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Smart regulation for inclusion

Muddled regulation will merely retard financial inclusion and obstruct the achievement of the UPA government's growth agenda, says **Sanjay Sinha**

UPA chairperson Sonia Gandhi recently reminded the country that inclusive economic growth lies at the heart of the UPA government's agenda. It is to demonstrate its commitment to such growth that the government has launched programmes such as the Rural Landless Employment Guarantee Programme (RLEGP). For some, the RLEGP provides what is termed a "smart subsidy". It is intended to provide employment to those genuinely in need and has built-in checks to ensure that the "undeserving" do not have access to it. However, every programme is only as good as its implementation arrangements will allow. Thus, while the RLEGP, amongst other such programmes, may have a palliative effect on the national conscience, it is well known that bureaucratic failure at various levels can divert outreach and severely limit its impact.

So, are subsidies the answer to economic inclusion or would a completely different strategy be more effective? There is an argument to be made for facilitative regulatory arrangements rather than subsidies. It is interesting, for instance, to note that for decades the public sector telephone monopoly was unable to provide even those who could afford their high cost services with the lines they craved. Yet, within a few years of the change in regulatory regime that made competition possible, every plumber and carpenter in the National Capital Region seems to have a telephone of his own. Along the coastline in southern India, inexpensive telephones have facilitated economic inclusion by enabling fishermen to keep track of market prices even as village honey producers in Bihar have been able to communicate with buyers in Delhi and Kolkata about the availability of their produce.

Telephones are not the only example. The banking system is far from widespread in rural areas. Yet, in situations where access to banks is possible, the advent of greater competition in banking has enabled greater economic inclusion. In rural Jaipur district, Nanhu Ram, a village *jooti* trader, is able not only to communicate with buyers in Mumbai and Bangalore on his mobile telephone; he is also able to obtain quick payment for delivered consignments of goods through instant credit into his account with a new generation bank. The buyer in Mumbai simply deposits money at the local branch of the bank and the amount is credited to the trader's account the same day. Not only does the trader benefit, the two dozen producers he services also receive payment the following day. A happy combination of benefits from greater competition in communications and banking means the entire transaction from production to market (and payment to the producer) now takes three weeks compared to the months it took earlier.

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The question here is how can efficient economic services be extended to larger proportions of the population. One way, employed by the Insurance Regulatory and Development Authority (IRDA), is to make it mandatory for insurance companies to originate a proportion of their policies in rural areas. The insurance regulation makes no other demand on the insurers — no price control, no complicated rules. This has forced insurers, public and private, to figure out efficient and effective ways of promoting inclusion in insurance services. Thus has blossomed a growing partnership between insurance companies, on the one hand, and cooperative banks, rural banks and microfinance institutions (MFIs) on the other. A number of schemes are now being rolled out with increasing confidence and growing outreach. Smart regulation rather than smart subsidy.

THE IRDA is a new institution in an economic sector that has received new life from economic liberalisation. In other financial services, the solid, respected, but sometimes too conservative Reserve Bank of India holds sway. Here, in spite of signs of an effort to keep up with the times, evidence of the old lines of thinking are apparent. Thus, the RBI announced the business correspondents' model earlier this year. In allowing banks to appoint NGOs, cooperatives, NBFCs and other MFIs as their agents for providing "small value" financial services on their behalf, the RBI took an apparently enormous leap forward into an era of financial services with far-reaching implications for economic inclusion. Imagine the increase in the number of Nanhu Rams and his producer-suppliers in areas like Chhattisgarh, Vidarbha, even Assam who would be able to conduct banking transactions and benefit from such a measure.

Yet, as if the central bank was scared of its own boldness, the same circular hobbled the measure in a throw-back to the old India: the fee to be paid to the business correspondents must be borne by the bank and specifically prohibits them from charging the customers directly for their services. In a regime of controlled bank interest rates on small value deposits as well as credit, what this effectively means is that the banks must pay the business correspondents while continuing to bear negative margins on small value accounts. While the business correspondent may save some bank staff time, the fee paid by the bank for this service would certainly cost more than the time saved. Not surprisingly, eleven months after the issue of the circular, the banks are still looking for a viable model with which to tempt MFIs to act as correspondents.

Similarly, the central government's reluctant acquiescence in providing a regulatory regime that enables MFIs to operate in an environment of legitimacy is on the verge of being hobbled by the RBI's reluctance to act as the regulator. The creation of a dual regulatory regime — one (under Nabard) for societies, trusts and cooperatives providing microfinance services and another (under the RBI) for microfinance companies — will simply create a muddle over the provision of thrift services. The success of Sahara and Peerless in generating large volumes of deposits from rural India demonstrates the demand for such services. Why is the RBI shy of others providing these services as well? A smart regulatory regime would ensure that non-serious players do not enter the microfinance space; muddled regulation will merely retard financial inclusion and obstruct the achievement of the UPA government's goals.

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