FINANCIAL INCLUSION – REMITTANCES

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"Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost" (Dr. C. Rangarajan, 2008).

"Financial Inclusion, broadly defined, refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products" (Rajan, 2009).

"The RBI defines financial inclusion as the process of ensuring access to appropriate financial products and services needed by all sections of society in general and vulnerable groups, such as weaker sections and low-income groups in particular. This should be at an affordable cost in a fair and transparent manner by regulated, **mainstream institutional players" (Dr. K.C. Chakrabarty, 2013)**

ABSTRACT

The RBI defines financial inclusion as the process of ensuring access to appropriate financial products and services needed by all sections of society in general and vulnerable groups, such as weaker sections and low-income groups in particular. This should be at an affordable cost in a fair and transparent manner by regulated, mainstream institutional players. Remittances (internal and external) are important elements of financial inclusion. Remittances have an impact at the micro level and macro level. The financial sector regulator has permitted non-banks to offer external inward remittances while the constricting them from offering internal remittances. Banks presence particularly in rural India is sub-optimal. There are 105,753 *branches across all scheduled commercial banks in India of these. Of these, about 39,336 branches are in rural India. The article examines alternate channel for internal remittances which would contribute towards financial inclusion and thence economic development.*

KEY WORDS: Financial Inclusion, remittances, Non-Banking institutions, migration, money transfer scheme, payments system, economic development.

Introduction:

The essence of financial inclusion is to ensure delivery of financial services which include - bank accounts for savings and transactional purposes, low cost credit for productive, personal and other purposes, financial advisory services, insurance facilities (life and non-life) etc. Financial inclusion primarily implies access to a bank account backed by deposit insurance, **access to** affordable credit and the **payments system**.

Financial inclusion represents reliable access to affordable savings, loans, **remittances** and insurance services and pension. RBI definition of financial inclusion “access to appropriate financial products and services needed by all sections of society…. **mainstream institutional players”.** In other words RBI believes that financial inclusion (including remittances) should be brought about only by mainstream institutional players.

Migration:

Migrate is to move from one country or region and settle in another. Broadly migration could be external - people leaving the home country and going abroad or internal – people leaving the home state and going to another state. Migration in both the situations could be permanent or temporary.

Why do people migrate? There could be several factors contributing towards migration. These factors could be either pull factors or push factors. Generally,

Push factors

Strife: Due to strife people migrate to save themselves. Strife could be internal or external like war. Variants of this could be based on religion, caste, language etc.

Climatic conditions: Climatic changes play a very important role in migration of people. Drought, floods etc are the main reasons. In addition, due to old-age etc people often migrate to places of comfort.

Comfort zone: People living in urban areas often would like to lead a peaceful life post-retirement and hence migrate to rural areas where they could feel more comfortable.

Higher Education: Youngsters often migrate from developing countries to advanced economies seeking higher knowledge.

Pull factors

Livelihood: People leave a place for better environments conducive to a better life. People leave their place of living in search of greener pastures.

Family: If an immigrant has found better economic opportunities in a country, he or she will often try to have the family reuniting with him/her. So this brings in his relatives and friends to the new world.

State Policy: The policy of some nations is to attract people from other countries which would help them build their economies. There could be several reasons for this like non-availability of local labour, higher cost of local labour, lack of technical knowledge etc.

Migration of people in large numbers will eventually cause strain on availability of good land, water and public facilities and may again lead to reverse migration. Reverse migration creates pressure on the home state if the region is not equipped to handle the same.

In addition to migration of people which could be for a long term or short term there are also travel undertaken by people both internally and externally. The reasons could be several as marriages, religious ceremonies, vacation, conferences, socializing, sports, vocation related etc etc.

Remittances:

Population whether migrant or otherwise need to transfer funds/remittances due to several reasons which could include medical emergencies, higher education, pressing payments, investments, maintenance of family etc etc.

Remittances could be either external or internal. External remittances are those made by expatriates living in different countries to the home country. Also popularly known as international remittances they are resorted to mostly by international migrant labourers (white collar and blue collar).

Impact of remittances: Impact of remittances can be viewed from a macro perspective or at a micro perspective. At the micro level, remittances (whether external or internal) could be motivated by trade, investment or personal factors. For the rural population it is the personal factors which are preponderant. These include funds transfer to meet medical emergencies, children education, family maintenance, loan repayment etc. etc.

At the macro level remittances have an impact on economic growth of a country and promote balanced regional development. Remittances are a very important segment of financial inclusion the promotion of which would alleviate poverty and provide access to finance.

