INTERNATIONAL JOURNAL OF DEMOCRATIC AND DEVELOPMENT STUDIES (IJDDS), VOL. 1, NO. 1, OCTOBER 2012, 66-75
DOI: RCMSS/IJDDS/12006
http:/www.rcmss.org/ijdds/Vol.1/No.1/.pdf

INCLUSIVE GROWTH IN INDIA: A CHALLENGING TOOL FOR BANKING AND FINANCIAL SECTOR

***N. Santosh Ranganath
Faculty Member
Dept. of Commerce and Management Studies
Dr. B.R. Ambedkar University
Srikakulam, Andhra Pradesh – 532410
Phone: +91-8942-240919(off)
Fax: 91-8942-281972
Mobile: (0) 94400 69570
E-mail: nsranganath@yahoo.com
www.brau.in

And

Dr. G. Tulasi Rao
Professor and Head
Dept. of Commerce and Management Studies
Dr. B.R. Ambedkar University
Srikakulam, Andhra Pradesh – 532410

Abstract

As a nation is still in the process of developing itself, it would be perhaps be very premature to let go of the dream of inclusive growth. The Indian economy, which has over the last six decades passed through various phases of growth, is now all set to enter an altogether different orbit marked by a high rate of expansion, combined with 'Inclusive growth'. Enabling more inclusive growth requires improving access for the poor to participate in the market either as entrepreneurs or employees, i.e. through economic opportunities. Education, health and sanitation, ICT are all key enablers to more productive market participation. Banks and other financial services players largely are expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. With the arrival of banking technology and realization that poor are bankable with good business prospects, financial inclusion initiatives will strengthen financial deepening further and provide resources to the banks to expand credit delivery. Banking is a key driver for inclusive growth. This paper describes the challenges faced by the banking and financial sector in India towards inclusive growth.

Keywords: Micro-finance, Inclusive Growth, ICTs, Financial Inclusion, Empowerment.

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Inclusive Growth: The New Mantra

Inclusive growth by its very definition implies an equitable allocation of resources with benefits accruing to every section of society. But the allocation of resources must be focused on the indented short and long terms benefits and economic linkages at large and not just equitable mathematically on some regional and population criteria. As a nation still in the process of developing itself, it would perhaps be very premature to let go of the dream of inclusive growth but with some hard realities thrown in too. Society by its very definition implies coming together of a variety of peoples and sharing of benefits in order to survive and grow. There is no economic activity, which is stand-alone and isolated from its immediate and external environment.

In an expanding economy more people with wide skills are required. In today's increasingly global, dynamic and competitive economy such notions are based on inherent failure to identify the skill/activity linkages present and missing in the real sense. Growth in a competitive economy is and will always be inclusive, because it cannot be other wise. But it is immensely fashionable to criticize and play down innovations in economy. The key element of the strategy for inclusive growth must be "to provide the mass of our people access to basic facilities such as health, education, clean drinking water etc, and that governments at different levels have to ensure the provision of these services". The proponents of "Inclusive Growth" have some vogue notions of growth and fail to see a vast change underway.

Inclusive growth as the literal meaning of the two words refers to both the pace and the pattern of the economic growth. The literature on the subject draws fine distinction between direct income redistribution or shared growth and inclusive 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. Inclusive growth is, therefore, supposed to be inherently sustainable as distinct from income distribution schemes which can in the short run reduce the disparities, between the poorest and the rest, which may have arisen on account of policies intended to jumpstart growth. While income distribution schemes can allow people, to benefit from economic growth in the short run, inclusive growth allows people to “contribute to and benefit from economic growth”.

Among India's politicians and commentators, there has long persisted a belief in the country's economic uniqueness. During debates on the nation's growth approach, many echoed the words of one former prime minister. "India," he had noted, "is not like any other country." Since India has launched on a market-oriented development path in the last three decades, this has become more or less the truth. The state's role in the Indian economy has long been a prominent one, and our Five Year Plans are closely followed and debated. However, the nature of the government's role has shifted significantly in the years since Independence. Nevertheless, even as many aspects of India's economic policies have seen upheaval, its core objectives stayed the same.

