*Finance and Opportunity in India**

By Dr. Raghuram Rajan
Governor, Reserve Bank of India

Thank You very much for inviting me here. Mrs. Pratima Doshi, Mr. Bharat Doshi, Mr. Saharia, Mr. Kshatriya, Mr. Gagarani, Mr. Bongirwar and distinguished Ladies and Gentlemen. As you have heard Mr. Lalit Doshi, was an IAS Officer who passed away at the very young age of 52 in 1994. Even though his career was cruelly cut short it was very distinguished. He was one of those bureaucrats who have constituted the steel frame of this country. I did not know him personally, but as I picked up, "He always had a smile on his face irrespective of the magnitude and the tension of the work". Let me assure you that is very difficult especially in the bureaucracy. In these days where work seems perpetual and overwhelming, he really sounds like someone who it would have been a pleasure working with. He was just a little older than I am now. His brother, Bharat Doshi, has been tireless in his efforts to honour Lalit's memory. I have known Bharat Doshi and he tells me that all three brothers looked-alike. Well, if they behaved -alike, it was a truly tragic loss and I can sympathise with the deep shock his family must have experienced. I am glad that Bharat asked me to do this and I thank him for inviting me to give today's lecture.

I am going to do a little “bait and switch”. You have come here expecting a lecture on “Financial Sector Reforms” etc. and when I sat down a few days ago to write down a speech, I said, “What? Am I going to list all the financial sector reforms we promised and what's been done?”. My colleagues in the Reserve Bank groan when they hear the five pillars. I thought about it and I said maybe I should do something different. So the title of this talk is not “Financial Sector Reforms”, I will get there, but it is entitled **“Finance and Opportunity in India”.**

We are approaching the 67th anniversary of our Independence. Sixty seven years is a long time in the life of man – indeed, it is about the average Indian's life expectancy today. Since life expectancy was shorter at the time of Independence, it is safe to say that most Indians born just after independence

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are now no more. It is useful to take stock at such a time. Did we achieve the dreams of our founding fathers for freedom's first children? Or have we fallen woefully short? What more do we need to do to make that dream a reality?

Clearly, our founding fathers wanted political freedom for the people of India – freedom to determine who we would be governed by, as well as freedom of thought, expression, belief, faith, and worship. You will see the words of the preamble to the Constitution here. They wanted justice and equality, of status and opportunity. And they wanted us to be free from poverty.

We have made substantial progress in achieving political freedom. Our democracy has matured, with people confidently choosing to vote out governments that lose touch with their needs. Our institutions protecting the freedom to vote have grown stronger, with the Election Commission and the forces of law and order ensuring free and largely fair elections throughout the country. Political parties, NGOs, the press, and individuals exert checks and balances on public policy. And the judiciary has taken important steps to protect individual freedom. That is on the political side.

On the economic side, our economy is far richer than it was at the time of independence and poverty has come down substantially, no matter what poverty line you look at. Of course, some countries like South Korea that were in a similar situation then are far better off today but many others have done far worse. Indeed, one of the advantages of a vibrant democracy, that has accompanied our growth, is that it gives people an eject button which prevents governance from getting too bad. Democracy has probably ensured more stable and equitable economic growth than an authoritarian regime might have.

Yet a dispassionate view of both our democracy and our economy would suggest some concerns. Even as our democracy and our economy have become more vibrant, an important issue in the recent election was whether we had substituted the crony socialism of the past with the crony capitalism of the present, where the rich and the influential are alleged to have received land, natural resources and spectrum in return for payoffs to venal politicians. Clearly crony capitalism is harmful to free enterprise because it kills transparency and competition and therefore it is also harmful to opportunity and economic growth, something our founding fathers cared very much about. And by substituting special interests for the public interest, it is harmful to democratic expression. If there is some truth to these perceptions of crony capitalism, a natural question is why people tolerate it. Why do they vote for the venal politician who perpetuates it? Because, I said we do have democratic freedom of expression and of the vote.

A hypothesis on the persistence of crony capitalism

One widely held hypothesis of why we have crony capitalism or corruption in public life, is that our country suffers from want of a “few good men” in politics. This view is unfair to the many upstanding people in politics. But even assuming that it is true, every so often we see an experiment where we have the emergence of a group, usually upper middle class professionals, who want to clean up politics. But when these “good” people stand for election, they tend to lose their deposits. Does the electorate really not want squeaky clean government?