Impact of Remittances at the Micro level:

Enables meet life cycle working capital and exigencies: Remittances enable the receiver to meet economic emergencies. The need for funds could be to meet daily life cycle working capital requirements like payment of school fees, rent, fuel bills, electricity charges or in other words family maintenance. While majority of the remittances could be for meeting routine family expenses many a time medical emergencies, religious functions, family commitments also depend on remittances. These remittances are for small amounts but made regularly.

Reduces cost of funds: In the absence of a vibrant remittance corridor the cost of funds in deficit areas goes up. Finance is the life line for economic growth and non-availability would have adverse economic consequence. In rural areas the absence of remittance facilities leads to dependence on the informal sources for finance like money lenders and comes at a much higher cost. It is not that funds are not available to the seeker. The provider needs to transfer the funds from another geographical area and is handicapped by the absence of a medium of transfer.

Alleviates poverty: Timely availability of funds alleviates the poverty of rural India as otherwise they have to depend on the informal sources of finance. Access to finance also improves the self-efficacy of the people and develops entrepreneurial spirit. Remittances are an effective tool to reduce poverty levels.

Investments: Remittances are essential for rural folks for investing their hard earned savings. Remittances also supplement the rural resources. Investment could be in financial or non-financial assets. Rural folks would be willing to invest in financial assets (which would be useful for economic development) if the financial system enables free flow of inward and outward remittances. These remittances could be sporadic and relatively large.

Impact of Remittances at the Macro level:

Economic Impact: "For some countries money sent back in the form of remittances from migrant workers comprise a substantial portion of GDP and their balance of payments. For very poor countries like Tajikistan, remittances make up nearly 50% of GDP so clearly it is very important for increasing GDP and living standards. This money can be used to reduce relative poverty and fund capital investment. It counts as a credit in the balance of payments current account (net transfers) and so enables a higher standard of living. It can fund capital investment and small business. It could be seen as a positive demonstration of globalisation. The free movement of labour, enables greater opportunities for people in developing economies and also helps developing economies gain important foreign currency revenue. Developed countries benefit from a more elastic supply of labour, enabling greater labour market flexibility" (Economicshelp).

Remittances sent to family members enables them to meet emergencies, children education, small business, maintenance of family et all. Remittances enable to reducing global inequality of income distribution.

Reduces economic imbalance: "While previous research in the 1970s and 1980s was centered on the short-run effects of international transfers, mainly within the framework of static trade models, the focus gradually shifted to long-run considerations, notably the role of remittances in the dynamics of inequality and development. Developing countries are characterized not only by high levels of poverty, but also high levels of inequality and income volatility; since remittances have an effect on each of these dimensions, their overall economic impact – and, hence, the marginal value of a dollar of remittances – is likely to be quite large. As to their economy-wide consequences, it is clear that remittances may have a short-run macroeconomic impact through their effects on price or exchange rate levels. The long run implications of remittances, however, would seem to be more significant. First, remittances impinge on households' decisions in terms of labor supply, investment, education, migration, occupational choice, fertility, etc., with potentially important aggregated effects. Secondly, another channel whereby remittances may affect a country's long-run economic performance is through their distributional effects and impact on economic inequality, a key issue from an endogenous growth perspective" (Hillel Rapoport, 2005).

Balance of Payments: In India the external inward remittances in 2013-13 were around $67.6 billion exceeded the FDI inflow of $46.84 billion. Further, "remittances from overseas totaled $71 billion in 2013, making India the top destination for a record 6 years in a row, reveals a recent report by the World Bank(WB)". In 2012, India had received over $69.5 billion (FDI $46.84 billion). In 2012, India's IT exports had totaled $69.7 billion.

"Remittances act as a major counter-balance when capital flows are not forthcoming. Also, when a nation's currency weakens, inward remittances rise and, as such, they act as an automatic stabilizer. For Bangladesh, remittances provide vital protection against poverty" (Basu, 2013)

Economic development: Remittances or transfer of funds are important channels in reducing poverty and economic development of a country. For economic development a country needs financial resources and for this financial inclusion is a necessity. Remittances are important medium which ensures transfer of funds from surplus areas to deficit areas reduces. This important avenue does not dry up even when other channels do not contribute.

This is true both with external and internal remittances.

Provides Liquidity: Liquidity is a very important factor for markets and institutions in an economy. Bond prices, interest rates, prices etc are affected due to lack of liquidity. Unless there is a vibrant remittance channel both internal and external liquidity will be constricted with adverse consequences. Liquidity has a greasing effect on the wheels of the economy and absence of which could result in a stagnant economy.