The most visible result of this shift has been an explosion of entrepreneurship. As the government removed restrictions in doing business and licensing across different sectors, Indians were able to spot and leverage opportunities across the country. Across sectors such as manufacturing, power, banking and insurance, telecom, transport and aviation infrastructure, we have seen a rapid rise in the role of entrepreneurs, which in turn resulted in rapid growth and job-creation across these industries.

Inclusive Growth in India

'India' is the new global buzzword. The economy growing at a phenomenal rate, combined with a flourishing democracy is making people sit up and take notice across the world. Yet, it is at cross-roads today. It is far from reaching its true potential. The country remains shackled in corruption, red tape, age old social barriers and a puzzling lack of transparency. Growth is not uniform across sectors; and large cross-sections of the populace remain outside its purview. Several social, political and economic factors need to be tackled for sustaining a high rate of growth, as well as to make this growth inclusive. Elimination of child labour, women empowerment, removal of caste barriers and an improvement in work culture are just a few of the things the Indian society needs to introspect on. Tackling corruption in high places, removing the ills of the electoral system, shunning politics of agitations and keeping national interest above petty politics may not be too much to ask of the country's policy makers. Rapid growth in the rural economy, well planned and targeted urban growth, infrastructure development, reforms in education, ensuring future energy needs, a healthy public-private partnership, intent to secure inclusivity, making all sections of society equal stakeholders in growth, and above all good governance will ensure that India achieves what it deserves.

Financial inclusion is an important priority of the government as only 38 per cent of the 87,051 bank branches of commercial banks are in rural areas and only 40 per cent of the country's population has bank accounts, he said. In order to address the need of banks in rural areas, Finance Minister Pranab Mukherjee said he had in 2010-11 directed all banks to provide appropriate banking facilities to places having population over 2,000 by March 2012 using branchless banking through business correspondents. Accordingly, the banks have formulated their road maps through the forum of state level banker committees for financial inclusion and have identified over 73,000 habitants having a population of over 2,000 for providing banking facilities.

The Indian economy, which has over the last six decades passed through various phases of growth, is now all set to enter an altogether different orbit: one marked by a high rate of expansion, combined with 'inclusive growth.' "Globalization must not leave the 'bottom billion' behind," remarked the new chief of the World Bank. India's economic growth has passed through four major phases over the past 60 years, and is now set to enter a new phase. The first 30 years after Independence, GDP (gross domestic product) grew at an unremarkable 3.5 per cent per annum. During the 1980s, with the initial whiff of reforms, it accelerated to 5.6 per cent per annum. In the reforms era of the 1990s, the average growth rate of the GDP went up slightly to 5.8 per cent. But the last five years have seen the fastest pace of growth in the country's history – to an average of 8.5 per cent per annum.

Collective efforts for Inclusive Growth in India

India has the potential of becoming a leading economy and has the unique opportunity to make that growth inclusive, provided there is willingness on the part of all sections of society to put in hard and disciplined work, together with serious, sustained and purposeful planning. First, there is much that needs to be done to build up India's potential. Better governance, more and better educational institutions, higher agricultural productivity, controlled inflation and improvement in infrastructure are some of the major and more important steps required in this direction. These are mentioned specifically, because each of these steps has a bearing on the inclusiveness of growth as well.

Agriculture is extremely important for inclusive growth, since a large majority of the Indian population is dependent on farming. Improved agricultural productivity would bring in its wake increased family incomes for this vast majority. This, together with better infrastructure in the countryside – greater rural connectivity, rural electrification and investment in irrigation, would aid tremendously in tackling rural poverty, as well as add to the overall prosperity of the nation. The ‘India Shining’ campaign of the previous government failed to impress the people precisely for this reason because a majority of the rural populace had remained outside the purview of the increase in national GDP.

Better governance is the need of the hour, more so because the government in India still has a majority stake in almost all essential sectors e.g. in the crucial sectors of health, sanitation and water. It is in such social sectors that we find the political parties least interested, especially once they come to power after elections. Yet these are the fields which need to be paid more attention to if we are to improve human development alongside economic growth; with the current situation, it is no wonder that India figures extremely low on world human development index reports. There is a need for more public-private partnerships. The private sector should take more social responsibility and contribute towards making growth more inclusive.

