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Banking with the Poor in Sri Lanka

Synopsis

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The author, in this study sponsored by IMTFI, assesses whether the poor have been able to gain access to banking facilities in the backdrop of the initiatives taken by the authorities to provide finance for all. Financial inclusion or providing finance for all has been increasingly recognized in recent times as a pre-requisite to economic development and poverty reduction. Financial inclusion can be defined as the process of ensuring timely delivery of financial services at affordable cost to the disadvantaged sections of the society. Financial inclusion empowers the poor to deal with the formal financial institutions, and thereby to enhance their savings, investment and risk-absorption capabilities. This enables them not only to facilitate consumption smoothing on a day-to-day basis but also eventually to come out of poverty. Despite the expansion of formal financial facilities following the financial sector reforms in Sri Lanka, the available evidence suggests that a greater proportion of the poor in the country are still unbanked.

1. Aims and Methodology of the Study

It has become extremely difficult to make a proper assessment on financial exclusion in the country due to the lack of a comprehensive database and qualitative information pertaining to access to finance. This has caused severe gaps in the decision making process with regard to financial access. This study was conducted with the intention of filling this lacuna by collating the necessary information, and developing a much needed database. The major aim of this research study is to ascertain the current status of financial inclusion in Sri Lanka, and to identify the constraints and prospects in the financial inclusion process with specific focus on the individuals who receive less than a dollar a day.

The study was conducted in several stages. The first step of the study was designed to collect qualitative information on the monetary habits of the selected poor households. In-depth interviews and focus group discussions were used for the purpose. These were followed by a quantitative survey covering a sample of around 1,000 households randomly selected from different districts. Based on the empirical evidence collected, further in-depth interviews and focus group discussions were conducted in remote villages which do not have any banking or other infrastructure facilities. Such a qualitative survey conducted in a poverty stricken village known as “Rathree Weva” (Night Lake) reveal how the poor villagers attempt to make a living in an environment vulnerable to frequent wild elephant attacks and hostile climatic conditions. Their livelihood has also been adversely affected in recent times by the illicit activities of some wealthy people who have come from the urban areas and encroached the jungle areas and cultivation lands with the blessings of the local politicians.

2. Financial Landscape in Sri Lanka

Prior to the spread of bank branches in the rural areas, the poor communities had used informal systems of savings and borrowing systems. Informal savings mechanisms included savings at home (in cash or in kind) or mutual savings arrangements with neighbors. In order to meet their day to day needs or to meet the expenses of a family function or a funeral, the villagers had the habit of borrowing from relatives, friends or boutique owners. In the traditional societies, the Rotating Savings and Credit Associations (ROSCAs), which are known as “Cheetus” in Sri Lanka, have been playing a crucial role in providing financial intermediation. These informal associations consist of about 15 members who form themselves as a group, and make regular contributions at regular intervals (e.g. monthly) to a common fund. The accumulated savings in each cycle is given as a lump sum to one member. The members of such groups are predominantly women in the neighborhood.

Since the 1960s the banking facilities have expanded rapidly in the country mainly as a result of the expansion of the branch networks of the two state owned banks – the People’s Bank and

the Bank of Ceylon. This process has accelerated further in the late 1970s with the adoption of the economic and financial liberalization policies which led to a branch expansion of private commercial banks and other financial entities as well. The financial institutions in the formal sector include commercial banks, specialized banks, merchant banks, finance companies and leasing establishments. Money-lenders, indigenous bankers, pawn brokers, retail traders, landlords, friends and relatives are some examples of intermediaries in the informal financial market, as mentioned earlier. Poorer households which are generally excluded from formal financial institutions still rely on such informal sources to borrow money.

3. Access to Finance

Of all households covered in the field survey of this survey, around 85 percent maintained an account with a commercial bank. The two state-owned banks are the most popular ones in the formal sector. However, it is significant to note that 25 percent of the moderately poor households and 31 percent of the ultra-poor households do not have a commercial bank account. In comparison, only 11 percent of the non-poor households have no bank account. This indicates that financial exclusion is more acute in the poorer segments of the society. Of the total number of households surveyed, only 17 percent maintain an account with specialized banks and 3 percent with non-bank financial institutions.

