NEW FINANCIAL INCLUSION FOR ECONOMIC GROWTH IN INDIA

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Abstract

India is one of the largest and fastest growing economies of the world, but what has been the most disturbing fact about its growth is that its growth has not only been uneven but also discrete. It has been uneven in the sense that there has been no uniformity in its growth performance and it has been discrete and disconnected with regard to growth and distribution of growth benefits to certain sectors of economy. And thus the need for inclusive growth comes in the picture of Indian economic development. However for attaining the objectives of inclusive growth there is a need for resources, and for resource generation and mobilization financial inclusion is required. It plays a very crucial role in the process of economic growth. As the majority of the rural population is still not included in the inclusive growth, the concept of financial inclusion becomes a challenge for the Indian economy. Since 2005, many concerted measures are initiated by the Reserve Bank of India and Government of India in favour of financial inclusion.

Keywords: Financial inclusion, Business correspondents, Indian economy.

I. INTRODUCTION

India is one of the largest and fastest growing economies of the world, but what has been the most disturbing fact about its growth is that its growth has not only been uneven but also discrete. It has been uneven in the sense that there has been no uniformity in its growth performance and it has been discrete and disconnected with regard to growth and distribution of growth benefits to certain sectors of economy. The majority of the population remained outside the ambit of basic health and education facilities during this high growth phase. In recent decades, economic and social inequalities have increased alongside high growth rates which have increased regional inequalities. Over 25% of Indians continue to live in abject poverty. As a result, Inclusive growth has become a national policy objective of the Union Government. And thus the need for inclusive growth comes in the picture of Indian economic development. In context of Indian growth planning it is a relatively new terminology which got the attention of policy makers in the Eleventh Five Year Plan.

Inclusive growth as the literal meaning of the two words refers to both the pace and the pattern of the economic growth, it basically means, broad based, shared, and pro-poor growth. As per the Planning Commission of India “The term “inclusive” should be seen as a process of including
the excluded as agents whose participation is essential in the very design of the development process and not simply as welfare targets of development programmes.” In a simpler and wider sense it means that inclusive growth as a strategy of economic development should not only aim at equitable distribution of growth benefits but also at creating economic opportunities along with equal access to them for all. In the present paper an effort has been made to understand the inclusive growth phenomenon its need and financial inclusion as an instrument to attain it with reference to its extent in Indian States.

**Literature Review**

Levine (1997) empirically tested the neo-classical view and finds that countries with larger banks and more active stock markets grow faster over subsequent decades even after controlling for many other factors underlying economic growth. Equally important is access to finance by all segments of the society (Levine 1997, Pande and Burgess 2003). Finance can also play a positive role in poverty reduction. A well developed financial system accessible to all reduces information and transaction costs, influence saving rates, investment decisions, technological innovation, and long-run growth rates (Beck et al. 2009).

Binswanger and Khandker (1995) and Pande and Burgess (2003) suggest that Indian rural branch expansion program significantly lowered rural poverty, and increased non-agricultural employment. A key objective in development economics is to work out ways to lift people out of poverty. Access to finance has been seen as a critical factor in enabling people to transform their production and employment activities and to exit poverty (Aghion and Bolton 1997, Banerjee 2001, Banerjee and Newman 1993, Pande and Burgess 2003, Yunus 1999).

In recent years, financial inclusion has assumed public policy relevance. Many countries like India (Government of India 2008) and the United Kingdom (UK) (2006) and International organizations like the United Nations (2006), World Bank (2008, 2009) have set up task force/committees to understand financial inclusion and to improve its scope.

These studies throw light on various aspects of financial inclusion. However, the measurement aspect of financial inclusion has, so far, not extensively been covered by these reports. For India, being a very well diversified economy and society, it is imperative to give adequate attention to measurement of financial inclusion. There are few scholars who have attempted to measure some aspects of financial inclusion.