Inflation: A vibrant remittance corridor enables smooth flow of funds from/to different regions resulting in more production of goods and services. This would result in inflation control. The poor, sick, elderly without jobs, handicapped etc are the most affected by inflation. The suffering of this silent lot goes unheard. The cruel effect of inflation makes these people even poorer.

"The Rangarajan committee, which has retained consumption expenditure as the basis for determining poverty, has pegged the total number of poor in the country at 363 million or 29.6 per cent of the population against 269.8 million" (Rangarajan, 2014).

Banks and Remittances:

Banks model has two variants – 'brick and mortar' or electronic (e-banking).

With low level of literacy and a sub-optimal level of financial literacy in the rural areas the e-model of banking would be shunned by the rural folk.

The model adopted by the banks in India is 'brick and mortar' presence.

Remittances play a significant role in financial inclusion. It provides access to finance. "From a household's perspective, remittances act as a risk transfer mechanism, helping them cope with domestic income shocks ex-post. In many developing countries, remittances have been found to vary inversely with domestic income shocks; increasing in periods of low income and decreasing at other times. In this sense, they take on an insurance role and facilitate consumption smoothing.

By relaxing financial constraints ex-post, remittances provide households with a greater ability to take risk ex-ante. In this sense they have also been credited for promoting investment in human capital and physical assets and increasing credit demand" (Shilpa Sathe).

The design structure for transfer of funds/remittances within the country (internal remittances) is sub-optimal and leaves much scope for improvement. The challenges faced by a rural person in this regard are immense.

Low level of bank penetration: "In aggregate, there are 105,753 branches across all scheduled commercial banks in India of these. Of these, about 39,336 branches are in rural India" (Mor, Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, 2014).

"Banks are important financial intermediary, but our problem is that banks access is not there, today out of 600,000 villages only 40,000 villages have bank branch;.... banks penetration is very important," (Dr.K. C. Chakrabarty, 2013)

The corridor designed by the financial sector regulator for internal remittances is that there should be a bank account/bank atleast at one part of the transaction. Meaning either the remitter or receiver should have a bank account. This requirement hurts the rural folk due to non-availability sufficient number of 'brick and mortar' branches in rural areas. The delay in receiving remittances also has an impact on the cost of funds in rural areas and adds to the cost of borrowing. The poor have no choice but to rely on the village money lender till they receive the funds from traditional money transfer methods such as money orders. Alternatively, the people living in rural areas depend on the informal tappawalas. "Ganjam migrants in Surat send home Rs. 100 crore a year, through the unique Tappawala courier system" (P.Sainath, 2009). Relying on informal remittance channels carries enormous risk for the poor.

Banks with their sub-optimal in rural areas would not able to contribute much towards the financial inclusion agenda. In addition

Corridors for Remittances: As per RBI norms to participate in the Payment and Settlement System an institution needs to obtain regulatory approval. Banks by virtue of their scheduled status become eligible to offer remittance products (subject to observing regulatory norms and regulatory approval). Hence banks can offer remittances of all types – internal and external- both inward and outward.

In addition to banks the regulatory norms also permit certain institutions to offer money transfer facilities from outside in India to any part of the country. They are "covered by Money Transfer Service Scheme (MTSS) which is a quick and easy way of transferring personal remittances from abroad to beneficiaries in India. Only inward personal remittances into India such as remittances towards family maintenance and remittances favouring foreign tourists visiting India are permissible. No outward remittance from India is permissible under MTSS.

The system envisages a tie-up between reputed money transfer companies abroad known as Overseas Principals and agents in India known as Indian Agents who would disburse funds to beneficiaries in India at ongoing exchange rates. The Indian Agent is not allowed to remit any amount to the Overseas Principal. Under MTSS the remitters and the beneficiaries are individuals only" (RBI, Master Circular, 2014)

The institutions who have regulatory approval include Western Union, Money Gram, UAE Exchange etc. These institutions have presence in far flung areas and are boon to migrant population living outside India. They are able to use this corridor and within a short time funds from abroad can reach the outlets of the institutions. Withdrawal of funds by the receiver is also simple and quick and does not involve much paper work.

However, the corridor provided by the financial sector regulator **for the transfer/remittance of funds within India** (internal remittances) is only through banks. The corridor which is made available for remittances from abroad to India is not available for transfer of funds locally. This is because the regulator wants that there should be bank involved in the transfer either remitter or at the receiver end. Perhaps the regulatory concern could be that lighter KYC observed by non-banks would lead to possible money laundering. However, this argument does not hold good as the regulator has permitted international inward remittances by non-banks. The possibility of money laundering beyond territorial waters is difficult to control rather than within a country.

