Transition and Innovation in Rural Finance in India –
A Call for Action in this Golden Decade

By

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“...A moment comes, which comes but rarely in history, when we step out from the old to the new, when an age ends, and when the soul of a nation, long suppressed, finds utterance. It is fitting that at this solemn moment we take the pledge of dedication to the service of India and her people ...” Jawaharlal Nehru, just before midnight, 14th August, 1947
Abstract

This paper attempts a grand review of rural finance in India since ancient times till 2010 to answer one simple question - what are the lessons from the past and how can we apply these to redesigning and revitalising the rural financial system (RFS) in this decade – 2010 to 2020? Our review shows that the main purpose of the RFS has been to manage the primary paradox – that of the need to expropriate the rural surplus, and the need to accumulate and re-invest it. Over different historical periods, either expropriation or reinvestment took precedence, based on the exigencies of the state and the enlightenment of the rulers.

As the RFS became more and more institutionalised, a stage came when a secondary paradox emerged – that of the need for ensuring institutional sustainability versus the need for financial inclusion. The secondary paradox was driven by the price (lending interest rates, savings interest rates, insurance premia, etc.) that could be charged to remain in business versus the transaction cost of broadening and deepening inclusion. If prices are lowered below breakeven levels, so as to enhance inclusion, by serving those who cannot afford the higher prices, then it affects the sustainability of financial institutions. On the other hand, if prices are raised in pursuit of profitability and institutional sustainability, it leads to massive exclusion.

The breakeven point for a financial institution depends on its cost structure, which is itself a function of regulation, volume and technology. As an increasing proportion of the population is seeing higher income levels, the volumes of financial transactions are going up and costs coming down. On the other hand, improvements in technology such as core banking system software and hardware, tele-connectivity and biometric identification, are leading to a reduction in transaction costs. Finally, regulation is beginning to state inclusion as a goal.

The authors are convinced that these efforts have reached a point where, with concerted action, it will become possible to achieve Universal Financial Inclusion (UFI) - by 2020. Thus this paper is a call for action and also suggests some details of how to go about achieving that goal. To do all these in a mission mode, we need to establish a Nationwide Electronic Financial Inclusion System (NEFIS), as recommended in the report of the Raghuram Rajan Committee on Financial Sector Reforms, to enable micro-transactions (below Rs 1000 or Sub-K), at a convenient distance, less than 1000 metres (Sub-K) from home or workplace, at an affordable transaction cost, below Rs 10 or 1000 paise (Sub-K). Only then will the gates of the financial sector open to the poor. We argue that the resources, technologies and regulations are in place and this is the Golden moment pledge to achieve Universal Financial Inclusion – Sub-K-Liye!

The authors believe that this step will at least resolve the secondary paradox, as financial institutions profitably provide wider and deeper financial inclusion services. They concede that the primary paradox is more refractory, but end with the hope that the urgency of mitigating the effects of climate change will lead to re-investments in nature, and thus in rural areas, and this may even be done in market friendly ways, such as using carbon credits.
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1 Rural Finance in Ancient, Medieval and Colonial India

1.1 Ancient India – surplus flowed from Dasas to Rajas via the Setthis

By the time of the Atharva Veda, the term kusida had evolved to cover the lending of goods or capital to earn interest, which may be defined as the practice of ‘usury’. In the Baudhayana Dharmassura of about the fifth century BC, it was stated that only members of the Vaishya varna should lend on interest, at a maximum rate of 10 per cent per annum. The Aryan kingdoms which emerged from about the fifth century BC were based in the plains regions, where the forest was cut and plough agriculture introduced. 1

Kosambi has argued using the Arthasastra- that at the time of Chandragupta Maurya, the state maintained its own store house and the keepers of the stores collected a share of the harvest and other produce directly from the subservient peasantry. As the expropriation of harvest share was in kind, it cannot strictly be called a financial transaction. The storekeepers supervised the cleaning, pounding and milling of the grain and carried on a large trade in produce. Prices were controlled by the state. They also arranged for advances to be made to the peasants in kind. These advances were also mainly in the form of grains.

This state run system operated only in a fairly limited area. Most of India was still controlled by clan groups – the dasas- who subsisted largely on hunting, gathering and swidden agriculture in the hilly regions, and pastoralism in the open grasslands of the subcontinent. As succeeding Mauryan rulers extended their kingdoms by conquering these independent clan groups, it appears to have been necessary for the rulers to use vaniks (the trading class) to deal with these communities.

The growing social importance of rural credit during the Gupta period is reflected in the tenets on lending on interest to be a respectable occupation to be carried out by members of the Vaishya Varna. There was an expansion of settled agriculture during the time of the Guptas in many areas formerly controlled by clan chiefs, such as Bengal and the Deccan. It is likely that the provision of credit to peasants by Vanik stesthin and setthis – that is, merchants and bankers organized in guilds was important to the process of agricultural expansion. Thus we see the re-investment role of the rural financial system (RFS) even in ancient times.

The Manusmrti set out the different rates of interest which could be taken from each of the four varnas - 2 percent per month could be taken form a Brahman, 3 percent from a Kshatriya, 4 percent from a Vaishya and 5 percent from a Sudra – typically a peasant and artisan. Rules and regulations regarding pledges, sureties and rates of interest were systematized still further and with much greater intricacy in the fifth and sixth centuries AD, which must have reflected the growing economic importance of rural credit at the time.

Bhraspati distinguished different forms of interest payment, each of which was given a distinct name. There were monthly repayments special high rates of interest to be paid in times of distress (karita), compound interest which never ceased to grow (chakravrdhithi), interest to be paid by the bodily labour of the debtor (kakiya), and interest paid by allowing the creditor the use of a property, such as a house or a field (bhogalabha). Bhraspati also stated that loans should never be advanced without an adequate security being provided, or without a bond or a pledge of some sort, such as a field. The lender was not permitted to dispose off the pledge – that is, to sell off the field – until after the principle had doubled through interest or the

1 Malamoud, Charles (1983)
stipulated repayment date had passed. Also, the lender was not permitted to make use of the pledge without the authorization of the debtor.

From about 500 AD there was a sharp decline in trade in grain and other agrarian produce, which brought about a crisis in the empire and the assertion of more localized polities. There is evidence from south India that temples controlled by Brahmans became important centres for rural credit at this time. Inscriptions record the granting of loans to assemblies of landowners in particular villages, who in return contracted to supply exact quantities of goods to the temples on a regular basis. This arrangement was described as being a ‘gift to god’. Repayment was to continue indefinitely; it was not expected that the principle be repaid. If payments were not forthcoming, the temples could dispose of the peasant’s surplus. In the case of north India, a deed of 1212 shows the head of a Shaivite temple accepting the mortgage of a village in return for a loan, and being allowed to collect the taxes of the village so long as the debt remained unpaid.