Around 43 percent of the households have an account with semi-formal institutions, mainly MFIs. This sector mainly serves the low-income groups: 57 percent of moderately poor households and 54 percent of ultra-poor households maintain accounts with these institutions. Thus, despite the claims made by proponents of microfinance a significant proportion of low-income households are not served by MFIs; 43 percent of moderately poor households and 54 percent of ultra-poor households do not have an account with MFIs. Around one third of the households reported that they faced some form of barrier in accessing finance during the reference period. A larger proportion of poor households faced barriers compared with the non-poor indicating that the poor have less access to financial services. Of all the households

surveyed, 45 percent reported lack of regular employment, and another 31 percent reported inadequate income as the main reason for their inability to open a bank account. A greater proportion of the poor failed to open an account due to these two reasons. Among the non-poor, unawareness of banking activities is also a major reason for not having an account.

It is clear from the above findings that effective access to financial institutions largely depends on a person's ability to earn and save. Mere availability of financial facilities to all, as advocated by the proponents of financial inclusion in recent times, does not guarantee that everybody can use such facilities. If the person's income is not sufficient to generate adequate savings, then he cannot effectively utilize saving and credit facilities. These micro level findings are supported by our earlier argument based on macroeconomic foundations which showed that the country's national savings rate remains low as a result of the low per capita income level.

4. Financial Exclusion in a Poverty Stricken Village Affected by Wild Elephant Attacks

Taking into account the above geographical disparities, we conducted in-depth surveys among selected households in several remote villages in less-developed districts to examine the extent of financial exclusion in such areas. In urban areas which enjoy better infrastructure facilities the degree of financial inclusion is much higher when compared with remote rural villages. The underprivileged rural areas are mostly poverty stricken and often neglected by commercial banks and other formal financial institutions due to their low economic activities. Hence, financial exclusion is prevalent in these areas. Information regarding such problems is not available. Therefore, high priority was given in this study to understand these problems. Accordingly, qualitative surveys were conducted in the selected villages in poverty stricken areas. One such survey was conducted in the *Moneragala* District which has high poverty incidence. The financial facilities available in the *Moneragala* district are not satisfactory in comparison with metropolitan areas. This is reflected in the low banking density index which is only 11 in the *Moneragala* District as against 26 in the *Colombo* District.

We conducted several in-depth interviews with the selected households in a village known as '*Raththree Wewa*' (which means 'night lake') belonging to the *Buttala* Divisional Secretariat of in *Monaragala* District. The name of the village - *Raththree Wewa* – was originated from the name of the lake. This village is about 20 kms away from the nearest town, *Buttala*. It is situated close to the boundary of the jungles of the *Yala* wildlife area. The village settlement was started about thirty years ago and most of the settlers have migrated from the surrounding areas like the *Okkampitiya* village and the *Monaragala* town. Some settlers have come and settled down from far away places and the original purpose of their migration to the area was not cultivation, but some other activities like gem-mining. The settlers have cleared tracts of land areas from the jungle, and initially they had '*chena*' cultivations. Now some of them are cultivate irrigated (partly under rain water), and non-irrigated agricultural lands. The village consists of 81 households with a population of nearly 250. The first and second generations of the cultivators still continue with their work, while the third generation tends to move away from agricultural related work and concentrate more on education, private sectors jobs and vocational training.

The lack of water resources is a major obstacle for agriculture in the village. The villagers cultivate paddy using the water of the lake. The sole water source for the reservoir is rain water. Therefore, the cultivation depends heavily on the pattern of rainfall.

Large scale cultivators are also there. They cultivate 50-100 acres with the blessings of politicians. These people come from areas like Rthnapura, Nuwara and Galle. Large tract holders have 'solar fence' and elephants are attracted to small land holders' plots".

Since the village is carved out from the jungle area, it is frequently attacked by wild elephants that infiltrate into the village. The accumulated physical assets and food of the villagers are vulnerable to such calamities, and this has aggravated their poverty conditions. Elephants come to the village in large herds. Usually elephants come after the harvest is reaped. Major reason for this is the clearing of the jungles. This area is known as '*alinge bodima*' (the boarding place of elephants). The path of elephants (*Alimanthale*) cuts across this village. Often the cultivations are

affected by weather (heavy rain or draught) and wild elephant attacks. Another observation that we made during our field visit was that large extents of jungles are being cleared by large scale cultivators, hotel developers and other entrepreneurs who have come from other parts of the country dislocating wild elephants from their original forest areas. According to the villagers, most of such entrepreneurs are politicians or their supporters. Therefore, the villages are afraid of these powerful encroachers.