Apart from the conceit that high morals lie only with the upper middle class, the error in this hypothesis may be in believing that problems stem from individual ethics rather than the system we have. In a speech I made before the Bombay Chamber of Commerce in 2008, I argued that the tolerance for the venal politician is because he is the crutch that helps the poor and underprivileged navigate a system that gives them so little access.[1] This may be why he survives.

Let me explain. Our provision of public goods is unfortunately biased against

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[1] *This idea was inspired from those in Richard Hofstadter's seminal book The Age of Reform on the difficulties of reform in the United States around the early twentieth century.*

access by the poor. In a number of states, ration shops do not supply what is due, even if one has a ration card – and too many amongst the poor do not have a ration card or a BPL card; Teachers do not show up at schools to teach; The police do not register crimes, or encroachments, especially if committed by the rich and powerful; Public hospitals are not adequately staffed and ostensibly free medicines are not available at the dispensary; …I can go on, but you know the all-too-familiar picture.

This is where the crooked but savvy politician fits in. While the poor do not have the money to "purchase" public services that are their right, they have a vote that the politician wants. The politician does a little bit to make life a little more tolerable for his poor constituents – a government job here, an FIR registered there, a land right honoured somewhere else. For this, he gets the gratitude of his voters, and more important, their vote.

Of course, there are many politicians who are honest and genuinely want to improve the lot of their voters. But perhaps the system tolerates corruption because the street smart politician is better at making the wheels of the bureaucracy creak, however slowly, in favour of his constituents. And such a system is self-sustaining. An idealist who is unwilling to "work" the system can promise to reform it, but the voters know there is little one person can do. Moreover, who will provide the patronage while the idealist is fighting the system? So why not stay with the fixer you know even if it means the reformist loses his deposit?

So the circle is complete. The poor and the under-privileged need the politician to help them get jobs and public services. The crooked politician needs the businessman to provide the funds that allow him to supply patronage to the poor and fight elections. The corrupt businessman needs the crooked politician to get public resources and contracts cheaply. And the politician needs the votes of the poor and the under-privileged. Every constituency is tied to the other in a cycle of dependence, which ensures that the status quo prevails.

Well-meaning political leaders and governments have tried, and are trying, to break this vicious cycle. How do we get more politicians to move from “fixing” the system to reforming the system? The obvious answer is to either improve the quality of public services or reduce the public's dependence on them. Both approaches are necessary.

But then how does one improve the quality of public services? The typical answer has been to increase the resources devoted to the service, and to change how it is managed. A number of worthwhile efforts are underway to improve the quality of public education and healthcare. But if resources leak or public servants are not motivated, which is likely in the worst governed states, these interventions are not very effective.

Some have argued that making a public service a right can change delivery. It is hard to imagine that simply legislating rights and creating a public expectation of delivery will, in fact, ensure delivery. After all, is there not an expectation that a ration card holder will get decent grain from the fair price shop, yet all too frequently grain is not available or is of poor quality.

Information decentralization can help. Knowing how many medicines the local public dispensary received, or how much money the local school is getting for mid-day meals, can help the public monitor delivery and alert higher-ups when the benefits are not delivered. So information helps, transparency helps. But the public delivery system is usually most apathetic where the public is poorly educated, of low social status, and disorganized, so monitoring by the poor is also unlikely to be effective.

Some argue that this is why the middle class should enjoy public benefits along with the poor, so that the former can protest against poor delivery, which will ensure high quality for all. In other words the middle-class parent will go fight the teacher who is not working and the poor child in the class room will also benefit. But making benefits universal is costly, and may still lead to indifferent delivery for the poor. The middle class may live in different areas from the poor. Indeed, even when located in the same area, the poor may not even patronize facilities frequented by the middle class because they feel out of place. And even when all patronize the same facility, providers may be able to discriminate between the voluble middle class and the uncomplaining poor.

So if more resources or better management are inadequate answers, what might work? The answer may partly lie in reducing the public's dependence on government-provided jobs or public services. A good private sector job, for example, may give a household the money to get private healthcare, education, and supplies, and reduce their need for public services. Income could increase an individual's status and increase the respect they are accorded by the teacher, the policeman or the bureaucrat.