In short, we see that the primary paradox of the rural financial system, that of expropriating surplus from agriculture and reinvesting in it to ensure stable and growing production, had emerged even in ancient times.

1.2 Medieval India – moneylenders enabled payment of land revenue in cash

At the turn of the thirteenth and fourteenth centuries, the Delhi sultan, Alauddin Khilji, required the peasants to sell their grain to merchants immediately after the harvest at prices fixed by the state. The system was extended to Gujarat in a small way to by Sultan Muhammad Tughluq, who reigned from 1325 to 1351. This sultan is known to have arranged for pre-harvest loans to be given to peasants. It is likely that these were given through local merchants. With the state backing them, these merchants would have been able to extend their own private businesses in the rural areas, in time becoming merchant usurers occupying a central role in the economic life of the villages.

Under the sultans a more centralized system of rule was made possible through the development of a more efficient army, a tax collecting bureaucracy, a greatly extended system of banking, credit collecting bureaucracy, a greatly extended system of banking, credit and accountancy, and the growing use of paper for record-keeping. An important figure in this new state system was the small trader and usurer who dealt directly with the peasants, the sahukar. He provided the crucial link between the peasantry and the town. His capital was borrowed from big urban merchant capitalists and advanced to the peasants, who were thereby able to pay their taxes to the sultan’s collectors. In many cases the peasants themselves hardly handled any money: the necessary payments were made for them by the usurers who managed their financial affairs.

Thus in the medieval era, the RFS continued to play the dual and contradictory role of expropriation of surplus from agriculture and reinvestment in the productive capacity of agriculture. However, the main difference from the ancient times was the use of money rather than grain for transactions on both side.

1.3 Colonial India – from expropriation to institutionalisation

1.3.1 Peasant revolts

The condition of the peasants had been a prime cause of rural unrest in British India. During the early part of the nineteenth century, land was of major importance to almost all the people of the Indian countryside because most of them depended on cultivation for their subsistence. The main reason, which led to a deep-rooted dissatisfaction within the farmers, was that they had to pay a tribute in the form of rent to the British government for the land, which they tilled themselves.
At the same time agriculture started becoming commercialized, that is producing substantial surpluses for sale to cities. The advent of money lenders helped make the backward agricultural regions commercialized. However, as the production was highly variable based on the monsoon, in bad years, farmers were unable to repay loans and even did not have any money to pay the land revenue. Thus they were forced to borrow from money lenders and in many cases had their lands taken away after many years of indebtedness. Some historians are of the opinion that the emergence of the new money lending class was the cause of many of the uprisings that took place in the Indian soil in and around 1857.

Many agriculturalists were reluctant to pay the land revenue to the British government and they protested against it. For instance, sixteen large Jat villages of the Naultha district protested against the revenue system. They forcefully ousted the government officials from the village. The members of the villages had joined the disturbance of the Rohtak district and had visited Delhi. They had also threatened that continuation of such an activity will make them attack the Collector’s Office. Nineteen other villages from the Bhalsi and the Korana district also rioted and attacked the government establishments. All these happened because the majority farmers refused to pay the rent. Even the Gujjars were not far behind and they plundered about in the country.

Discontentment within the peasant class gradually became hard to contain and a number of rebellions took place in various regions of the Indian sub-continent. The peasant class rose in rebellion against the British to protest against the exploitative conditions which they were subjected to by the colonial government. The peasants wanted to maintain ownership of their land and could not accept its steady alienation to money lenders. Peasant revolts were a result of excessive expropriation of (the meagre) surplus and lack of re-investment by the state machinery during colonial rule. Not surprisingly, these resulted in corrective action which involved re-investment in agriculture.

1.3.2 Taccavi loans

In 1883 and 1884 two acts were passed in Bombay which were designed to allow government loans – known as taccavi – to be given to peasants more freely. Taccavi loans could be given only for agricultural purposes and had to be repaid within four years. Taccavi loans were given at low rates of interest to allow peasants to raise their long-term productivity by digging wells, improving fields, providing irrigation facilities and so on, with land deeds to provide as security. Short-term loans were also to be made available as matter of routine to relieve their condition in drought years. To obtain a loan, the peasant had to make an application on a prescribed form and present it at the taluka headquarters office. It was then forwarded to the district headquarters and a ruling was made as to whether the full sum or only a proportion should be advanced or nothing at all.

These measures proved a failure from the start. The taluka level officials did their best to prevent applications from being accepted, as a lot of extra work was required to administer them. They had to investigate the application, and then monitor the loan, submitting periodical returns and keeping an eye on improvements made, and also collect the instalments. As a rule, they would only act if the applicant agreed to pay for their application to be written, to be submitted to the officials, and in addition pay a large bribe. This made the effective rate of interest on taccavi loans comparable with, if not more than the rate taken by the Baniyas. When loans were given, the instalments were demanded on the dot, and if peasants failed to find the money their land was auctioned off with undue haste, unless – that is – they shelled out further bribes to officials to delay the proceedings. For these reasons, government loans were requested by only a very few peasants.

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2 BPBEC, vol.1 (1951-1952)
3 Hardiman, David (2000)
Taccavi loans were a measure by the colonial government for re-investment of financial capital in agriculture, so as to stabilise and enhance its surplus. Poor implementation and corruption by local bureaucracy made it unsuccessful. This led to search for alternatives.

1.3.3 Early steps in establishing cooperatives

Several enlightened British officials were aware of the rise of the cooperative movement in England and continental Europe, on the lines of the Rochdale principles and the Reifeissen system. Based on the study of these experiences and some early experiments, in 1904 the Government of India passed the Co-operative Credit Societies Act, which off required that provincial governments establish co-operatives as an alternative source of rural credit. A co-operative could be established in a village if at least ten people requested it, and about seven people had to be found who would agree to manage it. Villagers could join on payment of a small entrance fee, and they were expected to subscribe to it according to their means. The government was to provide the initial finance to get them off the ground. Money was to be lent at rates of interest lower than those normally taken by sahukars. Borrowers were required to provide good security. Loans were meant to be for productive rather than ceremonial purposes. Repayments could be made in instalments.

