

Inclusive Financial Systems – what are they?

In this fact sheet, financial systems will be discussed to the extent that they play a crucial role in the flow of remitted money in the context of government systems such as the National Right to Employment Guarantee Act and the social phenomenon of rural-to-urban migration in general.

The microcredit project has evolved from a program limited to providing credit for income-generating activities to a full movement with the objective of providing the most crucial financial services to even the most economically removed members of society. This fact sheet tries to cover the relationship between remittances and rural inclusion to formal financial systems. It will further explore programs that have a significant impact to this effect, such as NREGA and Business Correspondence Models.

Insofar as developing countries are concerned, the “inclusive financial system” movement is most importantly linked with a) the flow of migrant workers and b) the e-payment movement. It is suggested that these policy changes and revolutions could save approximately Rs. 1 lakh crore per annum (Tilman et al, 2012).

Rickshaw Pullers in Delhi – a story

A qualitative study conducted regarding rickshaw-pullers in Delhi (Nandhi, 2011) sheds light on the importance of remittances, and financial systems, to many migrant workers. Many of them may consider shelter an “avoidable expense” in their quest to send money back home. They work seven hours a day, usually sleep on the streets, eat fewer than three meals a day, and spend thriftily so that they may remit money to their families in rural India. They do all this without a bank account. Many actually report storing cash bills “in the mud”.

Not surprisingly, their money is frequently stolen. Why do they use informal and dangerous

systems such as informal lenders, shopkeepers, and the Earth itself? Most cannot open a deposit account due to the bureaucratic challenges as a result of Know Your Customer (KYC) regulations. Furthermore, they forgo an income for interest of nearly Rs. 100 a month, a not at all insignificant sum.

While the Rickshaw Puller survey may be prone to a selection bias, another randomized study conducted evidenced some similar reports. “Putting Money in Motion: How Much Do Migrants Pay for Domestic Transfers” conducted by the Center for Microfinance notes that there is an inverse correlation between convenience of remittance and cost thereof. It was found that the median cost of transmitting a normal remittance of Rs. 2000 was Rs. 80, or 4%, indicating a willingness to pay for security and convenience.

The figures are staggering: if migrants had access to formal banking systems upon which they could rely for transferring money, they would save in total almost Rs. 1000 crore (Tannirkulam et al.). This underscores the need of a cheap and effective manner of transferring money.

Migration, Remittances, and Financial Inclusion

Another study (Anzoategui et al., 2011) hypothesized that there should be some link between flow of remitted money and “financial inclusion” as defined by access to some formal financial institution. Indeed, as would be expected, it was found that remittances have a positive effect on financial inclusion as a whole. The increased money flow resulted in a greater demand for deposit accounts. To note, however, is that demand for credit decreased because the credit restraints were alleviated as a result of remitted money.

Financial inclusion is not only for migrants, but may help even permanent workers in urban areas. A case study conducted by the Center for

CENTRE FOR MICROFINANCE FACT SHEET SERIES

INCLUSIVE FINANCIAL SYSTEMS – IMPROVING THE LIVES OF WORKERS AND MIGRANTS WITH FORMAL BANKING

Microfinance (“Rethinking Reserve Bank of India Regulations for MFIs”) noted that there was a positive correlation between those who had access to a formal banking system and the savings rate. Although this does not indicate a causal relationship per se, the increase in demand for savings accounts would at least partly support the claim that it is.

A large subtopic of financial inclusion discusses the technical advances necessary to ensure sound implementation of banking systems. To this end, there is a wealth of literature regarding current Indian projects that strive to enhance financial inclusion vis-à-vis modern technology, for example the Unique ID or e-banking (which would ideally work in concert). Although red-tape through policies such as KYC is a big reason the poor do not have bank accounts, other reasons include lack of awareness and perceived lack of need.

Studies by McKinsey and Co., however, suggest that there could be incredible financial windfall for many stakeholders across India were there to be an e-payment system, allowing for frictionless remittances, safe ID with biometric scanning, removal of corruption, and vastly improved efficiency overall.

McKinsey estimates that for an initial investment of Rs. 1 lakh crore (~\$25 billion), there would be an Rs. 1 lakh crore increase in efficiency per year. Government expenditure would decrease, migrants would not fear using banking systems, and many economic frictions would be removed altogether.

Other methods of financial inclusion include the Business Correspondent Model (BC). BCs capitalize on existing networks to roll-out “last-mile” financial services. In effect BCs are external agencies that represent formal banks and carry out the relevant transactions in remote areas. For example, Airtel could act as a BC in a remote village as a conduit for flow of finances through SBI.

Migration and NREGA – what’s the question?

