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Five-spice rural finance

Although India's rural financial system is ahead of China's in coverage and outreach, both countries have yet to find the harmonious blend necessary to achieve financial inclusion, says **Sanjay Sinha**

RETURNING from Beijing with a set of five pairs of chopsticks from the Yun Hong Chopstick Shop, this writer was faced with the inevitable question: "Why five?" The answer is that the number five plays an essential part in the traditional Chinese way of life. Natural phenomena are classified into the five elements: wood, fire, earth, metal and water, which are then used to describe all interactions and relationships.

The Chinese simply do not believe in the concept of the dozen (let alone half a dozen) left with us in India as a legacy of the British Raj. Hence, in culinary matters too there is five-spice, a harmonious blend of peppercorns, star anise, cloves, cinnamon and fennel. It is not surprising, therefore, to find that Chinese economists and regulators classify their rural finance system along five channels: "policy" financial institutions, commercial banks, niche market financial institutions, co-operatives, and the informal sector. Given the fact that China is generally deemed to be economically ahead of India in every way, from the poverty ratio to infrastructure, it is surprising, however, to discover that, in the organisation of the rural financial system, India is actually more advanced.

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"Policy" financial institutions is, of course, a uniquely Chinese way of describing institutions such as the Agriculture Development Bank of China and the agricultural insurance company that are regarded as the front-end of financial policies aimed at providing subsidised and directed services to all sections of the population. In India too, we have the NABARD as a kind of policy financial institution though it functions at the wholesale level working through the public sector commercial banks.

The operations of commercial banks in rural China, as much as in rural India, are very much under the aegis of the public sector, though India's banks, unlike those of China, have the advantage of a well established property system that facilitates collateralisation of loans. This is a major advantage in the extension of credit, notwithstanding the deficiencies and delays in our legal system. While China's commercial banks have, since 1994, gradually withdrawn from the countryside as part of the reform process, India's have rationalised and reformed but not actually withdrawn significantly.

It is in the next two channels — the niche market financial institutions and the co-operatives — that there are further real differences between the two rural financial systems. China's niche financial institutions, its town and village banks, microcredit companies and NGO microfinance institutions (MFIs) are either recently formed or still in the process of being established. In India, by contrast, we have had an extensive network of regional rural banks for decades, while non-bank finance companies and NGO MFIs have, in recent years, become a significant part of the rural financial system.

Similarly, China's network of around 32,000 rural credit co-operatives and its hierarchy of 2,500 county and higher level unions is left in the shade by India's 100,000 co-operative outlets in rural areas supported by a network of some 370 district co-operative banks and state co-operative banks. Further, consolidation as the buzzword of the reform process in China has seen the increasing withdrawal of the co-operative system from the village to the county level with an inevitable focus on larger size customers to the detriment of the average rural resident. There the difference ends, however, as India's co-operative system is as ridden with the ills of government control, issues of poor governance and obligations to act as the front-end of the subsidy mechanism as that of China.

AS IS well known, this has crippled the efficacy of both systems in serving the needs of poor rural residents while vitiating the credit culture in the countryside. Only a small caveat here is the existence in a number of Indian states of new co-operative laws that enable the establishment of independent, member-owned institutions, outside the ambit of government control. Unfortunately, except in the state of Andhra Pradesh the effects of these new laws are yet to be widely felt and, even in AP, there have recently been attempts to undermine the independence of these co-operatives.

The fifth channel, the informal sector, exists in China as much as in India and moneylenders as well as informal joint savings and credit mechanisms flourish, as they do anywhere in the world, apparently unworried by any element of official control or regulation.

Despite the superior coverage of the Indian system, however, India (and China even less) has not been able to find the harmonious blend provided by five-spice in Chinese cuisine. The key problem here is that financial mandarins in both countries — at finance ministries and central banks — have tended to see rural finance as a necessary evil rather than an integral part of the financial system essential for fuelling the growth of the economy.

It has been a stop-start approach: every now and then there is an upsurge of concern for the flow of credit to rural areas, the mandarins wake up and a new financial service delivery channel or piecemeal measure of reform is added. Hence, China's town and village banks; hence, India's independent, new generation, co-operatives; hence, China's microcredit companies; hence, India's exemption from registration for not-for-profit companies engaged in microfinance — incremental flavouring, no *panch phoran* here.

So, the mandarins in neither country appreciate that if you have "policy" financial institutions, it really ought not to be necessary to hobble niche market institutions with the burden of interest rate caps; that a vibrant system of independent financial co-operatives is the most effective way of ensuring that deposit services reach low income families and, that effectiveness of rural finance regulation develops over time with transparent operations and growing experience and there really is no need to outsource it just because the designated financial services regulator is presently unfamiliar with rural conditions.

Consistent and harmonious systems generate financial and economic inclusion, incremental flavouring merely generates a soggy mess.

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