Financial Inclusion on Economic Growth: A Survey

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Abstract

Despite recent economic development rates that have been higher than those of other affluent countries, India's populace remains mostly unbanked. Financial Inclusion is a relatively new socioeconomic idea in India that tries to shift this dynamic by offering financial services at low rates to the disadvantaged who would not otherwise be aware of or able to pay them. Global trends demonstrate that expanding financial services to all segments of society is critical for achieving inclusive development and progress. Overall, financial inclusion in rural and financially underserved urban areas is a win-win situation for all parties concerned, including banks/NBFC intermediaries and the unbanked urban populace. Banks will manage basic infrastructure and services, while Business Correspondents (BCs) will operate as executors and represent these banking and financial organisations when engaging with end-users. For carrying out their online banking operations in the field, Business Correspondents (BCs) will be carrying handheld terminals such as Tablets (GSM enabled) with portable biometric scanners, smart card swipe devices, and thermal Bluetooth printers. Once an institution becomes an approved UIDAI user, the UIDA provides authentication and customer information via NPCI or NSDL. It is critical to assist earners in managing their finances and facilitating incoming and outgoing payments when income levels and, as a result, savings in rural regions rise. Allowing individuals to open basic, no-frills current and savings accounts, reducing KYC requirements, and immediately transferring social benefits to account holders will help rural regions adopt a more inclusive approach to finance and banking.

Keywords : Sub-national, economic growth, financial deepening, banking outreach, financial intermediation, developmental expenditure, social indicators

Introduction

Over the last few decades, financial outreach has taken a prominent place in the narrative on inclusive economic growth, particularly in emerging market countries (EMEs). Financial outreach, which tries to integrate marginalised groups into the mainstream economy, results in resource reallocation through financial intermediation, contributing to more equitable growth. It is a well-known fact that finance/capital is one of the most important variables in production, and financial outreach would give economically disadvantaged people access to this resource. Demirguc-Kunt and Levine (2009) make a similar case, arguing that the financial system may influence capital allocation and close the wealth gap by affecting specific qualities such as entrepreneurship, education, and so on. Financial outreach might result in more credit being allocated to the excluded sector, allowing them to become innovators and, as a result, more productive economic activities by this group of individuals. In a similar vein, Townsend and Ueda (2006) point to changes in the financial system that

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can influence both aggregate output and the proportion of credit, thereby shifting demand for low- and high-skilled employees and affecting income distribution1. Financial outreach also instils the habit of saving in the general public, hence increasing national savings and investment.

With the nationalisation of 14 commercial banks in 1969, India began its banking outreach journey in the 1970s, when commercial bank branch opening was restricted with special permission for the unbanked and rural regions. The Reserve Bank of India (RBI) urged banks in its mid-term review of the 'Annual Policy Statement for 2015–16' to make available a basic banking 'no frills' account either with 'nil' or very low minimum balances as well as low charges that would make such accounts accessible to vast sections of the population and ensure greater financial inclusion in the second half of the 2000s. The Government of India announced the Pradhan Mantri Jan Dhan Yojana (PMJDY) in 2014, with the goal of delivering basic financial services (such as banking/savings and deposit accounts, remittance, credit, insurance, and pension) to the poor at an affordable cost. These activities have radically altered the landscape of banking outreach, resulting in a massive increase in bank accounts and deposits.

In principle, financial intermediaries, instruments, and markets lower transaction costs, encourage saving habits, and boost economic development, according to various theories. Another body of theoretical literature demonstrates the dynamic connections between finance and growth, in which the financial system drives economic growth and the latter influences the financial system's development. Bagehot (1873), Schumpeter (1911), Gurley and Shaw (1955), Goldsmith (1969), and McKinnon (1973) all believe that financial markets contribute to economic progress. Despite the fact that there is a considerable literature suggesting a favourable association between financial outreach and economic growth, there are a handful of publications that call the relationship into doubt (Ardic and Domar, 2006).

In light of this, the purpose of this study is to investigate the relationship between banking outreach and economic growth at the subnational2 level in India. Several scholars (Chakraborty, 2010; Giri and Mohapatra 2012; Kumar, Sarkar, and Bonnerjee, 2014; Pradhan et al., 2014) have looked into different areas of banking outreach in India. Ghosh (2011) looked at the influence of financial outreach on per capita income development at the subnational level in India from 1973 to 2004 in a research. Following then, two significant policy interventions (the no-frills account and PMJDY) occurred, making a re-examination of the financial outreach in the recent time eminently sensible. In terms of temporal coverage and explanatory factors, this study varies from Ghosh (2011). The sample period for this study is 1996–2015. It has also taken into account state-level control factors, such as fiscal and human development indicators, which differ from Ghosh's control variables (proportion of manufacturing in GSDP) (2011). In the study, the words financial outreach and banking outreach were used interchangeably.

