Financial Inclusion- A Strategy for Inclusive Growth in India

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Abstract: The two decades of post reform period in India demonstrated the transformation of the economy in to one of the fastest growing economies of the world signaling the emergence of the nation in the new geo political and economic order and hence eliciting lot of international attention. These developments suggest that the economy is now at a point when it can achieve sustained economic expansion that has the potential to bring significant improvement in the lives of our people. If this momentum can be accelerated in the years ahead, it will put India on the path to becoming one of the key players in the world economy over the next two decades.

These positive factors notwithstanding, a major weakness observed in the economy is that the growth is not perceived as being sufficiently inclusive. The percentage of the population below the official poverty line has come down from 36% in 1993–94 to 28% in 2004–05. However, not only is this still high, the rate of decline in poverty has not accelerated along with the growth in GDP, and the incidence of poverty among certain marginalized groups, for example the STs, has hardly declined at all. Because population has also grown, the absolute number of poor people has declined a marginally from 320 million in 1993–94 to 302 million in 2004-05.

I - WHAT IS INCLUSIVE GROWTH

"Rapid and sustained poverty reduction is a prerequisite for inclusive growth, that allows people to contribute to and benefit from economic growth." Rapid pace of growth is unquestionably necessary for substantial poverty reduction, but for this growth to be sustainable in the long run, it should be *broad-based* across sectors, and *inclusive* of the large part of the country's labor force. This definition of inclusive growth implies a direct link between the macro and micro determinants of growth.

The inclusive growth approach takes a longer term perspective as the focus is on productive employment rather than on direct income redistribution, as a means of increasing incomes for excluded groups.

II - STRATEGY FOR MORE INCLUSIVE GROWTH

Economic growth models do not establish or suggest, however, an explicit causal-effect relationship between a country's rates of economic growth and the resulting poverty reduction, although policymakers often assume an implicit connection. The current literature provides some guidelines about conditions under which economic growth might be 'inclusive' or 'pro-poor', although how these concepts should be defined remains controversial.

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One view is that growth is 'pro-poor' only if the incomes of poor people grow faster than those of the population as a whole, i.e., inequality declines (e.g., Kakwani and Pernia, 2000). An alternative position is that growth should be considered to be pro-poor as long as poor people also benefit in absolute terms, as reflected in some agreed poverty measure (Ravallion, 2004). The empirical evidence about the relationship between economic growth and poverty reduction suggests that no particular development model is uniquely pro-poor and that the relationship can only be considered empirically, at the case-by-case level

Recent literature suggests that while sustained economic growth must be a necessary condition for significant poverty reduction, it is not a sufficient condition. It is now being argued that Financial inclusion of the large mass of poor is an essential prerequisite of inclusive growth.

III - IMPORTANCE OF FINANCIAL INCLUSION:

By financial inclusion, we mean the delivery of financial services, including banking services and credit, at an affordable cost to the vast sections of disadvantaged and low-income groups who tend to be excluded. The various financial services include access to savings, loans, insurance, payments and remittance facilities offered by the formal financial system. Among the key financial services that are of great relevance here are risk management or risk mitigation services vis-à-vis economic shocks. Such shocks may be an income shock due to adverse weather conditions or natural disasters, or an expenditure shock due to health emergencies or accidents.

Financial inclusion, when promoted in the significant wider context of economic inclusion, can lead to significant improvement in the financial conditions and improve the standards of living of the poor and deprived section of population. Access to affordable financial services would lead to increasing economic activities and employment opportunities for rural households with a possible multiplier effect on the economy.

It could enable a higher disposable income in the hands of rural households leading to greater savings and a wider deposit base for banks and other financial institutions.

It will enable the Government to provide social development benefits and subsidies directly to the beneficiary bank accounts, thereby drastically reducing leakages and pilferages in social welfare schemes. Thus, financial inclusion could be an instrument to provide monetary fuel for economic growth and is critical for achieving inclusive growth.

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IV Financial Inclusion In India: Current Status.