Inclusive Growth: Role of Financial Sector

There are supply side and demand side factors driving Inclusive Growth. Banks and other financial services players largely are expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. Access to financial products is constrained by several factors which include: lack of awareness about the financial products, unaffordable products, high transaction costs, and products which are not convenient, inflexible, not customized and of low quality. 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.

The empirical evidence shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. If we are talking of financial stability, economic stability and inclusive growth with stability, it is not possible without achieving Financial Inclusion. Thus financial inclusion is no longer a policy choice but is a policy compulsion today. And banking is a key driver for inclusive growth. However, we must bear in mind that apart from the supply side factors, demand side factors, such as lower income and /or asset holdings also have a significant bearing on inclusive growth. Owing to difficulties in accessing formal sources of credit, poor individuals and small and macro enterprises usually rely on their personal savings or internal sources to invest in health, education, housing, and entrepreneurial activities to make use of growth opportunities.

However, some of the critical indicators for access to finance in India along with benchmark indicators for selected high-income OECD member countries (Table 1) reveal that

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while there have been improvements during 2001-08 but it is still very adverse as compared to OECD economies.

Table 1: Getting Finance Indicators for India, 2001-08

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	Bench-mark (OECD)
Branches per 1,00,000 people	6.42	6.33	6.25	6.26	6.33	6.37	6.35	6.6	10-69
ATMs per 1,00,000 people					1.63	1.93	2.4	3.28	47-167
Deposit accounts per 1000 people	416.7	421	418.7	426.1	432.1	443	459.5	467.4	976-1671
Loan accounts per 1000 people	50.99	53.9	55.84	61.88	71.42	78	83.59	89.03	248-513
Branches per 1000 km2	22.18	22.3	22.41	22.57	22.99	23.5	24.13	25.49	1-159
ATMs per 1000 km2					5.93	7.11	9.11	12.68	1-437

(Source: Getting Finance in South Asia 2010, The World Bank)

Note: The Benchmark Indicator ranges are for selected high-income OECD member countries (Australia, Canada, France, Germany, Italy, Japan, the republic of Korea, New Zealand and the United States)

There is unanimity in thinking among the intelligentsia that if India is to become an economic power, growth has to be inclusive and touch the lives of millions of people living in rural India. It is heartening to note that the Government is conscious of the fact and has taken unique steps to which will go a long way in alleviating the sufferings of poor people. The pattern of growth in the financial sector which is gradually being opened up for private participation also follows the model of inclusive growth. It was rightly expected that the financial sector in its new avatar would provide succor to the rural poor. While efforts have been made in this direction an overall policy is sadly out of place.

In case of banks, Reserve bank has adopted a two pronged strategy to ensure banks participate in the economic revival of all sections of society by controlling distribution and by making lending to priority sectors mandatory. Distribution is managed by granting license for opening new branches with a stipulation that for every three branches opened in rural and semi urban areas one new branch is allowed to be opened in city area which are more profitable. This ensures that more branches are opened in non urban centers. The mandated provisions have certainly been responsible for flow of credit to rural poor and other less financially affluent sections of society. Banks have done a commendable job in this direction.

In case of Insurance, the regulator IRDA has set equally challenging targets for the industry. They have not mandated opening of offices in rural/semi urban areas like Banks. But companies are required to do minimum amount of rural business and cover certain minimum number of lives from the social sector comprising of unorganized sector and groups from socially weak and vulnerable sections.

SEBI has not prescribed any minimum stipulation for mutual funds to distribute products in rural areas or cover people in the social sector. There is also no stipulation like in case of banks that certain minimum branches will be opened in non city and non metro areas. This has lead to concentration of mutual fund branches in urban areas with 75 % of the turnover arising from 16 major towns. One can only guess the reasons for this. Certainly people in rural and semi urban areas need to be encouraged to save under these secure schemes rather than allow them fall to the temptation of entrusting their savings to informal sector and lose their hard earned money. This business may not be as profitable as in the major cities but is in tandem with the road map for growth envisaged by our Government. The regulatory indulgence is quite surprising.