A comprehensive study on the correlation be-

tween rural-to-urban migrant workers and NREGA (Papp 2012) yields useful insights for policymakers and researchers studying financial inclusion among the rural poor. Briefly, NREGA is India’s largest public works program – as the name indicates, it is an off-season guarantee of employment to the rural poor.

As per mandate, the government is required to provide 100 days of employment to those who ask for it, but in practice most states only achieve around 35 days worked per-capita. It was further established in this survey that this is not due to a deficiency in demand, rather due to a poor implementation suggesting a broken transmission mechanism and other supply-side factors including dearth of political will and sufficient administrative capacity.

However, despite the questionable implementation of the program, the study showed that NREGA has had a relatively significant effect on migration patterns across northwest India. As would be expected, migration in rural India is seasonal. During the harvest and monsoon seasons there are relatively plentiful opportunities for the casual workers therefore limiting the need for either NREGA or short-term migration.

However, during the agricultural off-season there is a far greater demand for work than available. This is partially alleviated by the implementation of NREGA. However, there is still a significant flux of workers in the off-season (with approximately 80% of families having reported at least one member partaking in short-term migration, wherein short term is defined as more than two consecutive days but less than 11 months outside of the village). The importance of this vis-à-vis domestic migration is compounded by another study (Johnson, 2009) that indicates that NREGA allowed workers to compensate for exogenous income shocks usually due to weather related events. Had NREGA not existed, migration rates and poverty levels might have gone up.

Of interest is that the study shows insofar as NREGA strives to increase the income of the ru-

ral poor, other programs such as cash transfers may be more effective. This is suggested because many of the rural poor said that they did (or would if they had the opportunity to do so) stay back in the village with NREGA employment as opposed to taking an urban job that pays almost double the wage.

This suggests that migrant workers are facing significant “flow costs” as a result of migration – an estimated 75% of their income! Therefore, NREGA is an effective program not only in that it aggressively redistributes income from the rich to the poor in the village, but it also curbs the incidence of migration. As accepted by Papp, NREGA is successful to the extent that it strives to mitigate the negative effects of migration.

Conclusion

A CMF (Tannirkulam et al, 2011) study concluded that the two most important factors migrant workers consider while remitting money are security (by far) and then speed of delivery. Currently, the prevalent mode of transport are Hawala Couriers. Banks are not used despite their lower costs, security, and speed as they are usually not available in the villages to which money is being remitted. That being said, the proliferation of the “Business Correspondent Model” might allow for money to be remitted through formal banking systems with the current technology.

Current policy recommendations follow the standard claim of increased access to a formal banking system, more bank branches, distribution of ATMs, etc. However, modern technology will allow a villager to be “financially included” with nothing more than a phone and a fingerprint.

References

- Anzoategui, Diego, Asli Demirgüç-Kunt, and María S. Pería. Remittances and Financial Inclusion: Evidence from El Salvador. Working paper no. WPS5839. N.p.: World Bank, 2011. Print.
- Ehrbeck, Tilman, Rajiv Lochan, Supriyo Sinha, Naveen Tahilyani, and Adil Zainulbhai. Inclusive Growth and Financial Security: The Benefits of E-payments to Indian Society. Rep. N.p.: McKinsey and, n.d. Print.
- Johnson, Doug. Can Workfare Serve as a Substitute for Weather Insurance? The Case of NREGA in Andhra Pradesh. Working paper no. 32. Chennai: Institute for Financial Management and Research, 2009. Print.
- Kc, Deepti and Rao, Ashok, Rethinking Reserve Bank of India (RBI) Regulations for MFIs. Policy Memo, Center for Microfinance, 2012.
- Nandhi, Mani A. The Urban Poor and Their Money: A Study of Cycle Rickshaw Pullers in Delhi. Rep. N.p.: Microfinance Researchers Alliance Program, 2011. Web.
- Papp, John H. “Essays on India’s Employment Guarantee.” Diss. Princeton University, 2012. Print.
- Sinha, Abhishek. Interview by GE Balajee. IFMR Trust. Institute for Financial Management and Research, 07 Apr. 2012. Web. <<http://www.ifmr.co.in/blog/2011/04/07/banks-can-do-more-on-the-business-correspondent-front/>>.
- Tannirkulam, Ajay, Shreyas Gopinath, Justin Oliver, Supriyo Bhattacharya, and R.R. Kulkarni. Putting Money in Motion: How Much Do Migrants Pay for Domestic Transfers? Rep. Chennai: Institute for Financial Management and Research, 2011. Print



Centre for Micro Finance
IITM Research Park, A1, 10th Floor
Kanagam Road (Behind TIDEL Park)
Taramani, Chennai 600113
India

Tel: (91) 44 6668-7000

Fax: (91) 44 6668-7010

Website: www.centre-for-microfinance.org

Blog: www.centreformicrofinanceblog.blogspot.com