The first societies were established in Bombay Presidency in 1905. The progress of the co-operative movement was very uneven. In many areas it was hampered by the opposition of sahukars, who saw it as a threat to their business. Many shaukars warned their clients that if they joined a co-operative they would demand immediate repayment of all debts and a severing of future relationships. As co-operatives were permitted to provide loans only for agriculturally productive purposes and not for social and ceremonial expenditure, which was often a major reason for borrowing, the peasants could not afford to alienate their sahukars. Thus the co-operatives did not prove an effective replacement for the sahukars in many other crucial ways. Loans could be granted only after an enquiry had been made into the state of a peasant's financial affairs. This was a cumbersome and slow process, and often a loan was sanctioned after the need for it has passed. According to a representative of a peasant association in Bharuch district:

It is very difficult and wasting of time in getting money from the co-operative societies and then too it is not to be had in time, because the loan application of a farmer has to go through the secretary of the society, supervising union, its inspector, district bank committee, its chairman, inspector and organizers and even then the report is returned if there is any mistake.

1.3.4 Yet the moneylender prevailed

The sahukars, on the other hand, provided a loan the moment it was required. The amounts of money sanctioned for loans from cooperative were frequently less than had been requested, being in-adequate for the purpose intended. Repayment demands were made inflexibly by co-operatives and peasants who defaulted were likely to lose land. This became a particularly grave problem during the 1930s, when the depression in prices made it very hard for peasants to repay loans, leading to the co-operatives taking harsh action against them. The general experience of the peasants during the early twentieth century was that the sahukars tended to be more flexible over repayment, gauging the peasant's capacity to repay depending on a range of circumstances, adjusting demands accordingly, and foreclosing less ruthlessly that the co-operatives. Thus the moneylender prevailed as a pervasive presence in rural credit in India.

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4 Wilberforce, S. (1914)
5 BPBEC, Vol. III (1929)
6 BPBEC, vol. III (1929)
7 Kumarapp (1931)
2 Rural Financial System (RFS) in Modern India

2.1 From 1947 to 1969 – Independence to Green Revolution

2.1.1 Gorwala Committee report

A major initiative after independence by GOI was the appointment of the Gorwala Committee in 1951 by the Government, popularly known as the All India Rural Credit Survey Committee. Its main finding was the extent of borrowing from institutional sources was less than 8 percent and most farmers depended on informal sources of credit, mainly moneylenders. It observed that large parts of the country were not covered by cooperatives and in such areas where it had been covered, a large segment of the agricultural population remained outside its membership. Even where membership did exist, the bulk of the credit requirement (75.2%) was met from other informal sources.

The Committee recommended introducing an integrated system of rural credit, partnership of the government in the share capital of the cooperatives and also appointment of government nominees on their boards, thus participating in their management. The earlier Imperial Bank of India which was renamed State Bank of India from 1955, was asked to open 400 branches, mostly in upcountry districts. The Committee also recommended setting up of a National Agricultural Credit Long Term Operations Fund and National Agricultural Credit Stabilization Fund to be reviewed at the end of five years, responsibility for which would be with the Reserve Bank. The Government and the elected representatives accepted the basic approach and the major recommendations of the Gorwala Committee. A National Cooperative Development and Warehousing Board were set up. The Reserve Bank of India Act was amended to enable it to play an active role in building up of cooperative credit institutions.8

It is not a surprise that in a nation which had barely merged from the Bengal Famine of 1943-44, growing more food was a priority and it being a newly independent nation, reinvestment in agriculture took precedence over expropriation of surpluses, in the early years after Independence. However, the RFS was being worked upon through other channels to mop up surpluses in rural areas. The Government took several routes for this, The National Savings Organisation was established in 1945, in the wake of the need to increase fiscal resources after the World War II, but the idea of small savings mobilisation was much older. Indeed the Government Savings Bank Act was enacted in 1873. The Post Office collected these savings as an agent of the government. National savings outstanding in 1950 were a mere Rs 378 crore, comprising Rs 275 crore of post office savings and Rs 103 crore of certificates.

The independent Indian government enacted the Government Savings Certificates Act, 1959 to introduce new instruments like National Savings Certificates, Kisan Vikas Patras and later Indira Vikas Patras. The Public Provident Fund Act, 1968 enabled people who were not in government or organised sector employment to open savings account of 15 year duration, as a measure for long-term financial security. Though the rural share is not authoritatively known, it is unlikely to be less than a third. The main source of savings mobilisation, however, remained the banking system. Bank deposits increased from Rs 990 crore in 1947. The Government appropriated a large part of these bank deposits through Statutory Liquidity Reserve (SLR) requirements, which were as high as 40 percent and even today are in the range of 25 percent. These SLRs were invested by banks in government securities to finance expenditure of the government. Only a small part of that went into re-investment in agriculture. Thus expropriation of rural surplus again became the predominant function of the RFS. But the need for food self-sufficiency would reverse that soon.

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2.1.2 Revamping the RFS in the wake of the Green Revolution

The RBI, at the instance of Government of India (GOI) appointed a Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) in 1979 mainly to understand and recommend the structure and operations of the Agricultural Refinance and Development Corporation in the light of the growing need for term loans for agricultural and allied purposes including village industries, marketing, processing and other services relevant to integrated rural development.

The CRAFICARD had suggested several recommendations to increase the direct lending to the farmers and rural households through different institutional mechanisms. It also emphasized on better coordination amongst banks through the concept of District Lead bank and the District Consultative Committee. Based on CRAFICARD recommendation, the National Bank for Agriculture and Rural Development (NABARD) Act, 1981 was passed by the Indian Parliament and NABARD was established on 12 July 1982 with an initial capital of Rs. 100 crore. NABARD is an apex institution accredited with all matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas. It co-ordinates with the rural financing activities of all the institutions engaged in developmental work at the field level and maintains liaison with Government of India, State Governments, Reserve Bank of India and other national level institutions concerned with policy formulation.

The Green Revolution in the late 1960s and 1970s necessitated adequate availability of credit that could enable the purchase of inputs such as fertilizer, high yielding varieties of seeds, pump sets for irrigation, and the like. The Green Revolution had created both enhanced and diversified type of credit requirements for agricultural production. Though the outreach and the amount of agricultural credit have increased over the years, there are several gaps in the system like inadequate provision of credit to small and marginal farmers, paucity of medium and long-term lending and limited deposit mobilization and heavy dependence on borrowed funds by major agricultural credit purveyors. (Rakesh Mohan, 2004).

By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian Economy. The Nationalization of Banks in 1969 has been one of the significant economic, political and social events of post independence India. It was made mandatory for banks to provide 40 per cent of their net credit to “priority” sectors. Within this, banks had to provide 18 per cent of their net credit to the agricultural sector, so as to reduce the hold of moneylenders and make more funds available for agricultural development. Enhanced bank credit to the farm sector became instrumental for the success of green revolution and the increase of aggregate food grain production in north and northwest India in the 1970s.