Although the research does not distinguish between financial outreach and financial deepening, most studies use the number of bank branches, Automated Teller Machines (ATMs), and accounts as financial outreach/access factors. Financial deepening measures include credit and deposit, which represent borrowing and saving, respectively. The Banking

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Outreach Index was created using five different factors (BOI). These are conventional variables used to measure banking and economic progress in the literature. All of these factors have one thing in common: a rise in their values suggests an improvement in banking outreach. The establishment of a bank branch in the area is a key sign of banking growth since it allows individuals to perform banking, which includes saving and depositing money in their accounts as well as obtaining credit. Mobile phones, online banking, and the availability of e-wallets have all helped to alleviate the inconvenience of having a physical (brick and mortar) branch in recent years. However, because these technologies have only recently acquired traction, data on technology-driven financial services is not available for the whole study period. Furthermore, considering branches in terms of population (i.e., number of branches per lakh population) may not be the best indicator for some of the country's sparsely populated states, particularly in the north-east, where branches per geographical unit of area (say, per 1,000 sq km) may be a better indicator. However, for consistency's sake, we used the number of bank branches per lakh people as a measure of financial outreach in this study.

As indices of financial outreach, the number of credit and deposit accounts standardised by population has limits, as these may not necessarily represent the intensity of banking activity. As a result, the credit-deposit ratio is sometimes considered a more accurate indication of banking progress. However, in order to determine the impacts of credit and deposit on economic development independently, both variables were taken into account rather than just one (credit-deposit ratio). The number of credit accounts per lakh population, per capita credit, per capita deposits, and number of deposit accounts per lakh population are all used to calculate the influence of banking outreach factors on per capita income growth. It also looks at how states' per capita development spending and literacy rates affect economic growth.

It is possible that a financial system will exclude the less fortunate from benefiting from the synergy generated by bridging the financial gap between financial suppliers and users in an economy. Because the development of a financial system is determined by the extent to which it improves access to financial services for poorer sections of the population, the importance of financial systems and, by extension, financial inclusion to economic growth has become even more pronounced in recent years. In this context, empirical data was used to do research on the relationship between India's financial system, financial inclusion, and economic progress. To investigate associations between research variables, correlation and regression analyses were used. Financial inclusion has a favourable influence on economic development, according to the study. More financial institutions should be built in rural regions, according to the findings of this study. In order to reach out to the unbanked, financial solutions that fulfil the needs of the financially disadvantaged should be offered. Financial inclusion is also emphasised in the research as an essential aspect of corporate social responsibility and sustainable development that financial institutions should embrace.

The International Growth Centre has published a synthesis study (Singh 2017) that lays out the fundamental ideas of financial inclusion and evaluates a variety of IGC and other financial inclusion research. Rohini Pande (Harvard Kennedy School), S. Krishnan (State government of Tamil Nadu), Ashok Bhattacharya (Business Standard), and R Gopalan (ex-

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Ministry of Finance) discussed the key lessons emerging from research, policy implications, and areas where more work is needed at a workshop organised by the IGC in collaboration with Ideas for India and Indian Statistical Institute.

Along with depth, efficiency, and stability, financial inclusion or access is a component of financial development. Financial development is critical for economic progress, and financial inclusion, in particular, affects equity.

Access to a transaction account is a first step toward broader financial inclusion because it serves as a gateway to other financial services such as credit or insurance, reduces transaction costs for everyday economic activities, allows for long-term planning, and allows for the creation of an emergency fund.

Financial inclusion may also improve the efficiency and targeting of government assistance programmes, as well as reduce corruption and terrorism in general, by better monitoring and regulating financial activities using digital technology.

Why financial inclusion is important: The macro context

Prof. Singh's lecture was expanded upon by Rohini Pande, who emphasised some of India's significant macro themes that should affect how we think about financial inclusion. Middle-income nations, such as India, currently house over 70% of the world's poor. In many nations, public social protection investment is inadequate, and health shocks remain one of the most common causes for households re-entering poverty after previously escaping it. As a result, people must be provided the skills to deal with shocks over the long term, as well as the human and financial capital investments necessary to ensure a consistent income. Furthermore, India is witnessing 'jobless growth,' with entrepreneurship – notably among women – serving as the primary source of employment outside of agriculture, which is strongly reliant on access to capital.

