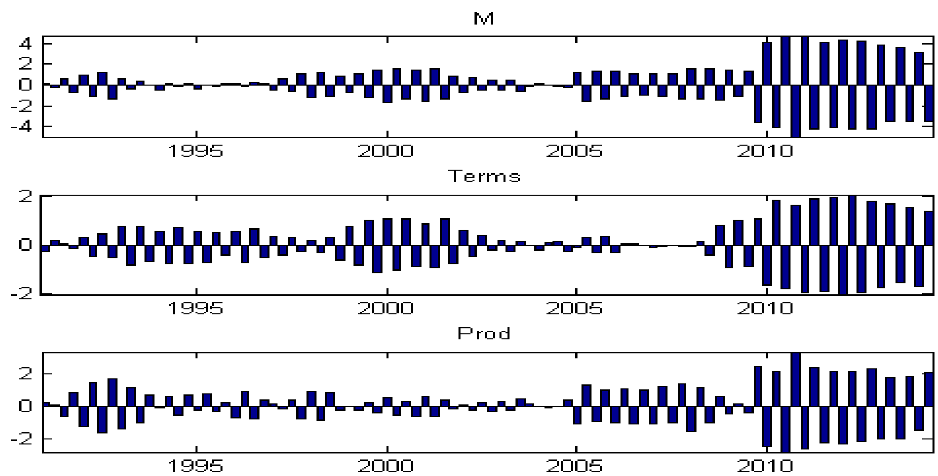


Chart-2: Trends of GDP, Consumption, Investment and Government Expenditure

Results from Dynamic Stochastic General Equilibrium (DSGE) model: Historical Shock Decomposition

Policy analysis over the period from 1990 to 2013-14 show that from 2010 during financial inclusion drive of Bangladesh Bank the impact of monetary policy shock, terms of trade shock and productivity shock all increased significantly in output compared with the other periods (Chart-3) showing increased economic activity during these years when the present Governor initiated financial inclusion drive by taking all bank on board through priority lending in agriculture, SME particularly women entrepreneurs, environmentally sustainable financing,

Chart-3: Historical Shock Decompositions of GDP Growth



Conclusion:

Although there is no one size fit policy for all, Bangladesh can be benefited by implementing sustainable financing policies to increase output. Financing in research and development would be key to achieving higher long-term sustainable GDP growth. Investment to increase quality human capital like South Korea, innovation in policies and a product like developed economies will get a higher sustainable return. Financial inclusion policies would ensure equity there is also need to reward efficiency to get a higher performance. A good coordination between monetary and fiscal management, high saving rate, investment in the greater value chain, trade openness are the key to achieving higher growth path.