2.2 From 1970 to 1991 – The rise and fall of the directed credit regime

2.2.1 Rural branch expansion and Regional Rural Banks

In the period following the nationalization of India’s 14 major commercial banks in 1969, they were given a mandate for rural expansion. The declared objectives of the new policy that came to be known as “social and development banking” were (i) to provide banking services in previously unbanked or under-banked rural areas; (ii) to provide substantial credit to specific activities, including agriculture and cottage industries; and (iii) to provide credit to certain disadvantaged groups such as, Scheduled Caste and Scheduled Tribe households.9

An important feature of the policy of social and development banking was that it recast completely the role of commercial banks in rural banking. The Reserve Bank of India (RBI) issued specific directives which included targets for expansion of rural branches, ceilings on interest rates, and guidelines for the allocation of credit. Advances to the rural areas increased substantially, although they were, as was the green revolution itself, biased in respect of regions, crops and classes.

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In 1975, the Government established by ordinance and then legislation a new network of rural financial institutions called the Regional Rural Banks (RRBs), which were promoted by the Government of India, State governments and commercial banks to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalised sections – small and marginal farmers, landless and the rural artisans. Although the cooperative banks and the commercial banks had reasonable records in terms of geographical coverage and disbursement of credit, in terms of population groups, the cooperative banks were dominated by the rural agriculturalists, particularly the medium farmers, while the commercial banks had a clear urban bias. In addition, the potential and the need for diversification of economic activities in the rural non-farm sector had begun to be recognized, and this was a sector where the RRBs could play a meaningful role.

The following one-and-a-half decades saw large-scale efforts to increase the number of banks, bank branches, and disbursements nationwide. By 1991, there were 196 RRBs with over 14,000 predominantly rural branches in 476 districts with an average coverage of three villages per branch. Perhaps the most significant achievement of the RRBs during this period was in enabling the weaker sections of the rural community access to institutional credit. The bulk of the loans from RRBs were to the priority sectors, which accounted for over 70 per cent of the total. In addition, the RRBs were instrumental in extending credit for poverty alleviation schemes (e.g., IRDP) and disadvantaged area development programmes.

A business unit has all the freedom to take decisions on many matters such as opening branches, deploying its resources, staff recruitment, its purchases, methods of rendering services etc. But the RRBs could not be flexible in many of their affairs; even their clientele was specific, scattered, remote and not assisted by anyone. Thus arose the secondary paradox which we referred to in the introduction – the paradox of institutional sustainability and financial inclusion. The RRBs aimed at enhancing inclusion, but coupled with price (interest rate) restrictions, which were inadequate to meet their operating and risk costs, they soon became unviable as financial institutions.

2.2.2 Directed Credit – Its high point, the IRDP, 1980 and its low, the ARDR, 1990.

Several programmes to improve the incomes of the disadvantaged sections of the society have been implemented in the past that promoted self-employment opportunities through credit supported asset creation. Integrated Rural Development Programme (IRDP) was the main such programs. Block level governmental machinery played a key role in implementation of this programme by identifying below poverty line (BPL) families and activities for which they were to be given a loan. The government matched the loan with a subsidy that varied from 25 to 50 percent of the loan amount. From 1982-83 to November 1998, more than 5.38 crore below poverty line (BPL) families were covered with bank loans aggregating over Rs. 19,500 crore. However, only about 20 per cent of the borrowers crossed the poverty line after assistance.

The banks did not have any role in identification of activities and borrowers. Political interests dominated the process and this patronage led to corruption. From the borrowers’ point of view, the subsidy they received turned out to barely meet the cost of borrowing in terms of the foregone wages because of the repeated visits to government officers and the bankers, and the bribes to be paid up front. According to a World Bank study on transaction costs in availing a loan of average size of Rs 7000, the poor borrowers incurred about 18.9 per cent towards informal expenses and wage loss. So once they managed to get the loan, they were reluctant to repay, even in the minority of cases where the asset actually led to increase in income.

As bad debts of RRBs and commercial banks linked to IRDP lending mounted, the Government of India formulated the Agricultural and Rural Debt Relief Scheme (ARDR), 1990 for providing debt relief not exceeding Rs. 10,000 per borrower to selected category of borrowers of public sector banks (PSBs) and Regional Rural Banks (RRBs). The State Governments also formulated their own schemes on lines of the Central Scheme for borrowers of Cooperative Banks. The ARDR, which was announced by the then Deputy Prime Minister, Devi Lal, was the low point in
the history of directed credit, as it led to a complete collapse of the idea that banks could be used for social lending. Bankers, who had already been resistant to lending to the poor, became cynical. Borrowers, who had found banks always difficult to get loans from, were relieved once of repayment, in turn for a lifelong status of being a “defaulter” and a persona non grata for banks. Quite perversely, the IRDP, which was designed to enable the poor to access credit, led to over 50 million poor people being officially treated as defaulters, never to be considered for a loan again.

2.3 From 1992 to 2009 - Liberalisation and its discontents

Liberalization after 1991 decimated the formal system of institutional credit in rural India. It represented a clear and explicit reversal of the policy of social and development banking, such as it was. The policy objectives of liberalization in 1991 are encapsulated in the Report of the Committee on the Financial System, which was chaired by M. Narasimham (RBI, 1991). In its very first paragraph, the report called for “a vibrant and competitive financial system to sustain the ongoing reform in the structural aspects of the real economy.” The Committee said that redistributive objectives “should use the instrumentality of the fiscal rather than the credit system” and, accordingly, that “directed credit programmes should be phased out.” It also recommended that interest rates be deregulated, that capital adequacy norms be changed (to “compete with banks globally”), that branch licensing policy be revoked, that a new institutional structure that is “market-driven and based on profitability” be created, and that the part played by private Indian and foreign banks be enlarged.

Share of Agriculture Credit in Total Scheduled Commercial Bank’s Credit

The period after nationalization was characterized by an expansion of bank credit to rural areas: the credit outstanding from rural branches tripled in the 1970s, and continued to rise in the 1980s. After 1988, however, the credit outstanding from rural branches as a proportion of total credit outstanding declined, from around 15 per cent in 1987 and 1988 to 11 per cent in March 1999, and 10.2 per cent in March 2002. In addition to reduction in the proportion of credit to rural areas, policies of financial liberalization also worsened regional inequalities in rural banking in India. Pallavi Chavan has examined the growth and regional distribution of rural banking over the period 1975-2002. She documents the gains made by the underprivileged regions of east, north-east, and central India during the period of social and development banking. These gains were reversed in the 1990s: cutbacks in rural bank branches and in rural credit-deposit ratios were steepest in the eastern and north-eastern states of India.