Data from Census, 2011 estimates that only 58.7 percent of the households have access to banking services. The present banking network of the country (as on 31.03.2014) comprises of a bank branch network of 1,15,082 and an ATM network of 1,60,055. Of these, 43,962 branches (38.2 percent) and 23,334 ATMs (14.58 percent) are in rural areas. According to World Bank Findex Survey (2012) only 35 percent of Indian adults had access to a formal bank account and 8 percent borrowed from a formal financial institution in last 12 months.

Access to formal financial institutions has improved gradually but thousand of villages still lack a bank branch; less than 10 percent of all commercial bank credit goes to rural areas, where around 70 per cent of the total population lives6. Data from the RBI show that only 46,126 out of 640,867 villages in India were covered by banks in March 20147. Thus the need for financial inclusion is beyond question.

V - CHALLENGES TO FINANCIAL INCLUSION

There are many challenges faced by banks in India on financial inclusion process. Even though there are many villages in the country without bank branches, penetration of bank branches in to rural areas is difficult as they are unviable, saturated and having higher transaction cost. The villages are fragmented limiting the scale of operation of banks in rural areas. This necessitates last mile of financial inclusion to be met with a combination of agents and providers through technology leverage.

VI - BUSINESS CORRESPONDENT MODEL

The concept was first mooted by the Reserve Bank of India in 2005 and Branchless Banking through Banking Agents called *"Bank Mitr"* (Business Correspondent) was started in the year 2006. In the year 2011, the Government of India gave a serious push to the program by undertaking the *"Swabhimaan"* campaign to cover over 74,000 villages, with population more than 2,000 (as per 2001 census), with banking facilities2. Because of the RBI" s drive for financial inclusion, the number of bank accounts increased by about 100 million during 2011-13.

The present Business Correspondent (BC) model is too restrictive, cash delivery points are too modest and the ideal financial inclusion model is yet to evolve in the country. The compensation paid to the B C was also not very attractive. The Swabhimaan campaign, was also limited in its approach in terms of reach and coverage. Convergence of various aspects of comprehensive Financial Inclusion like opening of bank accounts, digital access to money (receipt/credit of money through electronic payment channels), availing of micro credit, insurance and pension was lacking. The campaign focused only on the supply side by providing banking facility in villages of population greater than 2000 but the entire geography was not targeted.

Pradhan Mantri Jan Dhan Yojana – A Fact Sheet: The scheme aims to provide at least one bank account to each household across the country, with a target of covering 75 million households by 26 January 2015. Targeted at those who have never had a bank account in their lives, the scheme has simplified the whole process of opening an account.

The KYC (know-your customer) rules to open a bank account have been simplified; the only document required is either Aadhar card, voter's identity card, driving license, PAN card, or card issue under MGNREGA. Even if the address mentioned in the document is different from the current residence of the applicant, a self-declaration will suffice. For those who do not have any of above mentioned identity proofs, a "small account" could be opened with a self-attested photograph along with signature or thumb impression in the presence of the bank official.

The PMJDY is being implemented in two phases. In the first phase (till August 14, 2015) every account holder will receive a RuPay debit card, and will be able to use basic mobile banking services, such as balance enquiry. Further, every account holder under the scheme will get an accident insurance cover of Rs.1 lakh. Bank accounts opened between 28 August 2014 and 26 January 2015 would also get life insurance cover worth Rs30,000/-. These accounts are also eligible for over draft facility of Rs.5,000/- based on performance during the first six months.

There will also be a financial literacy programme, expansion of Direct Benefit Transfer under various schemes through the beneficiaries" bank accounts, and issuance of RuPay, Kisan Card. In the second phase (from August 2015 to 14 August 2018), micro insurance and unorganized sector pension schemes would also be provided. Bank accounts opened after 26 January 2015 would be eligible for life insurance cover and micro insurance in this phase. As it is difficult to spread bank branches across all unbanked areas, Business Correspondents (BCs) will be deployed on a large scale to help execute the plan.