The new NPS is of recent origin. It is too early for any mandated rural foray. But it will be advisable to lay a long term inclusive growth pattern and to make it mandatory at some future point of time. Merely hoping that various POP’s in the rural or semi urban areas will get some business may lead the beneficiaries under the scheme to be confined to cities and urban areas as in case of mutual funds. While some major initiatives have been taken in ensuring that financial sector touches all sections in the country there is inconsistency in approach. It is high time that a composite policy is put in place to ensure that all participants in the financial sector contribute to the inclusive growth of the economy.

Inclusive Growth in Banking Sector

The number of “no frills” accounts increased from 4,89,497 at end-March 2006 to 3,30,24,761 at end-March 2009. Notably, the public sector banks account for the majority of these “no frills” accounts as at end-March 2009 (Table 2). Similarly, the number of credit as well as savings accounts per 100 adults has also shown increasing trend over the period 2002 to 2007.

Table 2: Progress of ‘No frills’ Accounts in the Banking Sector in India

Category	March 31, 2006	March 31, 2007	March 31, 2008	March 31, 2009
Public Sector Banks	3,32,878	58,65,419	1,39,09,935	2,98,59,178
Private Sector Banks	1,56,388	8,60,997	18,45,869	31,24,101
Foreign Banks	231	5,919	33,115	41,482
Total	4,89,497	67,32,335	1,57,88,919	3,30,24,761

Source: 1. Report on Trend and Progress of Banking India – 2009-10.
2. Data for 2009-10 are received from banks

All self-employment programmes integrated into *Swarnajayanti Gram Swarojgar Yojana* (SGSY) in April 1999 has made rapid progress over time covering more than 31 lakh (Table 3). However, only 22 per cent of the SHGs were provided with bank finance for undertaking income generating activities including micro enterprises. The bank assistance was abysmally low leading to low level of investment activity. This shortcoming has been attributed to failure of public intervention to enhance the credit absorption capacity of SHGs as well as to the failures of credit delivery systems to reach the poor. The poor credit absorption capacity of poor can be illustrated by the prevalent credit-subsidy ratio under SGSY at about two, much below the target ratio of 3:1, partly due to failure to strengthen the demand side of the credit by improving the capacity of the poor to absorb credit for income generating activities (GoI, 2009).

Table 3: Physical Progress under SGSY since Inception

(Thousands)

Years	SHGs formed	No. of SHGs Passed Grade - I	No. of SHGs Passed Grade - II	SHGs taken up Economic Activities	SHG Swarojgars Assisted	Individual Swarojgars Assisted
1999-2000	292	125	--	29	35	586
2000-2001	223	214	74	26	319	687
2001-2002	434	176	54	31	365	573
2002-2003	399	190	95	36	414	112
2003-2004	392	205	91	51	578	320
2004-2005	266	220	106	68	789	327
2005-2006	276	211	92	80	873	278
2006-2007	246	222	156	138	1472	220
2007-2008	306	251	117	181	1154	254
2008-2009	298	201	62	46	557	117
Total	3134	2014	948	685	6869	3772

Source: Ministry of Rural Development, Govt. of India, 2009.

Challenges to Indian Banking Sector

Indian banking sector is going great guns. The sector was one of the foremost contributors to help the country to overcome the global economic recession. But the question arises whether the banking sector is just a sector of financial activities or has helped the country to achieve inclusive growth. India's GDP could achieve 8.5% growth rate in the current financial year, after dipping during the recession period. Hence, growth is not a worry for the country, but for inclusive growth, the country has to go a long way. There are two factors, supply and demand side factors driving Inclusive Growth. Banks and other financial services players largely are expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system.

The financial stability, economic stability and inclusive growth with stability, it is not possible without achieving financial Inclusion. But, the empirical evidence shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. Thus, financial inclusion is no longer a policy choice but is a policy compulsion today. The task is of gigantic nature as the number of financially excluded people, in the country is much large.