Further, a close reading of the MTSS would indicate that non-banks undertake international inward remittances subject to norms laid down by the regulator. The pertinent ones are "a) cap of US $ 2500 has been placed on individual remittance. Amounts up to Rs.50,000/- may be paid in cash to a beneficiary in India. Any amount exceeding this limit shall be paid by means of account payee cheque/ demand draft/ payment order, etc. b) Only 30 remittances can be received by a single individual beneficiary under the scheme during a calendar year. c) Proper records of remitters as also beneficiaries pertaining to all pay-outs in India are to be maintained by the Overseas Principals d) Indian Agents can enter into Sub Agency agreements with entities, fulfilling certain conditions, for the purpose of undertaking money transfer business" (RBI, Master Circular, 2014).

Case Study: Consider a situation – two brothers elder and younger leave their home town in a rural area and travel in search of job. Elder one finds a job as a taxi driver in Mumbai and the younger lands in middle-east also as a driver. Both of them have no bank accounts. When they receive a message that their father is not well and urgently asked to send Rs.10,000/- the younger can easily remit the money by using UAE Exchange (MTSS) or any other international non-bank offering MTSS. The elder brother cannot remit money without a bank account. This is a peculiar situation and the people in rural area would not be able to appreciate the regulatory norms. Regulations should be enabling and not preventing transfer of funds under such circumstances. Should the regulator not consider re-visiting these norms and be aligned with the people's requirement ?

A similar facility for internal remittances would go a long way in enabling quick transfer of funds to the needy. A revisit of the regulations for internal remittances would bring about easy funds transfer and also enable financial inclusion.

Functional Perspective: "There are two fundamentally different perspectives for analysis of financial systems. The institutional perspective takes the institutional structure of the financial system as given, and looks to define what can be done to make those institutions perform their particular financial functions more efficiently. In contrast to the institutional perspective, a functional approach to designing and managing financial system, as proposed by Professor Robert Merton (Harvard Business School) and Professor Zvi Bodie (Boston University) in various papers over the last two decades, takes the functions performed by financial systems to be given, and studies the institutional structure that would best perform these functions. Financial Markets and intermediaries have been rapidly evolving due to technological advances and integration of financial markets and intermediaries around the world. Financial innovation ensures that the structure of the financial system changes over time, but the functions per se of the financial system remain stable. The basic functions of the financial system are essentially the same in all economies and do not change over time. These functions ultimately set the benchmarks for innovation in financial systems. This is why a functional perspective is more reliable and long-term than an institutional one, especially in times of a rapidly changing financial environment". (Darshana Rajendran)

Remittances could be made effective if viewed from a functional perspective and non-bank institutions allowed of offer internal remittances.

A well-functioning payment system contributes to monetary and financial stability and ensures economic efficiency. Financial inclusion has the potential to bring in the unbanked masses into the formal banking system, could lead to increased savings, provide timely credit to the unbanked masses and all these positive externalities would lead to economic growth.

"In 2007, the EU adopted the Payment Services Directive (PSD) for a harmonised legal framework for retail payment services. A Bank for International Settlement report on payments states that, in Japan, non-banks are allowed to provide funds transfers. In South Africa, non-banks can become designated clearing system participants and have full access to the clearing system provided that they meet the Central Bank's requirements. Given all these developments, any financial inclusion strategy would not be credible if it did not envisage a clear role for

independent non-bank participation in the provision of payment services" (Mor, Committee on Comprehensive Financial Services for Small Business and Low Income Households , 2013)

Conclusion: Financial inclusion and economic development are closely related. As per RBI financial inclusion is be brought by mainstream institutional players. However, it is found that banks have a number of challenges in this regard are found wanting in the financial inclusion drive. Non-banks like Western Union, Money Gram etc and payment institutions have a role to play with regard to remittances. Banks have challenges in ramping up their rural presence and have other handicap like high transaction cost, Basel III capital requirements, cost of operations, flexible timings etc etc. Non-banks and their sub-agents can score over banks in providing remittance facilities. Low cost model, minimum paper work, hazel free transfer of funds, low transaction cost, informal approach enables them to penetrate deep into rural areas. Till the banks have a presence in all villages in India and revisit their strategy, non-banks could play a role in internal remittances/funds transfer and in bringing about financial inclusion. Non-banks transfer of funds is a sustainable model and which has been proved over a period of time in respect of remittances from abroad can also be extended to cover transfer of funds internally. This could be leveraged upon to achieve the objective of Financial Inclusion.

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