Source: Expert Group on Farm Indebtedness 2007

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10 Govt of India (2007) Expert Group on Agricultural Indebtedness: Chairman Dr R. Radhakrishna
### Trends in Rural Banking after Reforms

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<tr>
<th>Loans and Advances</th>
<th>1994</th>
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<td>Priority Sector Accounts of Public Sector Banks (No. of A/c)</td>
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<td>% of Rural Advances of Scheduled Commercial Banks</td>
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<td>% of Agricultural Advances of Scheduled Commercial Banks</td>
<td>15.30 % (1991)</td>
<td>9.90 %</td>
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<td>Loan Accounts &lt; Rs. 25,000 of Scheduled Com.Bks: (No. of A/c)</td>
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<td>393 lakh</td>
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<tr>
<td>% of Small Loans to Total Loan Amount</td>
<td>18.30 %</td>
<td>7.90 %</td>
</tr>
</tbody>
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Percentages are to Total Bank Credit  
Source: - Various RBI Publications

By 2003, when the first UPA Government came to power, agricultural credit had become a key issue and the Finance Minister declared his intent to double agricultural credit in three years. As the cooperative credit system was not functioning well, the onus of this mainly fell on the RRBs and Commercial Banks. A detailed programme was worked out in consultation with NABARD and Indian Bank Association (IBA) to increase the ground level credit flow to agriculture by 30 per cent each year for the next three years. In addition to increasing the quantum of credit, the Finance minister also wanted additional farmers to come into the fold of commercial banks.

As a part of commercial banks' effort to enhance the flow of credit, each bank branch was asked to enrol at least 100 new farmers as borrowers per year. With 33000 rural branches and over 15000 semi-urban branches, this effort was expected to enlarge the universe of new farmers by around 5 million. In the event, the number of farmer loan accounts went up from 0.7 crore to 1.55 crore from 2003 to 2007 and the average loan size went up from Rs 36040 to Rs 74189.12 The total disbursement of agricultural credit went up from Rs 86,981 crore in 2003-04 to Rs 254,658 crore in 2007-08, under enormous pressure from the Central Government.13 No doubt, some of this was reckless lending, to fulfill targets. It was not a coincidence that in 2008, a loan waiver was announced, in which Rs 72,000 crore was written off as overdue bad debts.

#### 2.3.1 SHGs and MFIs as the alternative responses

Disillusionment with the IRDP led a number of NGOs working in livelihood promotion, such as MYRADA and PRADAN, to come up with alternative ways to enable the poor to access credit from banks. One of these was organising poor women onto so called "self-help groups" or SHGs, which meet periodically and save some money, building up a common kitty, out of which they would give out small loans to each other. Later, a bank could be persuaded to lend to the SHG, The Reserve Bank of India approved a pilot project for bank lending to SHGs in 1992. NGOs took lead in forming SHGs while NABARD provided the support for linking SHGs with banks.

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12 NABARD (2009). Doubling of Agriculture Credit – A Study Report
13 Govt. of India (2009). Department of Agriculture and Cooperation, Ministry of Agriculture,
This pilot was evaluated in 1995 and found to be worth replicating nationwide. In 1999, on the recommendations of a task force coupled with the impetus given by NABARD and state governments like AP, bank linkage with SHGs took off. By 2003, over 750,000 SHGs with over 1.2 crore members had received a cumulative of Rs 2600 crore of credit from banks. After that, the SHG–bank linkage program became the predominant method of extending micro-credit in India. By March 2009 SHG movement had 5.4 crore clients with loan outstanding of Rs. 24,100 crore from banks.

As the movement caught the attention of government officials and politicians, targets began to be imposed and as a result the quality of groups began suffering. A survey by APMAS in 2002 indicated that only 17 percent of all groups were of adequate quality for bank linkage and this was in a state which is considered the leader in the movement. Quantitative targets and government directed SHG formation are the main cause of this deterioration. Moreover, the average loan amount per borrower is still meager at about Rs 3000, and the geographical distribution of the program is skewed against the poorer regions of the country. While less than one-fifth of total loans to SHGs went into the Eastern and Central Regions taken together, they accounted for more than three-fifth of the total poor in India.

A number of NGOs built up substantial direct portfolios, supported by apex lenders such as, the Rashtriya Mahila Kosh and the SIDBI Foundation for Microcredit and others. Subsequently, a second track developed in micro-finance where the micro-finance institutions (MFI) lent to the poor, mainly through Grameen Bank Bangladesh style groups where the loans are given individually to each borrower and the group accepts joint liability. SKS, SHARE, Spandana, Cashpor and Bandhan are examples of such MFIs. By 2005, many of these NGOs transferred their portfolios and transformed into non-bank finance companies (NBFCs). In March 2009 Indian MFIs had 2.26 crore clients served by the MFIs with a loan outstanding of Rs. 11,734 crore.

The fact that in about 14 years, from 1995 to 2009, between the SHG and MFI models, about 7 crore poor households have got initial access to credit (taking into account some overlap between the two models) and the outstanding loan amount is nearly Rs 35,000 crore, is definitely a success of these alternatives to the mainstream financial sector.

In terms of sustainability, however, the SHG model is weak. To begin with, the cost of formation and ongoing handholding of SHGs is met by donors and government agencies. Then, because political pressure was brought upon banks to reduce their interest rates to 6-9 percent pa, well below breakeven point, even though SHGs continued to lend to their members at 18 to 24 percent per annum in most cases. Finally, due to politicians trying to woo SHGs as vote banks, repayment discipline has fallen, most notably in Andhra Pradesh, where over Rs 1000 crore was reported overdue in 2009.

The SHG model seems to have erred in the paradox of institutional sustainability and financial inclusion. The quest for higher inclusion (by any means) has in fact reduced the sustainability of the model. The MFI model demonstrates the opposite error in the paradox of institutional sustainability and financial inclusion. The quest for sustainability (by any means) has in fact reduced the inclusion potential of the model. In terms of sustainability, the MFI model scored well, but this was at the cost of charging higher interest rates to borrowers, generally ranging from 27 to 30 percent pa.

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14 Datta, Mahajan and Thakur (2005)
15 Srinivasan, N. (2009)
16 APMAS (2003)
17 Kumar, Pankaj and Ramesh Golait (2009)
In some cases, MFIs have continued to charge these higher rates even when their operational costs fell due to scaling up. This led some MFIs to make extra normal profits. The negative result of these steps on pursuing deeper inclusion will be seen in a few years. Though MFIs can claim that they have been high on inclusion as well, with over 2.2 crore members, this claim needs to be seen in light of the fact that a large part of the portfolio of bigger MFIs is concentrated in Andhra Pradesh and other southern states, while the outreach to the central, eastern and north-eastern regions and to remote, forested and hilly districts is weak. Moreover, MFIs tend to work with those low income households which are engaged in some economic activity already, thereby systematically leaving out the poorer households. Indeed, this is a critique of micro-credit in general, not just of MFIs.20

2.3.2 Revival of cooperatives – one more time – Vaidyanathan Reform Package

The decline in share of credit to rural areas and agricultural sector, showed a monotonic decrease since 1989. The share of cooperatives in rural credit also continued to decline. Eventually to address these twin concerns, in August 2004, the Government of India constituted a task force under the chairmanship of Professor A. Vaidyanathan for suggesting measures for the revival of cooperative credit institutions. The task force submitted its report in respect of a short-term cooperative credit structure and recommended a financial package for rural credit co-operative institutions21. Based on the consensus arrived at with the state governments and other stakeholders on the recommendations made by the task force, the central government approved the revival package that involves financial assistance of Rs 13596 crore.

