

provided since 2010. But even this is far short of estimates of what the banks would require if Basel III has to be complied with. One estimate places the requirement at Rs.5000 billion over the next five years.

Second, with the government still looking to the banks to provide the credit that would finance private investment (in areas varying from housing to power) and consumption (of automobiles and much else), non-performing loans are bound to increase. Hence, expectations are that the sums required for recapitalising the increasingly weak bank balance sheets would increase.

Third, since the start of the process of recapitalisation, the kind of capital required to beef up the capital on bank balance sheets has changed. Increasingly what is required is tangible common equity capital. If this has to be ensured while keeping the government's equity holding in public banks constant, much public resources would be required. D. Subbarao, an erstwhile governor of the RBI, had estimated that the government, which owns 70 percent of the banking system, will have to pump in Rs. 90,000 crore equity to retain its shareholding in the Public Sector Banks (PSBs) at the current level to meet the norms. It must then provide resources in the budget to buy into equity, with attendant implications for expenditures. If revenue increases cannot finance those expenditures, the fiscal deficit will widen, which goes against the self-imposed targets of the government. This has set off a demand that public sector banks should sell new shares in the open market to finance recapitalisation. But there could be one problem. Current law requires that the government should hold at least 51 per cent equity in public sector banks. A case is being made that reducing public shareholding from current levels to 51 per cent will not yield adequate capital for recapitalisation

that permits realisation of Basel III standards. Subbarao, for instance, is reported to have argued that "fiscal constraints pose significant challenges" to the efforts to re-capitalise banks and to ensure that they meet Basel III norms, but bringing down government holding to below 51 per cent can resolve the problem. The case for recapitalisation has been converted into a case for privatisation.

Thus, the call for privatising public banks also predates Rajan. The Narasimham Committee on Banking Sector Reforms had, as far back as 1998, called for a reduction of the government holding in 'public' banks to 33 per cent to make them more dynamic. The Percy Mistry Committee had gone further to argue that privatisation is needed because state-ownership had adversely affected the quality of financial intermediation. The only change now is that the case is being built on the grounds that privatisation is needed to ensure capital adequacy.

Thus, implementing this feature of the financial reform agenda is more difficult, since it requires changing the law, which in turn, needs political support that might be difficult to garner.

Financial Inclusion- Panacea for Poverty Reduction in India

Debasmita Padhi
II Year

"The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little."

- Franklin D. Roosevelt

Background

Poverty reduction has been an important goal of development policy since the inception of planning in India. However, a sizeable section of the population, particularly the vulnerable groups, such as weaker sections and low income groups, continue to remain excluded from even the most basic opportunities and services provided by the financial sector. Despite being one of the ten fastest growing economies of the world, India is still home to one-third of the world's poor. The Five Year Plan puts emphasis on adopting 'inclusive growth' as a strategy for poverty reduction. Therefore, ensuring access to financial services which include the entire gamut of savings, credit, insurance, remittance, etc to the excluded majority assumes significance in the Indian context.

The nationalisation of banks in India took place in the year 1969 with the focus on the social responsibility of banks in providing financial services to the poor and needy. Today, there are more than one lakh branches of scheduled commercial branches in India. But how many people actually have access to banking services? It is evident from the World Bank Findex Survey (2012) that the majority of the rural population, particularly in the rural areas, still remain excluded from the purview of banking facilities present in the country. As put so aptly by Amartya Sen, poverty is not merely insufficient income, it is, inter alia, the absence of the ability of the large numbers of poor - the 'bottom of the pyramid' - to participate in economic and political systems.

Present Scenario

The reason for lack of access to financial services by the majority of households could be several. Absence of banking

network in proportion to number of household and lack of financial literacy among the poor may be the most prominent reasons among them. Head count ratio of poverty is inversely proportional to the index of financial inclusion - Example, among SAARC nations, Sri Lanka has the high(est) FI Index and hence its head count ratio of poverty is the least. To broaden the scope of the formal financial sector in India, the Committee on Financial Inclusion under the chairmanship of Dr. C.Rangarajan had recommended setting up of two funds - Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF). The two funds have been established with NABARD, which is the coordinating agency of the financial inclusion initiative, with respect to creating awareness as well as providing physical facilities in the form of banking correspondents/facilitators.

Several other efforts have been made too. The Department of Financial Services in the Ministry of Finance, GOI and the Reserve Bank of India, has issued various instructions to financial institutions and banks on the implementation of financial inclusion programmes in India. The rural poor have immense need for banking services. Hence, providing access to financial services need not necessarily be viewed as merely social service, and the potential must be tapped as commercial venture by banks.

Banks are the shopkeepers of financial products and services. A financial product is built on small sums of money, and by purchasing it either from his current income (savings, insurance and remittance) or from his future incomes (loan or credit product), the individual can get large sums of money when he requires it the most. So, design features of a financial product or service are most crucial for a poor person to have access to them. Banks, on the other hand,

appear justified to some extent to look at the seemingly prohibitive cost of providing such facilities to these sections. Where population is low the cost of setting up a branch would have far outweighed the expected returns at least in the short run.

