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Financial inclusion and the future of the Indian economy

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ABSTRACT

Financial inclusion is an equalizer that enables all citizens to contribute to economic growth and to gain from it. India was ahead of its times when it first ushered in financial inclusion by nationalizing its banks in mid-1969 and then coming up with a slew of policies to operationalize it. The track record is a mix of successes and failures. This paper tries to capture some of these and visualize where India will gain and what it may lose over the next three or four decades. Considering India's growing economic importance and the projections that the Indian economy will be as big as the United States economy around 2050, the paper tries to understand how the economic upswing will mesh with India's socio-political and environmental processes that also influence financial inclusion; and what the different scenarios might be in 2050. This paper discusses what role financial inclusion will play in India's economy in the year 2050. It suggests some possible scenarios and policy measures to move towards a desirable scenario.

1. Introduction

Robust financial services boost economic growth by mobilizing savings for productive use, allocating capital funds efficiently and managing risks. Financial intermediaries and financial markets are essential for a vibrant, growing economy. For a real economic upturn, however, everyone must participate. A recent survey [1] reveals that three-quarters of the world's population has no access to even a bank account. Financial inclusion is the ability of all citizens to invest in their livelihoods, exercise control over their financial resources and overcome income and capability [3] poverty. In 2002, the UN arrived at the Monterrey Consensus which adopted banking as an effective measure to achieve financial inclusion. On December 29, 2003, the then UN Secretary-General Kofi Annan, put 'sustainable financial services' and 'full participation' of excluded people in the financial sector on the global agenda. Financial inclusion was to help people improve their lives, reduce inequalities and thereby overcome poverty.

Home to a sixth of the world's population, India is set to overtake China and become the most populous country [25] by 2050. Over half of India's current population is under 25 years and more than two-thirds is under 35 years. Given the demographic dividend (that India expects to reap in the coming decades) and the burgeoning working population, the extent of financial inclusion in India will be critical for delivering economic growth to the country. A number of other factors will influence the nature and extent of economic growth in India, including multiple structural inequalities and the vulnerability of its climate-sensitive agrarian economy.

Characterized by deep economic and social inequalities [16,23,24], India had already embarked on the road to financial inclusion in mid-1969 when it nationalized 14 of its banks. Described by political commentators as a 'masterstroke of political sagacity,' the move nevertheless resulted in enormous economic spin-offs for poor people, especially in rural India. Public sector banks were obliged to meet their targets for the priority sector – agriculture and small and medium enterprises

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Table 1
Select indicators of financial inclusion-cross country comparison 2011.

Country	Number of bank branches (per 0.1 million adults)	Number of ATMs (per 0.1 million adults)	Bank loan as per cent of GDP	Bank deposits as per cent of GDP
India	10.64	8.90	51.75	68.43
Australia	29.61	166.92	128.75	107.10
Brazil	46.15	119.63	40.28	53.26
France	41.58	109.80	42.85	34.77
Mexico	14.86	45.77	18.81	22.65
United States	35.43	–	46.83	57.78
Korea	18.80	–	90.65	80.82
Philippines	8.07	17.70	21.39	41.93

Source: Financial Access Survey, IMF.

(SMEs). The banks grew eight-fold between 1969 and 1991, reaching out to hitherto unbanked populations with three-fourths of these in rural and semi-urban areas. Population per branch reduced from 60,000 in 1969 to 14,000 in 1991. Regional Rural Banks were set up in 1975 and the National Bank for Agriculture and Rural Development (NABARD) came up in 1982 to solely focus on the priority sector. The social role of banks expanded in April 1980 when they were linked with government poverty alleviation programmes. In 1992 NABARD rolled out Kisan Credit Cards (KCC) for farmers to access quick credit and also piloted a self-help group (SHG)-bank linkage micro-finance programme modelled on Bangladesh's Grameen Bank success. The die had been cast. Between 2001 and 2011, the proportion of households availing bank services jumped from 35.5% to nearly 60% and India became the world's largest microfinance market [5].

Subsequently, financial inclusion has been 'both a national commitment and a public policy priority' [10], bringing all political parties together on this one issue. Over the last two decades, the drive has only become stronger. Identity requirements have now been simplified and streamlined. Financial services have been extended to include pro-poor products encompassing medical insurance, education loans, general credit cards, weather-based crop insurance, universal pension and even personal loans to buy houses and other durable assets. Private banks are allowed to open operations only if they locate at least a fourth of their bank branches in unbanked rural centres. There is an all-out focus on leveraging information and communication technologies (ICTs) to expand outreach to India's 1.2 billion people. A recent study [1] said India's track record on financial inclusion surpasses that of any other country.

Yet, the glass remains half empty. India is home to the world's largest number of unbanked individuals – 145 million. The banking system is unable to keep pace with the increase in numbers – population per branch slid from 14,000 in 1991 to 13,503 in 2011 and to 12,921 in 2013. Only half (55%) of the people have deposit accounts. India's unmet demand for microfinance remains the highest in the world. Less than 20% of the population is covered by life insurance and less than 10% by non-life insurance coverage. Only 18% of the people have debit cards and a mere two per cent have credit cards. There are a 100 million 'no-frill' accounts, or accounts with zero or minimum balance and small overdraft facilities, for poor people. Yet, 80–90% of these accounts are dormant [27,28], neither operated by the account owners, nor pursued by bankers. The Indian economy has grown at an average of seven to eight per cent over the past two decades, obviously without financial inclusion having played a significant role. In what has been called 'jobless growth,' much of the excess labour has been absorbed in the unproductive agriculture and allied sector prompting the government to legislate the unique Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) which gives at least 100 days of employment to poor people every year. India may have received kudos for her efforts in financial inclusion in the recent survey [1] but the status of financial inclusion in other developed and emerging economies is decidedly higher (Table 1).

Of course, a lot is set to change over the next three decades. In 2011 the Indian economy overtook the Japanese economy by a whisker ($0.02 trillion) and become the world's third largest economy, in purchasing power parity terms, after United States and China [9]. A forthcoming OECD study [2] projects that in less than two years, India will outdo the Japanese economy for good, surpass the Euro economy over the next two decades and leave the US behind by 2060. India's economy is projected to grow on account of its demographic dividend and expanding urbanization. Political support across parties is expected to continue for financial inclusion beyond the 2014 and future elections. But will India's story of economic growth be fuelled also by successful financial inclusion?

The answers to the above question will depend on three key factors. One, how rationally India's financial inclusion policy integrates with its changing economy which is becoming more diversified, service sector-driven, urbanized and is characterized by a younger workforce, increasing informalisation of labour and rising income inequalities. Two, how wisely India invests in its social capital, especially basic amenities, health and education, and is able to reach out to all sections of its highly stratified society. Three, given India's climate-sensitive agrarian economy and its high propensity to natural disasters, how smartly India deals with externalities including climate change, migration and global power equations.

The glass is both half full and half empty. What is in store for 2050?

2. India's road to financial inclusion

The apex Reserve Bank of India loosely defines financial inclusion as 'the process of ensuring access to appropriate financial products and services needed by all sections of the society in general, and vulnerable groups such as weaker