NABARD was designated as the implementing agency for the revival of the short term cooperative credit scheme. A Department for Cooperative Revival and Reforms has been set up in the head office of NABARD for facilitating the implementation process. For guiding and monitoring the implementation of the revival package, a National-Level Implementing and Monitoring Committee (NIMC) was set up under the chairmanship of the RBI Governor in 2007. The provision of financial assistance under the package was linked to reforms. In order to avail financial assistance under the package, states are required to sign an MoU with NABARD, committing to implement the legal and institutional reforms envisaged in the revival package.

Twenty five states, covering 96 percent of the short term credit cooperatives, have signed the MoU and also passed legislation ushering reforms. Of the 25 states, 13 have held elections for their SCBs. After special audits to determine the extent of bad debts, the balance sheets of SCBs, DCCBs and PACS have been cleansed of bad debts in these states, with a capital infusion of Rs 8906 crore and they have been made ready for business.22 The issue of institutional capacity building has been addressed rather perfunctorily through training programs for elected office bearers and members. As per NABARD,

“training has been imparted to 226 Master Trainers... who have trained 1,847 District Level Trainers to conduct field level Phase I training programme for PACS. So far, 70,843 PACS secretaries have been trained in fourteen States and 97,751 elected members of PACS have been trained in eleven States under Phase I.”23

The key building block of reform - restoring credit discipline – however, suffered a severe jolt in 2008, when a nationwide loan waiver was announced.

2.3.3 When will they ever learn? – Mega Loan Waiver 2008

The Agricultural Debt Waiver and Debt Relief Scheme was announced in 2008. As per initial estimates given out by the Government, 39 million farmers received state-supported relief of
waiver of their overdue farm loans. The overall bill for the nation was about Rs 72,000 crore. The major budget announcement on waiver of farm loans has been lauded and criticized in equal measure.24

By definition, the scheme can apply only to those who have outstanding loans with institutions. As per the National Sample Survey, 59th Round, 2003, nearly three-fourths of all rural households and 60 per cent of farm households report that they do not have any outstanding debt. Both access to institutional credit and the proportion of outstanding debt are skewed in favour of larger farms. Cultivator households with less than 2 hectares account for 85 per cent of all farm households; and report a lower incidence of debt (46 per cent) and of outstanding debt (30 per cent) than the overall average. Thus waivers of loans from formal institutions are biased in favour of the richer farmers.

Experience shows that loan waivers encouraged borrowers to presume that they can sooner or later get away without repaying loans. It reinforces the culture of wilful default, which has resulted in huge overdues and defaults in all segments of organised financial institutions. The deterioration in the cooperative credit system is, in large measure, due to the conscious state policy of interference in the grant and recovery of loans.25 In spite of these arguments, the Government of India went ahead and introduced this populist measure in the Budget 2008 and the process was completed by June 30, 2008. The timing was not a coincidence, coming as it did just before a number of major state elections and the national elections a few months later.

The main policy changes in the RFS in the post-independence India can be summarised in the diagram below, which is based on a similar one first posited by one of the authors at the end of a study of financial services for the rural poor and women, for the World Bank, in 199626:

![Institutional Sustainability Diagram](image-url)

25 Vaidyanathan, A. (March 30, 2008)
26 Mahajan, Vijay and Bharti Gupta Ramola (1996)
3 The Future of RFS in India – 2010 to 2020

3.1 The RFS diamond – supply, demand, intermediation and regulation

The RFS comprises four interlinked components, of which rural financial institutions or RFIs are only one. The components of the RFS are\footnote{Mahajan, Vijay and Bharti Gupta Ramola, 1996: (mimeo)}

\begin{figure}
\centering
\begin{tikzpicture}
  \node (R) {Regulation};
  \node (S) [below left of=R] {Supply};
  \node (D) [below right of=R] {Demand};
  \node (I) [below of=R] {Intermediation};
  \draw (R) -- (S);
  \draw (R) -- (D);
  \draw (R) -- (I);
\end{tikzpicture}
\end{figure}

In order to build a healthy RFS, attention has to be paid to all the four components simultaneously, rather than focussing narrowly on formal sector rural financial institutions (RFIs), which represent only the supply or the intermediation component.

On the supply side, it becomes necessary to define the RFS to include both the formal and informal sector. The supply component includes, among others:

- millions of rural households, farms and firms which generate savings, give loans to each other and in the event of adversity, mutually insure each other
- traders (input suppliers such as fertiliser dealers and yarn merchants, and output buyers such as grain merchants and handloom cloth wholesalers), with many of whom rural people keep deposits at the time of harvest, and who provide loans for crop or non-farm production. They also provide "insurance" by rolling over loans or extending cash advances at the time of contingency
- moneylenders and pawnbrokers, who are mainly providers of cash loans at the time of need

The demand component comprises primarily the millions of households, farms and firms in rural India. There were about 90 million farm households in India and about 45 million non-farm enterprises in 2005. All these households, farms and firms need financial services. However, from the point of view of RFS sustainability, having a huge need for credit, savings and insurance services is not enough. The users should be able to pay full cost for these services. Over the years, there has been a lot of subsidy extended to the financial services sector through various government schemes. This included loans at subsidised interest rates, subsidy on principal and in some cases, loan waivers. This had a great impact on the minds of the borrowers and has spoiled the repayment culture.

Similarly, in the case of insurance, most schemes in rural areas, particularly crop insurance, are highly subsidised. The IRDA has set up "rural and social obligations" as the equivalent of priority sector lending. In case of pensions, the government has just announced in the 2010 Budget, a co-contribution of up to Rs 1000 per annum for three years, to encourage lower income people to start pension savings accounts. In summary, the demand side is distorted through a combination of subsidies for consumers and obligatory requirements for service providers.
The intermediation component of the RFS comprises intermediaries who take money from households, farms and firms, in the form of savings or time deposits, endowment insurance or pension contributions. They use the funds so collected, to extend loans to rural households, farms and firms, to urban borrowers including trade and industry, or invest in government and corporate securities. The financial sector intermediaries include banks, post offices, life insurance companies, mutual funds and pension funds. The newer entrants, since the early 1990s, are microfinance institutions (MFIs) and self-help groups (SHGs). These added a layer of intermediation which was focussed on those who were hitherto excluded. The latest attempt at creating a new intermediation channel is the Business Correspondent model of the RBI, under which kirana shops, STD PCOs, CSCs (IT Kiosks) etc can enable transactions.

