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FINANCIAL INCLUSION AND ECONOMIC GROWTH

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ABSTRACT

This paper summarizes financial inclusion strategy of Indian banks across India. To accelerate the growth and development and condense the income inequality and poverty, the access to safe, easy and affordable credit and other financial services to the poor and vulnerable groups, are recognized as a pre-condition. The aim of financial inclusion is delivery of banking and financial services in a fair, translucent and impartial manner at reasonable cost to the vast sections of disadvantaged and low income group. Now-a-days, however, financial inclusion is seen to be something more than opening bank branches in unbanked areas to take formal financial services across the length and breadth of the country. The fundamental objective of all these initiatives is to reach the large sections of the financially excluded Indian population.

INTRODUCTION

India is one of the largest and fastest growing economies of the world, but what has been the most disturbing factabout 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 Indian economy, though achieved a high growth momentum during 2003-04 to 2007-08, could not bring down unemployment and poverty to tolerable levels. Further, a vast 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 aneffort 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). Evidences from 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. Mehrotra*et al.* (2009) also built up an index for financial inclusion using similar kind of aggregate indicators like number of ruraloffices, number of rural deposit accounts, volume of rural deposit and credit from banking data for sixteen major states of India. Moreover, World Bank (2008) provides a composite measure of access to financial services, that is, the percentageof adult population that has an account with a financial intermediary for 51 countries. While World Bank (2009) in*Banking the Poor* analyzed the association between access to banking services, as measured by the number of bankaccounts per thousand adults in each country, and several other factors like transactions offered at banks, or required bybanks, 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 systematicindicators 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 WestBengal (2011), has examined the extent of financial inclusion in West Bengal. According to the study there has been animprovement in outreach activity in the banking sector, but the achievement is not significant. An index of financialinclusion (IFI) has been developed in the study using data on three dimensions of financial inclusion viz- banking.

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Penetration (BP), availability of the banking services (BS) and usage of the banking system (BU). The paper provides acomparable picture between different states on the basis of IFI rankings.

The present paper focuses onto financial inclusion as an instrument for attaining inclusive growth- in context ofIndia, for which a fair deal of effort has been taken to understand the extent of financial inclusion in India as a whole and states as its part.

OBJECTIVES OF THE PAPER

The Specific Objectives of the Research Paper are as Follows

• To study & understand the meaning and need for inclusive growth.
• To study the role of financial inclusion in inclusive growth.
• To know the extent of financial exclusion/inclusion in India.
• 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. & Wichern D.W., 2000). The choices of measure of similarity are based on Euclidean distances betweenmultidimensional observations. Further hierarchical clustering method has been displayed by Dendrogram 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 forsustainable development and equitable distribution of wealth and prosperity. Achieving inclusive growth is important andis one of the biggest challenges for India. The challenge is to take the levels of growth to all section of the society and to allparts of the country. Rapid growth in the rural economy, sustainable urban growth, infrastructure development, reforms ineducation, health, ensuring future energy needs, a healthy public-private partnership, intent to secure inclusivity, makingall sections of society equal stakeholders in growth, and above all good governance will ensure that India achieves what itdeserves. 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 generationand mobilization financial inclusion is required. It plays a very crucial role in the process of economic growth. Financialinclusion through appropriate financial services can solve the problem of resource availability, mobilization and allocation

150 Radhika Dixit & Munmun Ghosh Particularly for those who do not have any access to such resources. Thus in the current paper an effort is made to study therole of financial inclusion in inclusive growth.

Financial Inclusion

By financial inclusion, we mean the delivery of financial services, including banking services and credit, at anaffordable cost to the vast sections of disadvantaged and low-income groups who tend to be excluded. The variousfinancial services include access to savings, loans, insurance, payments and remittance facilities offered by the formalfinancial system.

Rangarajan Committee (2008) viewed financial inclusion as “The process of ensuring access to financial servicesand timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at anaffordable cost”

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

Given below is the diagram which briefly describes the essential contents of financial inclusion:

Figure 1

Source: Rangarajan Committee Report

Role of Financial Inclusion

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

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 mechanismstrengthening the resource base of the financial institution which benefits the economy as resources become available forefficient payment mechanism and allocation.

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The poor are typically more vulnerable to financial exclusion this is simply because their major problems arise fromthe need for finances. The formal banking services, by exploiting economies of scale and making judicious use of targetedsubsidies may reduce or remove market imperfections and facilitate financial inclusion of the poor, ultimately leading tohigher incomes. The access to financial services by the poor would lead to their consumption smoothing and investments inhealth, 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 mobilityand empowerment of the low income group people.

Conclusion

At present in India we have bank accounts to only 60% of the people. There are 40% of the people who don't have any kind of access to banking services. So there is a definite necessity of Financial Inclusion in the country. These are the statistics of recent Jan Dan Yojna scheme launched by Narendra Modi. Once if we have a look at the statistics, it may have done better than the targets kept by government in the short run. But if we look at the no. of zero balance accounts and the small amount of insurance claims for life and accident received we can understand how the affect is going to be in the long-run. Table 3 shows the statistics of Jan Dhan Yojna scheme as of 31st January, 2015. Here we can see a good results in short run, But the effectiveness is in the long run is questionable.

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