Issues and Challenges

The constraints need to be addressed and understood from either side to get to the bottom of this paradoxical mismatch between the demand and supply sides. Like the monsoons in India, the earnings from the agricultural sector are also erratic. Manual labour is migratory and irregular in nature. Households in the subsistence economy depend on friends, family or usurious moneylenders to meet financial exigencies. They have no access to services that suit their needs, are suspicious of the corrupt babus in banks and red-tapism and end up using informal methods that trap them in the vicious cycle of poverty. Their necessities can be outlined as follows- ease of access, security and safety of deposits, low transaction costs, convenient operating time, minimum paper work, ability to transact easily and frequently, avail quick and easy access to credit and other products including remittances suitable to their income streams and consumption patterns. To say the minimum, they need easy loans and deposit-withdrawal facilities. The banks on the other hand, expect returns commensurate with the cost of providing such facilities to these sections.

This is where the role of group financing and Business Correspondents/Facilitators emerge. Group financing by banks is intended to minimize transaction costs to both the clients and the banks.

Turning to the dynamics of the process of financial inclusion, a two phase plan was put into action. In the first phase, banks

were advised to draw up a roadmap for providing banking services in every village having a population of over 2,000 by March 2010 and this target was achieved. In the second phase, Roadmap has been prepared for covering remaining unbanked villages i.e. with population less than 2000 in a time bound manner. About 4,90,000 unbanked villages with less than 2000 population across the country have been identified and allotted to various banks. The idea behind allocating villages to banks was to ensure availability of at least one banking outlet in each village. Branch authorisation has been relaxed to the extent that banks do not require prior permission to open branches even in tier I centres, subject to reporting. To minimise costs, a simple brick and mortar structure has been proposed in unbanked rural centres at a reasonable distance to act as an intermediary between the main base branches and these centres. Banks have been asked to set up their own three-year Financial Inclusion plans to identify goals and meet targets. The first plan (2010-13) threw light on some important roadblocks and the second plan (2013-16) addresses them. With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks were permitted by RBI in 2006 to use the services of intermediaries in providing financial and banking services through the use of Business Facilitators (BFs) and Business Correspondents (BCs). The focus is to increase the potpourri of services offered so that people can reap the benefits and the volume of transactions ensure that this remains a viable and profitable venture for the banks.

When we talk of minimum paperwork we essentially are referring to the KYC-Know Your Customer norms. These guidelines have been simplified such that small

accounts can be opened without any documentation by just giving a self certification in the presence of bank officials. 'Aadhaar', the unique identification number being issued to all citizens of India, can be used as one of the eligible document for meeting the KYC requirement. Talking of Aadhaar, it is important to emphasise the role that it can play alongside financial inclusion in plugging leakages due to corruption in social welfare schemes. The much debated direct-benefit-transfer will be possible only when the target population has access to banking services. And hence, financial inclusion is the way forward.

Future Strategy

SCRIPT- Savings, Credit, Remittance, Insurance, Pension, Payments transactions is an acronym that condenses the services of banks. The key to successful financial inclusion lies in recognizing the demand for the kind of banking services in the rural sector. Opening of no-frills account, an account that can have "nil" or negligible minimum balance along with ATM/debit card facilities allowing upto four withdrawals per month is the first step in this direction. Some other basic facilities being offered are- pure savings account, ideally a recurring or variable recurring deposit, a remittance product to facilitate EBT and other remittances, and entrepreneurial credit products like a General Purpose Credit Card (GCC) or a Kisan Credit Card (KCC).

Technology has always been the engine of growth. The reach of the mobile phone extends to the remotest villages today and mobile banking can be the way forward. Financial Inclusion has the potential to bring in the unbanked masses into the formal banking system, channelise their savings, stoke their entrepreneurial ambitions by making available credit and

thus give a fillip to the economy. The use of Hand Held Devices, Point of Sale machines, micro-ATMs, Banks-on-wheels could be adopted more to achieve the aim of inclusive growth which is needed for the sustainable development of the country.

Financial inclusion is not an option anymore, it is a NECESSITY.

State of Recovery and Raising the Repo Rate

Vasundhara Krishna III Year

The World Bank and the IMF have held out hopes of a recovery. A growth rebound in the US, signs that the recession has bottomed in Europe, and expectations that growth would revive in developing countries other than China seem to underlie the optimism. But, as the Chief Economist of the World Bank, Kaushik Basu, in an effort to protect the organisation against the likelihood of its projection proving wrong said that they were "cautiously optimistic". The reasons for this caution are obvious. First, as of now, every significant country of the world is either still in the midst of stagnation or growth deceleration. The 'recovery' is largely because of a minor upturn in a bent, from still low levels. But, as the Financial Times recently noted: "For the past four years, analysts have predicted an imminent acceleration in the US economy, and got it wrong. The mediocre record is growth of 2.5 per cent in 2010, 1.8 per cent in 2011, 2.8 per cent in 2012 and something around 2 per cent in 2013."