This just postpones the problem by one. How does a poor man get a good job if he has not benefitted from good healthcare and education in the first place? In this modern world where good skills are critical to a good job, the unskilled have little recourse but to take a poorly-paying job or to look for the patronage that will get them a good job. So we are back to square one, we have arrived at a contradiction: the good delivery of public services is essential to escape the dependence on bad public services? So how do we break this contradiction?

Money Liberates and Empowers...

We need to go back to the drawing board. There is a way out of this contradiction, developing the idea that money liberates. Could we not give poor households cash instead of promising them public services? A poor household with cash can patronize whomsoever it wants, and not just the monopolistic government provider. Because the poor can pay for their medicines or their food, they will command respect from the private provider. Not only will a corrupt fair price shop owner not be able to divert the grain he gets since he has to sell at market price, but because he has to compete with the shop across the street, he cannot afford to be surly or lazy. The government can add to the effects of empowering the poor by instilling a genuine cost to being uncompetitive – by shutting down parts of the public delivery systems that do not generate enough demand or custom.

Much of what we need to do to deliver cash to the poor is already feasible and possible. The government intends to announce a scheme for full financial inclusion on Independence Day. It includes identifying the poor, creating unique biometric identifiers for them, opening linked bank accounts, and making government transfers into those accounts. When fully rolled out, I believe full financial inclusion will give the poor the choice and respect as well as the services they had to beg for in the past. It can break a link between poor public service, patronage, and corruption that is growing more worrisome over time.

Undoubtedly, cash transfers will not resolve every problem, nor are they uncontroversial. A constant refrain from paternalistic social workers is that the poor will simply drink away any transfers. In fact, studies by NGOs like SEWA indicate this is not true. Moreover, one could experiment with sending transfers to women, who may be better monitors and spenders of the cash. Some argue that attaching conditions to cash transfers – for example, they will be made provided the recipient's children attend school regularly – may improve the usage of the cash. The danger of attaching conditionality is that if the monitor is corrupt or inefficient, the whole process of direct benefits transfers, which aims to by-pass the existing structure, can be vitiated. Nevertheless, it will be useful to monitor usage carefully where automation is possible, and automatically attach further benefits to responsible usage. One such benefit, for example, might be attach more credit availability when somebody uses their account responsibly and shows they can manage cash and this certainly is part of the idea behind the government's proposed announcement.

A related concern is whether cash transfers will become addictive – whether they become millstones keeping the poor in poverty rather than stepping stones out of it. This is an important concern. Cash transfers work best when they build capabilities through education and healthcare, thus expanding opportunities for the poor, rather than when they are used solely for inessential consumption, though indeed the poor do need to consume. The vast majority amongst the poor will seize opportunities, especially for their children, with both hands. Nevertheless, if there is evidence that cash transfers are being misspent – and we should let data rather than pre-conceived notions drive policy -- some portion could be given in the form of electronic coupons that can be spent by the specified recipient only on food, education or healthcare.[2]

Another set of concerns has to do with whether private providers will bother to provide services in remote areas. Clearly, if people in remote areas have the cash to buy, private providers will find their way there. Indeed, a particularly desirable outcome will be if some of the poor find work providing services that hitherto used to be provided by public servants. Moreover, implementing cash transfers does not mean dismantling the system of public delivery wherever it is effective – it only means that the poor will pay when they use the public service and command respect because of their ability to pay.

The broader takeaway is that financial inclusion and direct benefits transfer can be a way of liberating the poor from dependency on indifferently delivered public services, and thus indirectly from the venal but effective politician. In other words economics and politics come together. It is not a cure-all but will help the poor out of poverty and towards true political independence. But financial inclusion can do more; by liberating the poor and the marginalized from the clutches of the moneylender, by providing credit and advice to the entrepreneurial amongst the poor, and by giving household the ability to save and insure against accidents, it can set them on the road to economic independence, thus strengthening the political freedom that good public services will bring. This is why financial inclusion is so important and emphasised by the RBI.