While everyone agrees that access is a first step toward inclusion, it does not guarantee inclusion. According to Ashok Bhattacharya, the Indian experience shows that granting people access through bank nationalisation in 1969 did not result in inclusion. According to Prof. Pande, we are currently in danger of doing for financial capital what we have been doing for human capital for several years: we are now going to start counting it up by bank branches or PMJDY (Pradhan Mantri Jan Dhan Yojana) accounts, similar to how we have been counting it up by school enrolment or the number of hospitals in a district. It's crucial to understand that access is not the same as use.

COMPONENTS OF FINANCIAL INCLUSION

Banking

Much of financial inclusion is built on the basis of banking. While research in other nations have had mixed outcomes, greater banking access in India has been proven to have a largely favourable influence. A nationwide state-level research found that bank branch growth had a favourable impact on the poor and disadvantaged (Burgess and Pande 2005; Burgess, Wong and Pande 2005). Higher bank access leads to increased economic activity and savings (Young 2015). (Somville and Vandewalle 2015). Organizational arrangements inside lending institutions are important, according to research. In very different circumstances, Cole et al.

(2015) and Field et al. (2016) emphasise the relevance of organisational changes that strengthen incentives inside the sector.

Microfinance

The evidence on microfinance in the developing countries is varied. Banerjee, Karlan, and Zinman (2015) found a "similar pattern of somewhat good but not transformational outcomes" in a study of six randomised microcredit assessments. Over the course of several years, SEWA Bank's microcredit programme in India has aided women's integration into the labour force by increasing their engagement in domestic economic activities. There may be broader effects on fertility as well (Field et al. 2016).

The financial viability of the microfinance paradigm has been investigated in certain research. Cull et al. (2016), for example, show that while subsidies are widespread, they may not always be essential.

The design of microfinance interventions is proven to be quite important. Field et al. (2013) found that providing for a grace period between loan disbursement and the start of repayments enhanced short-run company investment and long-run profitability when looking at contract design. While default rates increased, the net welfare impacts appeared to be favourable.

Small-firm

Small businesses are frequently credit limited, and when that limitation is removed, they perform better (Banerjee and Duflo 2008). Raj and Sen (2013) find that finance constraints play an important role in the transition of small firms that use hired labour from family-labour-only firms to small firms that use hired labour, and even more so for the growth of the latter beyond six workers, in a comprehensive analysis of very small firms in India. Government initiatives currently in place do not appear to be assisting in this respect.

According to research, India has a lot to learn about the intricacies of easing financial restraints for microenterprises to larger small and medium businesses, including contract drafting, monitoring, and enforcement, as well as training (see, for instance, Barboni 2016).

Agricultural credit is frequently a political problem, and data shows that it is given inefficiently and inadequately (for example, Sharma and Kumawat 2014).

What can be done to improve the efficiency of agricultural credit? The finer points of market institutions and incentives are crucial. Maitra et al. (2014) found that TRAIL loans were more successful than traditional group-based loans (GBL) in improving production of leading cash crops and farm revenues in a field trial with trader-agent intermediated lending (TRAIL). This is due to the fact that farmers chosen by agents were more capable than those who self-selected for the GBL programme.

Another study (Mitra et al. 2012) revealed that combining financing with greater knowledge and market access might boost farmers' negotiating strength. As a result, market interconnection is important in agricultural financing.

Farmers' insurance can have good effects, according to studies from several countries, if attention is paid to aspects like farmer liquidity (Gine 2009) and price sensitivity of demand

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(Takahashi et al. 2016), as well as interactions between insurance and loan markets (Karlan et al. 2011). Farmers' insurance that is well-designed may be sustainable and successful, and it can also assist landless agricultural labourers, according to recent data from India (Mobarak and Rosenzweig 2013).
Only a money-back promise had a consistent and considerable influence on farmers' purchasing decisions in an experiment with alternative techniques of selling rainfall insurance to small-scale farmers in Gujarat (Gaurav et al. 2011). This suggests that establishing confidence in tangible ways is critical.