Most villagers do not have legal ownership to the lands that they cultivate for a long period of time. The distribution of the lands among the house-holds is unequal. The majority of the households own plots of land in the size of 2-4 acres. Only a few members of the village claim for medium size lands of about 15-25 acres, and they cultivate them with hired labor. The small holdings are cultivated by family members and both male and female labour contributes for the process. Lands can be divided as wet and dry (*goda/mada*) according to the type of cultivation. Mostly, paddy cultivation is done in wet land, which gets irrigated water from the village tank. Since irrigated water is scarce, paddy is also cultivated under rain water in dry lands. Usually, settlers intrude the jungle areas, and converted them into their own farmlands. At present new lands are not much cleared by villagers, but they complain that there is huge land business sponsored by politically influenced people. The study found that, for large scale cultivation of commercial crops like banana, outsiders (foreign or local) have been given lands illegally with the blessings of politicians. The villagers fear that their lands will also be taken over by such powerful groups.

Traditionally, paddy has been the main economic activity in this village. As paddy cultivation has become less profitable due to large requirements of water, labor, fertilizer and chemicals, the farmers have shifted to other crops such as maize (corn). They also cultivate a variety of fruits, vegetables and coconuts in their home gardens. These cultivations are frequently destroyed by wild elephants. The non-agricultural activities of the villagers include brick making, boutique trading, collecting forest resources, gem mining and milk collecting.

Although the large scale farmers (15-25 acres) have the capacity to earn a considerable income, the average small holding cultivators (1-5 acres) do not have sufficient income to meet their essential needs. As the income is insufficient, the villagers are unable to save or invest. As a result, they are not in a position to improve the productivity in their cultivation and small enterprise. This leads to low incomes and savings again. This situation in the *Rathree Wewa* village is somewhat analogous to the concept of 'vicious circle of poverty' introduced by Nurkse (1953) with regard to poor countries. He described 'vicious circle of poverty' as the basic cause of under-development of poor countries. According to him, a country is poor because it is poor. Being poor, the low income levels of a country have implications for both demand and supply sides. On the supply side, the low level of savings leads to low level of investment and to deficiency of capital. The low of investment leads to low level of productivity. When the productivity per worker is low, the real income will obviously be low and so there poverty and vicious circle is complete. On the side of demand when people have low incomes, the demand for goods is bound to be small. In a small market, therefore, there is no incentive to invest in physical or human capital. When the rate of investment is low, the productivity of the factors of production is bound to be low. Low productivity leads to low per capital income which is rapidly absorbed by the rising population growth. The country, therefore, remains poor.

In the context of the vicious circle of poverty, the villagers in *Rathree Wewa* do not have any space to engage in financial activities. As their savings are low, they do not need the services of banking institutions to meet any savings needs. For the same reason they do not have capacity to borrow from banking institutions. Therefore, the villagers hardly go to commercial bank branches located in the *Buttala* town. Non-bank financial institutions such as microfinance institutions do not exist in the village. The villagers have the habit of keeping their small savings in the form of cash in a safe place in the house.

5. Concluding Remarks

In this study we argued that providing financial access to all will not be a panacea for all socioeconomic ills. Even if financial facilities are available to all, each recipient of such finance

cannot become an entrepreneur and contribute to economic growth or poverty reduction. There are many other factors that inhibit economic progress in countries such as Sri Lanka. These include poor infrastructure, low productivity, political instability and macroeconomic imbalances. All these factors adversely affect the investment climate. A major factor that limits access to finance is low income levels and the resulting low savings of a large proportion of households. In such a situation these households are unable to deal with financial institutions for their savings or borrowing purposes. In most cases such households voluntarily withdraw from the formal financial sector, and engage in informal transactions. A mere improvement of financial inclusion will not help them to overcome poverty, unless there is a breakthrough in their income levels. Such progress can be achieved only through an acceleration of economic growth and employment generation. Therefore, it is essential to address the constraints in the overall economy so as to break the financial exclusion and poverty trap.

Although financial facilities have expanded following the financial reforms, a large proportion of households fail to save adequate amounts in banks, as their incomes are low. The qualitative surveys conducted in the less-developed villages reveal that most of the villagers, whose main income source is agriculture, do not have sufficient income to meet their basic needs, and they are trapped in a vicious circle of poverty. They are not in a position to engage in financial activities, and hence they are excluded from the financial system. Thus, an improvement in their living conditions cannot be expected by a mere introduction of financial inclusion.



Figure 1: A wild elephant behind the electric fence



Figure 2: Poor road conditions



Figure 3: An interview in progress



Figure 4 Road development



Figure 5: "Rathree Weva" (Night Lake)



Figure 6: Maize cultivation



Figure 7: A villager showing his bank pass book