



Nepal Rastra Bank

**49th SEACEN Governors' Conference,
High-level Seminar and
33rd Meeting of the SEACEN Board of Governors**
21 – 23 November 2013, Kathmandu, Nepal

Financial Sector Development Strategy for Inclusive Growth

NEPAL RASTRA BANK

21 November 2013

1



Nepal Rastra Bank

Outline

- **Background**
- **Financial Sector and Economic Growth**
- **Inclusive Finance and Inclusive Growth**
- **Reengineering of Financial Sector for Inclusive Growth**
- **Nepal's Experience on Inclusive Finance**
- **Conclusion and Observations.**

2



Background

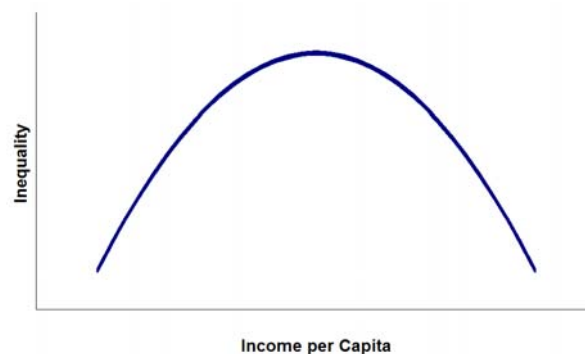
- Economic growth does not necessarily reduce poverty; nor does it raise employment.
- Often rapid growth widens inequality and makes growth unsustainable - this has taken time to be established.
- Kuznet's hypothesis: benefits from economic growth would eventually "trickle down" to lower echelon of society and thus deterioration in inequality would be naturally self-correcting.

3



Background...

Hypothetical Kuznet's Curve



Source: Kuznets (1955)

4



Background.....

- Country experiences: while economic liberalization and privatization spurred economic growth, they also resulted in wider income inequality.
- Growth not trickling down to the poorer segments of population, development thinking shifted to acknowledge the role of state for promoting inclusive growth and reducing inequality.
- Inclusive growth refers both to the pace and pattern of growth, which must be addressed together; focuses on productive employment.
- Growth is inclusive when it creates economic opportunities to the population at large along with ensuring equal access to them.

5



Financial Sector and Economic Growth

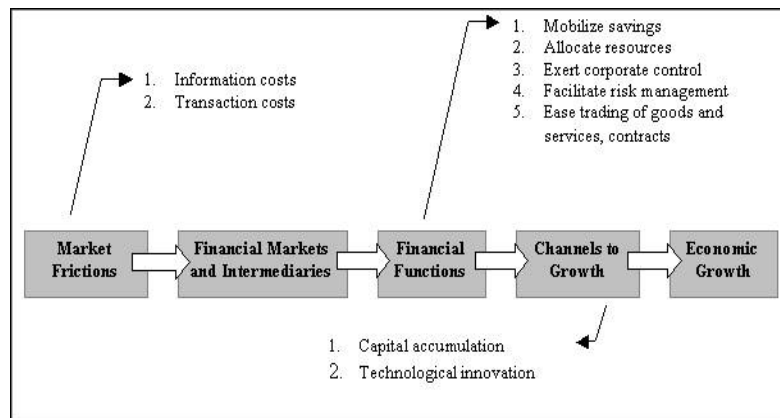
- Financial sector in general plays an important role in economic growth through efficient allocation of scarce financial resources.
- Developed financial sector ensures competition among financial intermediaries and therefore enhance the quality of financial services to expand economic activities.
- An efficient financial sector lowers the cost of production and thereby provides the essentials for income-growth and employment creation, making a vital contribution to raise standards of living.
- Financial sector also contributes to economic growth by means of overcoming market frictions, affecting saving and resource allocation decisions and altering the rate of technical innovation.

6



Financial Sector and Economic Growth...

Financial Sector-Economic Growth Nexus



7



Financial Sector and Economic Growth.....

- While financial sector development can result in higher economic growth, there is no guarantee that it will be inclusive.
- Financial sector development may itself aggravate inequality when increased number of financial institutions opt to lend only to those who possess collateral or concentrate services to a few clients.
- Poorer households or small and micro enterprises which do not have access to collateral may be rationed out of financial markets.

8



Financial Sector and Economic Growth.....

- To make contribution to inclusive growth, financial sector should possess following characteristics:
 - > Ensure wider access to finance
 - > Address supply side constraints through macro, messo and micro level credit policies
 - > promote financial safety net
- Since financial sector does not automatically take above mentioned characteristics, the role of the state and the regulators has to be realigned for achieving economic growth with equality.