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[2] *Eventually, we will have to find a way to wean those who start earning significant amounts from receiving such transfers. How to do this without providing disincentives to working and earning is a future problem born of success which is best left for another day. The United States has dealt with the disincentive effects of getting off welfare with programs like the earned income tax credit.*

Five Ps of Financial Inclusion

Let me end with a vision of how the RBI can speed up and enhance financial inclusion of the kind I have just outlined. Financial inclusion in my view is about getting five things right: Product, Place, Price, Protection, and Profit.

If we are to draw in the poor, we need products that address their needs; a safe place to save, a reliable way to send and receive money, a quick way to borrow in times of need or to escape the clutches of the moneylender, easy-to-understand accident, life and health insurance, and an avenue to engage in saving for old age. Simplicity and reliability are key – what one thinks one is paying for is what one should get, without hidden clauses or opt-outs to trip one up. The RBI is going to nudge banks, I am careful about using the word nudge, to offer a basic suite of Products to address financial needs.

Two other attributes of products are very important. They should be easy to access at low transactions cost. In the past, this meant that the Place of delivery, that is the bank branch, had to be close to the customer. So a key element of the inclusion program was to expand bank branching in unbanked areas. Today, with various other means of reaching the customer such as the mobile phone or the business correspondent, we can be more agnostic about the means by which the customer is reached. In other words, 'Place' today need not mean physical proximity, it can mean electronic proximity, or proximity via correspondents, such as the kirana shop. Towards this end, we have liberalized the regulations on bank business correspondents, encouraged banks and mobile companies to form alliances, I see the beginnings of that these days, over and above what they were doing earlier. There is a strong move to form these alliances especially using the USSD protocol. [USSD – Unstructured Supplementary Service Data – is a protocol used by GSM cellular telephones to communicate with the services provider's computers'] We have also started the process of licensing payment banks by putting out a discussion paper on this and we will move forward as rapidly as we can.

The transactions costs of obtaining the product, including the Price and the intermediary charges, should be low. So Product, Place, Price. The price has to be low to be affordable by the poor. Since every unbanked individual likely consumes low volumes of financial services to begin with, the provider should automate transactions as far as possible to reduce costs, and use employees that are local and are commensurately paid. Furthermore, any regulatory burden should be minimal. With these objectives in mind, the RBI has started the process of licensing small local banks, and is re-examining KYC norms with a view to simplifying them. Small banks, we hope, will be local in nature, use local employees, understand local needs and be more in touch with the local community. Last month, we removed a major hurdle in the way of migrant workers and people living in makeshift structures obtaining a bank account, that of providing proof of current address. Today they can give proof of any address and the bank will verify proof of current address over time.

New and inexperienced customers will require Protection. The RBI is beefing up the Consumer Protection Code, emphasizing the need for suitable products that are simple and easy to understand. We are also working with the government on expanding financial literacy. Teaching the poor the intricacies of finance has to move beyond literacy camps and into schools. We are trying to ensure that happens. Banks that lend to the entrepreneurial poor should find ways to advise them on business management too, or find ways to engage NGOs and organizations like NABARD in the process. I am glad to say this also is picking up. We are also strengthening the customer grievance redressal mechanism, while looking to expand supervision, market intelligence, and coordination with law and order to reduce the proliferation of fly-by-night operators. There are too many of them, unfortunately, in some parts of the country.

Finally, while mandated targets are useful in indicating ambition (and allowing banks to anticipate a large enough scale so as to make investments profitable), financial inclusion cannot be achieved without it being Profitable for the provider. So the last 'P' is that there should be profits at the bottom of the pyramid. For instance, the government should be willing to pay reasonable commissions punctually for benefits transfers, and bankers should be able to charge reasonable and transparent fees or interest rates for offering services to the poor. Together, I think these five “Ps” will help us on the way to sustainable and inclusive financial development.

Let me conclude. One of the greatest dangers to the growth of developing countries is the middle income trap, where crony capitalism creates oligarchies that slow down growth. If the debate during the elections is any pointer, this is a very real concern of the public in India today. To avoid this trap, and to strengthen the independent democracy our leaders won for us sixty seven years ago, we have to improve public services, especially those targeted at the poor. A key mechanism to improve these services is through financial inclusion, which is going to be an important part of the government and the RBI's plans in the coming years. I hope many of you in this audience will join in ensuring we are successful.

Thank you.

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