The regulation component is at present spread out between various authorities - the Department of Financial Services of the Ministry of Finance, Government of India (GoI), the Reserve Bank of India, State Registrars of Cooperatives, who have jurisdiction over credit and thrift cooperatives as well as over primary agricultural cooperatives credit societies (PACS) and State departments for enforcing Moneylenders' Acts, Chit Fund Acts and more recent Acts prohibiting deposit taking by thousands of so-called "finance companies".

The primary concern of regulators on the savings side has been that people should not lose their money to fly-by-night operators. However, the actual enforcement till about 1997 had been lax, leading to precisely this situation. The RBI since 1997 has tightened regulation of deposit taking and few NBFCs are now permitted this, and even those are phasing out. Cooperative banks have also been put under a tighter supervisory regime.

In the case of credit, the attempt had been to save small borrowers, particularly farmers from the "clutches of moneylenders", which was translated into increasing the rural branch network of cooperatives and banks, as well as extending loans at below breakeven level interest rates. In case of insurance, the concern of the regulators has been transparency in pricing and commission structures, lowering the extent of lapsing of polices after the initial years and the extent of delayed settlement and repudiation of claims by insurance companies. In case of micro-insurance policies, poor servicing of claims is a major issue.

3.2 Regulation must make inclusion its goal, in addition to growth and stability

The financial sector is traditionally assessed on the basis of whether promotes economic growth, in terms of making available finances for investment and consumption, and whether it ensures price stability - domestic prices in terms of low inflation and international process in terms of stable foreign exchange rates. However, in a vast majority of developing countries, the goal of financial inclusion has to be added as a deliverable from the financial sector, because for decades, these countries have witnessed a dual economy, with one part showing robust growth while another part has stagnated in terms of incomes. In India many of those who work as agricultural and unskilled/semi-skilled wage labourers, micro-entrepreneurs and low-salaried worker, are largely excluded from the formal financial system. Over 40 percent of India’s working population earn but have no savings. In spite of the vast network of bank branches and credit cooperatives, only 27 percent of total farm households had borrowings from formal sources. Less than 4 percent micro-enterprises had any access to formal sources of finance. This is unacceptable. Hence regulation must make inclusion its goal, not just the growth and stability of the Indian economy. This was forcefully argued in the report of the Raghuram Rajan Committee. Internationally, the demand for financial inclusion has been heard. In its Pittsburgh declaration in 2009, the G20 established a working group on financial inclusion.

3.3 Finance is more than just credit, it is a range of services

The Indian financial sector policy makers have been obsessed with credit. This is understandable, as could be seen from the history of the Indian financial system traced above. What the policy makers have failed to learn, however, is that rural households, including poor households, need a whole range of financial services, which include, among others:

- Bank accounts and transaction outlets (no-frills accounts with large number of business correspondent or BC type outlets)
- Payments (from government, like NREGA and to utilities, like Electricity bills)
- Remittances (from family members who have migrated to cities for work)
- Savings (to enable small amounts to be saved)
- Insurance (including life, health, crop, livestock and assets)
- Credit (both for consumption and for working capital and asset creation)
- Pensions (to ensure security in old age as traditional patterns of old age support change)
- Commodity Derivatives (futures and options, for hedging against price fluctuations)

Numerous and frequent financial transactions characterise the financial life of the poor. Studies sponsored by the Institute for Development Policy and Management, UK, (Patole and Ruthven, 2001), found that the aggregate financial transactions were between 113% to 167% of the annual income levels of the very poor and the poor respectively, in rural Allahabad and 149% to 135% in urban Delhi slums. The poor simultaneously can borrow and lend, and also save for both short term contingencies as well as long term commitments or aspirations, such as marriage of a daughter or going on a pilgrimage. They need someone to help them with all these transactions, not in a specialised but a composite way. To use the paradigm suggested by Rutherford (2000), the poor need “convenience, reliability, and a flexible range of financial services”. And ideally, they would like to carry out all types of financial transactions from the same outlet.

3.3.1 Payments

The outlay for just NREGA in 2010-11 is Rs 40,000 crore. In addition, payments under the various components of the National Social Assistance Program and newer schemes like the pension co-contribution, will add another Rs 8,000 crore. The recipients are likely to be about 80 million and will receive at least six payments in a year, in other words about 480 million payment transactions, with an average payment size of Rs 1000. There is no way this can be carried out in the old style way of sending out large chest of cash to rural payment centres with people lining up for hours in front of a cubby hole with a grill, to receive their Rs 1000 or less. The GoI must be credited with having seen this and enforcing the condition that NREGA payments must be made into bank (or post office) accounts. But as said earlier, this solves only half the problem. To withdraw their money, if the 80 million beneficiaries turn up at the nearly 30,000 rural branches of commercial banks and regional rural banks, six times a year, it means an average of over 50 transactions per branch per working day. One can clearly see the “one plus one man” rural bank branches being overwhelmed by this work load. What to do?

The obvious answer is to significantly increase the transaction outlets, perhaps by tenfold the number of branches as a first step, or 300,000 outlets. These business correspondent outlets or BCOs would be linked by fixed line or wireless to their respective parent bank servers, and will be equipped to authenticate the customer using biometric UID, get authorisation to collect or pay after balance confirmation, and record the payment to ensure non-repudiation. These BCOs, eventually numbering over a million, will be part of the Nationwide Electronic Financial Inclusion System (NEFIS), as was envisaged in the report of Raghuram Rajan Committee Report. Only when micro-transactions can happen in an affordable, reliable manner, can the doorway of the financial sector open to the poor.

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30 Patole, Meenal and Orlnada Ruthven (2001)
31 Rutherford, Stuart (2000)
3.3.2 Migrant Remittances

There are places like southern Rajasthan, where studies \(^{33}\) show that as many as three quarters of the households send out one or two family members. In Andhra Pradesh, the Mahaboobnagar district is known as the “labour district” of the south, sending out workers to Hyderabad, Bangalore, Chennai and Mumbai. The number of rural Indians who migrate every year from their village to a distant state or city for work, and stay away for more than three months, is not authoritatively known but is estimated to be between 30 to 50 million. These people all need to send money home. Assuming that the amount being sent is Rs 10,000 per annum per migrant, the total amount of transactions will be Rs 30,000 to Rs 50,000 crore in a year. The quantum of payments and remittances, excluding cross border remittances, which are largely channelled through banks now, could be nearly Rs 100,000 crore a year. The NEFIS we talked of above, coupled with the no-frill bank accounts, will be equally useful for sending migrant remittances home.