Honohan (2007) estimated the fraction of the adult population using formal financial intermediaries using the information on number of banking and MFI accounts for more than 160 countries, and then correlated with inequality (Gini Coefficient) and poverty. Sarma (2008) developed an Index for financial inclusion using aggregate banking variables like number of account, number of bank branches and total credit and deposit as proportion of GDP for 55 countries.

Rangarajan Committee (2008) viewed financial inclusion 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”.

Mehrotra et al. (2009) also built up an index for financial inclusion using similar kind of aggregate indicators like number of rural offices, number of rural deposit accounts, volume of rural deposit and credit from banking data for sixteen major states of India. World Bank (2008) provides a composite measure of access to financial services,
that is, the percentage of adult population that has an account with a financial intermediary for 51 countries.

World Bank (2009) in Banking the Poor analyzed the association between access to banking services, as measured by the number of bank accounts per thousand adults in each country, and several other factors like transactions offered at banks, or required by banks, and regulations adopted by country authorities that may affect banking access for 45 countries.

Beck et al. (2009) discusses about the availability of copious amount of data on many aspects of the financial system, but systematic indicators of inclusiveness of financial sector are lacking. Sadhan Kumar Chattopadhyay in a working paper for RBI on Financial Inclusion in India:

A case-study of West Bengal (2011), has examined the extent of financial inclusion in West Bengal. According to the study there has been an improvement in outreach activity in the banking sector, but the achievement is not significant. An index of financial inclusion (IFI) has been developed in the study using data on three dimensions of financial inclusion viz- banking.

II. OBJECTIVES
1. To study and understand the meaning and need for inclusive growth.
2. To study the role of financial inclusion in inclusive growth.
3. To know the extent of financial exclusion/inclusion in India.
4. To understand the extent of diversity in Indian states with regard to financial inclusion

Research Methodology

The research has been done using secondary data source. Analysis of natural hierarchical grouping cluster is done considering parameters like GDP per capita, literacy rate, unemployment rate and index of financial inclusion (Johnson R.A. and Wichern D.W., 2000). The choices of measure of similarity are based on Euclidean distances between multidimensional observations. Further hierarchical clustering method has been displayed by considering average linkage between the groups.

Need for Inclusive Growth

India needs inclusive growth in order to attain rapid and disciplined growth. Inclusive growth is necessary for sustainable development and equitable distribution of wealth and prosperity. Achieving inclusive growth is important and is one of the biggest challenges for India. The challenge is to take the levels of growth to all section of the society and to all parts of the country. Rapid growth in the rural economy, sustainable urban growth, infrastructure development, reforms in education, health, ensuring future energy needs, a healthy public-private partnership, intent o secure inclusivity, making all sections of society equal stakeholders in growth, and above all good governance will ensure that India achieves what it deserves.

The main thrust areas for need of inclusive growth can be summarized as below:
• Removal of poverty and unemployment
• Removal of income inequalities
• Agricultural Development
• Reduction in regional disparity
• For social sector development
• Protecting environment

However for attaining the objectives of inclusive growth there is a need for resources, and for resource generation and mobilization financial inclusion is required. It plays a very crucial role in the process of economic growth. Financial inclusion through appropriate financial services can solve the problem of resource availability, mobilization and allocation.
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.

Rangarajan Committee (2008) viewed financial inclusion 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”.

In simpler terms financial inclusion is about including the excluded in the financial system of the country, and to ensure that their financial & social security needs are taken care of through appropriate financial service providers.

Role of Financial Inclusion

Financial Inclusion is imperative for inclusive growth of India, with more than 25% of its population living in abject poverty government’s onus towards their growth and development is huge, and inclusive finance is one such measure which if targeted and attained in right manner will provide an apt solution to the severe problems of poverty and unemployment.

Providing access to financial services has significant potential to help lift the poor out of the cycle of poverty. Financial inclusion promotes thrift and develops culture of saving and also enables efficient payment mechanism strengthening the resource base of the financial institution which benefits the economy as resources become available for efficient payment mechanism and allocation.