9



Inclusive Finance and Inclusive Growth

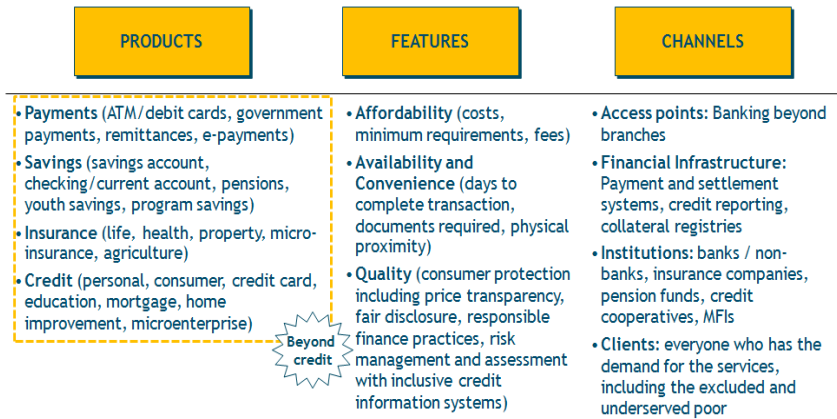
- Inclusive finance is a state in which all people of working age have access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, and with dignity for the clients.
- Inclusive finance encompasses normally the access of financial services, at reasonable cost, especially to low income groups to people excluded by location or geography.
- Safe savings, appropriately designed loans for poor and micro, small and medium-sized enterprises, and appropriate insurance and payments services can help people to work their way out of poverty.

10



Inclusive Finance and Inclusive Growth...

Key Dimensions of Inclusive Finance



Inclusive Finance and Inclusive Growth.....

- Constraints exist at both the demand and supply sides of inclusive finance
- Major demand-side constraints to inclusive finance: physical access, higher interest rates, documentation, lack of collateral, higher transaction costs, mistrust on financial institutions, etc.
- Major supply-side constraints: low temptation to retail banking, financial viability of micro-finance institutions, real and perceived risk in micro lending, high operating costs, wider competition and lack of capital.



Reengineering Financial Sector for Inclusive Growth

- Reengineer of the financial sector includes restructuring of institutional (legal & regulatory) and operational frameworks of financial institutions; re-orientation of central bank roles and responsibilities.
- Need to formulate a financial sector development strategy that caters inclusive growth
- Necessary to set defined roles and responsibilities of different stakeholders of the financial system.
- Requires a balanced role of the state, private sector as well as grass-root community and cooperative organizations in financial services.

13



Reengineering Financial Sector for Inclusive Growth..

- Financial service network including exchange and remittance services, and payment and settlement system should be scaled up appropriately so that its benefits are widely ensured.
- Access to bank accounts do not necessarily ensure inclusive growth; access to credit and other financial services are more important.
- On going discourse should guide us to a tailor made approach to formulate financial sector strategy that serves towards inclusive growth.
- Global and regional financial architecture also requires a revisit for the financial services to promote inclusive growth.

14



Nepal's Experience on Inclusive Finance

Measures taken by NRB for financial access and inclusive growth:

- NRB's monetary and financial policies oriented to support inclusive growth through macro level and micro level credit policies and financial access strategy.
- Banks and Financial institutions (BFIs) required to extend 20 % of their credit to productive sectors, comprising at least 12 % in agriculture & energy.
- Encouragement to establish financial institutions in underserved areas; interest free loan to BFIs for opening branches in those areas.
- Promotion of branchless and mobile banking in rural areas
- Targeted micro credit and financial literacy programs
- Oversight of saving and credit cooperatives.

15



Nepal's Experience on Inclusive Finance...

Measures taken by other regulators:

- Priority to local community in equity participation of hydropower projects; dedicated equity shares to local stakeholders.
- Deposit insurance of up to Rs. 0.2 million bank deposit; covers more than 80% of deposit holders
- Mutual funds catering financial instruments to the small savers; some financial instruments targeted to certain groups such as foreign employment saving bonds)
- Mandatory crop and livestock insurance schemes
- Wider participation of the people in the equity of financial institutions; 30 % shares mandatory to be floated for public.

16



Conclusion and Observations

- Evidence suggest that the financial sector, if left alone to the free market, may leave large section of society out of financial services & may heighten inequality by adversely affecting quality of economic growth.
- Financial inclusion, financial services for poor and low-income people, should be viewed as a vital and integral component of financial sector development.
- Balanced role of state in financial market and coordination among regulators are essential for promoting inclusive finance.

17



Conclusion and Observations...

Issues for further discussion:

- Role of the state & the market in promoting financial sector development that supports growth and reduces inequality...
- Key financial market regulatory strategies that foster inclusive finance to promote 'good' economic growth...
- Promoting more inclusive financial services that leads to broad based financial sector development...
- Expanding and deepening the financial sector till it can be called "inclusive"...
- New global and regional financial architecture that promotes inclusive financial system of emerging and low income economies of our region.

Thank you very much

18