3.4 The New Intermediaries – Business Correspondents

3.4.1 Financial inclusion – not just bank accounts but a transaction network

The term financial inclusion began to be used in the India policy circles around 2005 and in 2006; a Committee on Financial Inclusion (CFI) was set up under the Chairmanship of Dr Rangarajan, former Governor of the Reserve Bank of India. The report of the CFI (2008)\(^{34}\) recommended the opening of bank accounts for a large number of poor Indians, as a first step towards financial inclusion. Since then, India has made remarkable progress in the matter of bank accounts. Over 84 million accounts have been opened for NREGA payments, and over half of these are in banks, the rest in post offices. However, there are also reports that a substantial proportion of these “no-frills” accounts are dormant. Many are not being used even to make the payments they were meant to channel and others are merely used as a one-way channel, with the balance being brought down to zero as the household withdraws the last Rupee it receives. In most cases, banks have not added any staff to manage these large numbers of accounts, and the existing branch staffs are reluctant to service customers. The occasional customer who does come to the branch finds it a discouraging experience.

This has led to many formal or informal arrangements. In Andhra Pradesh’s Mahaboobnagar district, for example, the author saw that a Field Assistant of FINO turns up at the Gram Panchayat on pre-fixed days with large amounts of cash withdrawn from a nearby major bank branch and then distributes the money in smaller lots to NREGA workers. In contrast, in Bihar’s Gaya district, the author saw that a \textit{mukhiya} had collected all the NREGA passbooks and withdrawn money from the branch Post office in a nearby town and took the money to the village for distribution to NREGA workers, for a “fee” of Rs 40 for up to Rs 500.

The October 2010 circular of the RBI, liberalising the Business Correspondent (BC) guidelines, allowing \textit{kirana} shops to become BCs, is yet to be implemented by any bank in significant numbers, although several banks seem to have drawn up plans to do so in 2010-11. The fact remains that unless the 120 million bank accounts are serviced by at least 300,000 transaction outlets (or an average of 400 accounts per outlet), transactions will remain out of the reach of a vast majority of rural people and financial inclusion will remain mythical.

3.4.2 Financial Inclusion will have to be both high tech and high touch

To give credit where it is due, though, it has been recognised by the policy makers that financial inclusion in India will have to be high tech, using information technology, mobile telephony and biometric identification. This has been institutionalised in the establishment of the Unique Identification (UID) Authority of India, under the leadership of Nandan Nilekani, who has been quick to recognise that enabling financial transactions will be a major attraction for people to get an UID.

Thus, while the UID will only enable identification of a person, the devices to do so are being designed in such a way that they would serve two other steps necessary to complete any financial

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\(^{33}\) Aajeevika Bureau (2005),

\(^{34}\) NABARD (2008) Report of the Committee on Financial Inclusion: Chairman, Dr C Rangarajan.
transaction – after authentication of the customer, a balance enquiry and authorisation to withdraw, and finally an acknowledgement of receipt of cash to ensure non-repudiation. Though these are simple steps, a majority of users will require assistance in completing these actions, just as telephone calls from STD PCOs were often assisted by the PCO operators. Thus in addition to being high tech, the financial inclusion system will have to be high touch.

The operators at the BC outlets (BCOs) will have to be trained not just to provide courteous and reliable service, but also monitored against misusing their position to extract side payments from or defrauding hapless customers. Brick and mortar banking is institutionally unsustainable for achieving UFI and moneylenders are over exploitative making both the systems not meaningful to achieve UFI. But the last decade has shown us through the microfinance models like MFIs and SHG Federation to cater to the unreached and unbanked. Though there are many critiques to that but at least it seems to be a better solution than brick and mortar banking.

Customers should be served near their homes or work places, to avoid spending on travel and losing wages. This can be achieved by using MFI style mobile agents or through fixed location BCOs. Moreover competition among service providers will create product innovation and customers will also be more aware about different products and financial systems. Banks can keep on serving the medium and high level of customers for bigger transactions, while MFIs and BCOs can reach smaller ones.

3.5 Concluding Remarks - A Golden Decade – A Call for Action
India has nearly 600 million telephone connections – between mobile and fixed line. This phenomenon could not have been dreamt of ten years ago by even the most optimistic industry soothsayer. This provides the network infrastructure for enabling micro-transactions. With this for issuing of the Unique ID to all residents of India, and most banks linking 100 percent of their operational branches to core banking solutions, the infrastructure for on-line authentication of customer identity and transaction authorisation will fall in place. With the RBI approving kirana shops, STD PCOs and IT kiosks as BC outlets, the candidates for a million BCOs stand identified. With NREGA payments alone, the government will create a supply of billions of Rupees and thus the demand for millions of withdrawal transactions. A hundred pilot projects exist, full of lessons for technology, methodology and regulation. In other words, this is the golden moment!

This is a call for action. Let us enable every Indian to conduct a financial transaction, a deposit or a withdrawal, a payment or a receipt, of up to Rs 1000 (Sub-K), in a secure and convenient way, by going less than 1000 metres (Sub-K) away from home or work place, at an all-in cost, including authentication, transaction authorisation, cash-in/cash-out and non-repudiation (using printed paper receipts), for less than 1000 paise (Sub-K), or Rs 10. At a transaction size of Rs 1000, this would be one percent. Let us all in the financial sector take a pledge to usher Universal Financial Inclusion for all Indians (Sub-K Liye!) by 2020.

Will this resolve the two paradoxes we expounded on at the beginning of the paper – the primary paradox – that of the need to expropriate the rural surplus, and the need to accumulate and re-invest it; and the secondary paradox – that of the need for ensuring institutional sustainability versus the need for financial inclusion? We are more certain of the resolving the secondary paradox. As volumes go up in the Sub-K, and technological improvements roll in, transaction costs will come down and more and more people will be able to use Sub-K, enhancing inclusion, which in turn will encourage financial institutions to serve this market segment seriously and and earn more profits and be more sustainable.

The primary paradox is harder to crack, but we have some help from a most unexpected quarter – Mother Nature. Due to the enormity of what unmitigated climate change risk can do to all human beings – rich, poor; rural, urban – there is an increasing consensus that it is time to re-invest capital into restoring nature to its pristine glory. Carbon credits is one innovation which is already leading the way, but more will come. But that is the topic for another paper!
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