Financial Inclusion for Inclusive Growth of India- A Study of Indian States

Poors are typically more vulnerable to financial exclusion this is simply because their major problems arise from the need for finances. The formal banking services, by exploiting economies of scale and making judicious use of targeted subsidies may reduce or remove market imperfections and facilitate financial inclusion of the poor, ultimately leading to higher incomes. The access to financial services by poor’s would lead to their consumption smoothing and investments in health, education and income generating activities, thus expanding growth opportunities for them. Inclusive growth if targeted systematically may lead to financial stability, asset building and economic mobility and empowerment of the low income group people.


The above mentioned diagram clearly prescribes the three dimensional approach which is required for financial inclusion and its outcomes. Thus if we are talking about inclusive growth with stability, it is not possible without financial inclusion. However one need to understand that inclusive finance is a long run phenomenon which cannot be achieved overnight, especially with regard to developing country like India where the access to financial products is constrained by several factors such as lack of awareness, unaffordability, high transaction costs, and inconvenient, inflexible and low quality of products. In the further section of the paper we will try to find out the extent of financial inclusion in India.

Extent of Financial Inclusion in India

Several countries across the globe now look at financial inclusion as the means for a more comprehensive growth, wherein, each citizen of the
country is able to use his/her earnings as a financial resource that they can put to work to improve their future financial status and simultaneously contribute to the nation’s progress. Financial inclusion has always been accorded high importance by the Reserve Bank and Government of India to aid the inclusive growth process for the economy, the history of financial inclusion in India is actually much older than the formal adoption of the objective.

However in order to find out the group linkages the author has employed cluster analysis of few selected states on the basis of parameters such as GDP per capita (annual), literacy rate, Unemployment rate and Index of Financial Inclusion of the states. It indicates the Average linkage between the various groups formed on the basis of above said parameters.

The analysis shows that at five rescaled distance three major clusters emerged from the considered parameters. Following are some of the major interpretations made from the analysis:

- **Cluster-1** Comprises of states Karnataka, Gujarat, Kerala and Maharashtra.
- **Cluster-2** Comprises of states Kerala, Gujarat, Maharashtra, Tamil Nadu, Mizoram, Rajasthan, Orissa and Meghalaya
- **Cluster-3** Comprises of states Orissa, Meghalaya, Manipur and Uttar Pradesh.

The clusters are submerged within the states showing inter linkages amongst the clusters.

- It is noticed that the states with highest financial inclusion not only account for high GDP per capita and Literacy rate but also for high rate of unemployment.
- Moreover it is found that Gujarat is one such exceptional state where the GDP per capita & literacy rate is higher than the country’s average and the rate of unemployment is also quite low but the financial inclusion of this state is considerably low.

### III. CONCLUSIONS

Inclusive growth attainment depends a great deal on equitable distribution of growth opportunities and benefits. And financial inclusion is one of the most crucial opportunities which need to be equitably distributed in the country in order to attain comprehensive growth. It needs to be understood by the state that in order to bring orderly growth, order needs to be developed with regard to inclusive finance. The percentage of financial inclusion in the different states of the country varies differently. For instance Kerala, Maharashtra and Karnataka accounts for higher rate of financial inclusion but the states such as Gujarat, Manipur, Assam, Bihar, Uttar Pradesh, and Madhya Pradesh, etc stand poorly on the grounds of financial inclusion.

Undoubtedly the issue of expanding the geographical and demographic reach poses challenges from the viability/sustainability perspectives and appropriate business models are still evolving and various delivery mechanisms are being experimented with by the various government agencies at the central and state level. But somewhere the efforts taken are not good enough to encounter this staggering issue of financial exclusion.

Financial literacy and level of awareness continue to remain an issue with regard to usage of financial services/products. It calls for coordination of all the stakeholders like sectoral regulators, banks, governments, civil societies, NGOs, etc. to achieve the objective of financial inclusion. Challenges of financial exclusion are faced by most of the states of the country and in order to solve it states have to develop its own customized solutions drawing upon its own experiences and features and those of its peers across the country.
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