Another big challenge to the banking sector is to provide fool-proof service to its customers. The reports of frauds associated with banking sector raise a question whether banks are secured places for one's money? Reports of fraudulent withdrawal of one's hard earned money in online transaction or from ATM machines were not new. But Rs. 400 crore fraud in a Citibank branch in Gurgaon, where a relationship manager allegedly lured rich clients to invest in fraudulent schemes that promised high returns supposedly backed by the bank, has raised serious question about safety of one's money in banks.

Inclusive growth - A challenging opportunity

In case of banks, Reserve bank has adopted a two pronged strategy to ensure banks participate in the economic revival of all sections of society by controlling distribution and by making lending to priority sectors mandatory. Distribution is managed by granting license for opening new branches with a stipulation that for every three branches opened in rural and semi urban areas one new branch is allowed to be opened in city area which are more profitable. This ensures that more branches are opened in non urban centers. As per RBI data as of March 31, 2008, 48,633 commercial bank branches were operating in the rural/semi urban areas as against 29,140 in urban areas. On the lending side 40% of advances have to be made in the priority sector of which 18% are earmarked for agricultural lending and balance 22% for others including housing, education SME etc.

In the agricultural sector 25% of total loans have to be for direct lending for agriculture. These mandated provisions have certainly been responsible for flow of credit to rural poor and other less financially affluent sections of society. Banks have done a commendable job in this direction. Reforms undertaken in the early 1990s made India one of the world’s fastest growing economies. The boom of the IT industry and improved agricultural production created an atmosphere of optimism, which led to the coining of phrases, such as Incredible India, India Shining, and India 2020 around the end of the millennium.

The Indian growth story has been one of high Gross Domestic Product (GDP) growth but primarily driven by the growth in services sector. Not all sectors of the economy have grown at the same pace as is reflected in the relatively low agricultural growth rate, low-quality employment, poor education, inadequate healthcare services, rural-urban divide, social inequalities, and regional disparities. Growth that is not inclusive affects the society, the economy, and the polity. A lack of inclusive growth can result in real or perceived inequities, which has its own social ramifications. Inclusive growth promotes economic growth partly by broadening the base for domestic demand and partly by increasing the number of people with a stake in reforms and in a stable government.

Inclusive growth thus seeks to broaden the flow of benefits of globalization towards the currently excluded sections. However, for achieving inclusive growth, it is essential that the diffusion of opportunities be supported with good governance and accountability. In order to reduce disparity and promote inclusive growth, the Indian government has set state-specific targets for parameters, such as GDP growth rate, agricultural growth rate, new work opportunities, poverty ratio, dropout rate in elementary schools, literacy rate, gender gap in literacy rate, infant mortality rate and maternal mortality ratio. In the last few years, inclusive growth has been at the forefront of studies sponsored by multilateral aid agencies, such as the United Nations, the World Bank, Asian Development Bank, and several nongovernmental organizations (NGOs).

Successive governments have initiated several projects, such as Jawahar Rozgar Yojna, Integrated Rural Development Program, Rural Housing Scheme, and Swarnjayanti Gram Swarozgar Yojana to promote inclusive growth. However, for inclusive growth to happen in a country with the scale and size of India, private sector involvement is equally important. The private sector has started contributing with initiatives, such as the ICICI Foundation having been set up with the sole purpose of promoting inclusive growth. The government and private sector can play complementary roles in driving inclusive growth. There is a need for the public and the private sector in India to have a unified approach towards how they can extend, innovate, and collaborate in new ways to drive inclusive growth.

Conclusions

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. The banking technology initiatives meant for financial inclusion should be collaborative and innovative with an objective to reduce the transaction costs. Thus, financial inclusion along with the Governmental developmental programmes will lead to an overall financial and economic development in our country and as in the case for most developing countries, extending the banking services to everyone in the country will be the key driver towards an inclusive growth. This paper elaborates the need to build Inclusive India and emphasizes why it is imperative to focus on inclusive growth now. It presents the opportunities available for building an inclusive India by identifying key levers in governance, education, energy and resources, telecom and technology, infrastructure, healthcare, financial inclusion, and business model innovation.

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INTERNATIONAL JOURNAL OF DEMOCRATIC AND DEVELOPMENT STUDIES (IJDDS), VOL. 1, NO. 1, OCTOBER 2012, 66-75
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