Mr S. Gopalan, commenting on the issue of farm loan waivers, said that if the loan amount is adequate, farmers are provided with consumption loans, there is robust crop failure insurance, and structures are in place to enable farmers to access markets and get the best price for their produce, waivers may not be required.
The data on the advantages of community-based health insurance for the poor in India and other countries is mixed; it varies with period, region, and intervention implementation. An experiment done by Banerjee et al. (2014) with India's largest microfinance organisation found that combining microcredit with health insurance did not appear to succeed. Microcredit, on the other hand, was found to offer a buffer against health shocks by lowering the need to sell livestock in a Bangladesh research (Islam and Maitra 2012). There are a lot of intricacies and relationships here as well.
Health insurance is a solid source of credibility, thus it's crucial to have faith in it. Debnath and Jain (2015) illustrate how caste networks may be utilised to increase health insurance acceptability and implementation.
There are a variety of additional digital payment solutions in different nations, and further study on infrastructure, legislation, and design is needed. In India, digital payments are viewed as one phase of a three-part plan for financial inclusion based on digital technology, known as JAM (Jan Dhan, Aadhaar, and Mobile) (transactions). While there is evidence that biometric identity cards can reduce corruption (for example, Muralidharan et al. 2016), there are worries that the JAM framework is too limited when it comes to thinking about financial inclusion through digital innovation (Ravi and Gakhar 2015).
Mr Bhattacharya believes that India's present focus on JAM needs to be examined in the context of how it is unfolding. The lack of financial understanding appears to be preventing JAM from becoming a success. According to Mr. S. Krishnan, there are convenience difficulties in terms of last-mile connection when providing government rewards directly through bank accounts. As a result, one aspect of the JAM review that has to be addressed is outreach.
According to Mr Krishnan, technology may also be utilised to solve the issue of loan officer behaviour in the context of loan evaluation. The judgments appear to be made on the basis of appearances or personal relationships. Loans can be granted out based on the applicant's credit history if there is a credit information linkage.

While technology may do a lot, experts agree that it cannot completely replace humans at key stages in the process. Prof. Pande pointed out that this is especially true when it comes to

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teaching financial literacy, and that it is critical to carefully consider implementation and incentives.

The receiving end

Financial literacy is a key component that impacts financial inclusion on the demand side. Financial literacy is difficult, and even in developed nations, it remains a struggle (Lusardi and Mitchell 2014). It's not simple to overcome knowledge gaps (Alan et al. 2015). Financial education programmes are frequently ineffective (Miller et al. 2014), however general rules of thumb may be more beneficial (Drexler et al. 2014). In a study of a life insurance product in India, Halan and Sane (2017) discovered that 'too much' information might cause customers to lose concentration, and that information is more helpful if it can be understood in the context of past financial literacy. The evidence suggests that financial education is challenging but attainable, and that further research is needed in this area.

There are also behavioural variables such as difficulty in saving commitments (for example, Ashraf et al.2006, 2010); myopia or procrastination (Duflo et al. 2011); and inefficiency in business choices (for example, Ashraf et al.2006, 2010). (example, Beaman et al. 2014). These African research suggest that while planning financial inclusion programmes, behavioural biases must be carefully considered. The study of Bihar's rural livelihood initiative JEEViKA by Gangadharan et al. (2014) teaches us that societal factors and individualistic abnormalities must be taken into account.

The varied data on the impact of financial inclusion tools, according to Prof. Pande, is partially due to the fact that instruments work differently for various groups. A bank branch will have a very different impact on the middle class than it will on the destitute. Although we may conceive of informal sources of credit as being terrible for the poor, the affluent may prefer them because of their flexibility rather than the absence of collateral.

Regulation

The process of providing citizens with access to financial instruments in a rapidly rising, increasingly unequal economy is challenging. It is critical to consider the function of regulation in a scenario where various communities have varied demands for financial inclusion and private actors are primarily focused on the middle class and wealthy.

Mr. Gopalan believes that regulation for large, formal financial institutions should be distinct from that for small, informal financial organisations. Microfinance institutions in India were subjected to light-touch regulation, which clashed with market pressures that pushed them to earn profits. As a result, the interest rate increased, causing public outcry. As a result, societal regulation takes effect, which must be taken into consideration in research projects. In this case, financial literacy might be beneficial. Furthermore, we must consider the many informal financial arrangements that exist, such as social groupings or communities that lend and borrow amongst themselves, local money managers, and so on, when considering regulation.

Benefits of financial inclusion:

- The rural masses would be able to use fingerprint authentication to conduct banking transactions such as cash receipts, cash payments, balance inquiries, and account statements. The consumer receives assurance of fulfilment by receiving an online receipt.

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- The cash economy is shrinking as more money enters the banking system.
- It instils the habit of saving, hence enhancing capital formation and boosting the country's economy.

  Instead of real cash payments against subsidies, direct cash transfers to recipient bank accounts will be permitted. This also guarantees that the monies are delivered to the intended beneficiaries rather than being diverted along the road.

Conclusion

The availability of sufficient and transparent financing through official banking channels will encourage the masses' entrepreneurial spirit, resulting in increased productivity and wealth in rural areas. As a result, financial inclusion is thought to be the catalyst for the next wave of progress and prosperity. India has been pulling all the appropriate levers in the twenty-first century to achieve financial inclusion and economic citizenship by lubricating the system with its own transactions. The ability of India's 65 percent unbanked population (conservative 2017 World Bank estimate) to access financial infrastructure is critical to the country's economic progress.

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