VII - THE PROGRAMME FOR FINANCIAL INCLUSION UNDER THE PMJDY IS BASED ON SIX PILLARS:

1. The country will be divided into a number of sub-service areas (SSA), each with 1,000-1,500 households. One banking outlet (branch or BC) will be established within a distance of five km from every SSA by August 2015;
2. One bank account will be ensured for every household by August 2015, along with a RuPay debit card and an accident cover worth Rs.1,00,000. If the credit history is satisfactory during the first six months, the account holder will become eligible for an overdraft worth Rs.5,000;
3. Financial literacy programmes will be expanded by August 2015 to spread awareness about financial services;
4. A Credit Guarantee Fund will be created before August 2018 to cover potential defaults in overdrafts;
5. All willing and eligible persons will be provided with micro-insurance by August 2018; and
6. Pension payments under the Swavalamban Yojana scheme for workers in the unorganised sector will be paid through bank accounts by August 2018.

VIII - THE IMPLEMENTATION STRATEGY

The implementation strategy of the plan is to utilize the existing banking infrastructure as well as expand the same to cover all households. While the existing banking network would be fully geared up to open bank accounts of the uncovered households in both rural and urban areas, the banking sector would also be expanding itself to set up an additional 50,000 Business correspondents (BCs), more than 7000 branches and more than 20,000 new ATMs in the first phase. Keeping the stiff targets in mind, in the first phase, the plan would focus on first three pillars in the first year starting from 15th August, 2014.

The target for setting up additional 50,000 BCs is quite challenging given the constraints of telecom connectivity. In order to achieve this plan, phase wise and State wise targets for Banks have been set up for Banks for the period 15th August, 2014 to 14th August, 2015. Roles of various stakeholders like other five Departments of the Central Government, State Governments, RBI, NABARD, NPCI and others have been indicated. Gram Dak Sewaks in rural areas are proposed as Business Correspondent of Banks. Department of Telecom has been requested to ensure that problems of poor and no connectivity are resolved. It is understood that of the 5.93 lakh inhabited villages in the country (2011 census) only about 50,000 villages are not covered with Telecom connectivity.

IX - NEW INITIATIVE OF PAYMENT BANKS

The Reserve Bank of India has given its approval to 11 entities for opening of payment banks. Payment banks, is another revolution which intended at making banking easy for people. Anyone can open an account with a payment bank and transact. There are no criteria of level of income to open a savings or a current account. Payment banks aim at covering vast range of population that has no access to financial services. The biggest advantage of payment banks is connectivity. Even a grocery store can become a facilitator of a payment bank, which is very much unlike a traditional bank. Thus this will help to bridge the miles between bank branch and customers in the remote places of the country.

The capital requirement to start a payment bank was set at Rs 100 crore. Payment banks would provide barebones banking facilities. Like traditional banks, payment banks will accept deposits upto a sum of Rs 1 lakh, defray interest, convey remittances and dispense payments to recipients (on behalf of account holders) or issue debit cards. They can also offer financial products such as mutual funds and insurance.

But as the word 'payment bank' denotes, unlike traditional banks, they (payment banks) will not be able to offer you a loan or a credit cards. They can only lend to the Government (vide the need to invest at least 75% of their funds in Government securities), which thereby makes them the safest of the banks; as in mostly likely chances Government of India will not default.

X - FINANCIAL LITERACY INITIATIVE

Last but not the least, Financial Inclusion and Financial Literacy are twin pillars. While Financial Inclusion acts from supply side providing the financial market/services what people demand, Financial Literacy stimulates the demand side – making people aware of what they can demand. Several agencies have been at work in various parts of the country since last 3-4 years imparting education on microfinance that need to be broad-based to create more holistic awareness of people.

XI - CONCLUSIONS

Policy makers now consider Financial Inclusion as an important part of not only of Inclusive growth effort but also desirable from the point of view of direct intervention of the Government for poverty eradication. The Direct Cash Transfer of subsidies into the bank accounts of the beneficiaries is a landmark step in this direction.

Financial inclusion presents number of benefits to low income households and small and micro-enterprises in the country. It helps low-income families who have small, unpredictable, and often seasonal incomes to manage their resources well. Families use financial services to gain access to education, health care, and other necessities that improve their quality of life. Empirical evidence suggests that improved access to finance is not only pro-growth but also pro-poor, reducing income inequality and poverty. Use of innovative methods of providing financial inclusion, technology and the UID scheme have the potential of bringing revolutionary changes in financial inclusion in India.

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