Financial Inclusion

This article is based on **"Financial Inclusion and Digital India: A Critical Assessment"** which was published in The Economic and Political Weekly on 29/04/2020. It talks about impact and challenges pertaining to financial inclusion.

Financial inclusion may be defined 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 a diverse country like India, financial inclusion is a critical part of the development process. Since independence, the combined efforts of successive governments, regulatory institutions, and the civil society have helped in increasing the financial-inclusion net in the country.

The state of financial inclusion has improved considerably over time. However, the financial inclusion **hasn't reached the poorest of the poor** and there exist many bottlenecks and challenges which need immediate attention.

Thus, there exists both a great need and the potential to tap into the unbanked population and bring them into the financial net.

Financial Inclusion Initiatives

Jan Dhan-Aadhar-Mobile (JAM) Trinity

- The combination of Aadhaar, PMJDY, and a surge in mobile communication has reshaped the way citizens access government services.
- As per the estimates in March 2020, the total number of beneficiaries under **Jan Dhan scheme** have been more than 380 million.
- By significantly changing the concept of individual identity, Aadhaar has not only brought about a secure and easily verifiable system but also easy to obtain as well to help in the financial inclusion process.
- The government has also launched many flagship schemes to promote financial inclusion and provide financial security to empower the poor and unbanked in the country.
    - These include the **Pradhan Mantri Mudra Yojana**, , Pradhan Mantri Suraksha Bima Yojana, and Atal Pension Yojana.

Expansion of financial services in Rural and Semi-Urban Areas

Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (NABARD) have taken initiatives to promote financial inclusion in rural areas.
    - These include the opening of bank branches in remote areas.
    - Issuing Kisan Credit Cards (KCC)
    - Linkage of self-help groups (SHGs) with banks.
    - Increasing the number of automated teller machines (ATMs)
    - Business correspondents model of Banking, etc.

Promotion of Digital Payments

- With the strengthening of the **Unified Payment Interface (UPI)** by NPCI, digital payments have been made secure, compared to the past.
- The Aadhar-enabled payment system (AEPS) enables an Aadhar enabled bank account (AEBA) to be used at any place and at any time, using micro ATMs.
- The payment system has been made more accessible due to offline transaction-enabling platforms, like **Unstructured Supplementary Service Data (USSD)**, which makes it possible to use mobile banking services without internet, even on a basic mobile handset.

Enhancing Financial Literacy

- The Reserve Bank of India has undertaken a project titled **"Project Financial Literacy".**
    The Objective of the project is to disseminate information regarding the central bank and general banking concepts to various target groups, including, school and college going children, women, rural and urban poor, defence personnel and senior citizens.
- **Pocket Money** is Securities and Exchange Board of India (SEBI) and National Institute of Securities Markets (NISM's) flagship programme aimed at increasing financial literacy among school students.
    The objective is to help school students understand the value of money and the importance of saving, investing and financial planning.

Financial Inclusion: Success Story

Increased Access to Banks

According to the World Bank's Global Financial Inclusion Database or Global Findex report (2017), 80% Indian adults have a bank account against the 53% estimated in 2014.
    The Findex 2017 report also estimates that 77% Indian women have bank accounts, against 43% in 2014.

Multiplier Effect

- These initiatives have brought about major changes to increase the last-mile connectivity of financial services to its people.
- By providing access to financial resources to underprivileged and marginalised sections of society, financial inclusion has the potential to reduce poverty, create jobs, among others.

Enhancing Active Participation of Citizenry

- Earlier, private institutions did not engage with the poor as customers on a significant scale.

- This has now changed, and there has been an active participation of the private players (payment banks like paytm, airtel money and jio money), as they have also realised that bringing the poor into the financial net is beneficial to their business models as well.

Integration of Financial Services

The convergence of JAM trinity with the Direct Benefit Transfer (DBT) scheme has largely been successful.

- Due to this, there has been a significant improvement in terms of targeted and accurate payments.
- It has also helped in weeding out duplication of entries, and bringing down the reliance on cash mode of payments.

Associated Challenges

- **Non-Universal Access to Bank Accounts**

  Bank accounts are a gateway to all financial services. But, according to a report by the World Bank, about 190 million adults in India do not have a bank account, making India the world's second largest nation in terms of unbanked population after China.
- **Digital Divide**
  - The most common barriers to the adoption of digital technology which may promote financial inclusion:
  - Non-availability of suitable financial products
  - Lack of skills among the stakeholders to use digital services
  - Infrastructural issues
  - Low-income consumers who are not able to afford the technology required to access digital services
- **Implement Deficit**
  - For instance, the Jan Dhan scheme has resulted in the opening of many dormant accounts which never saw actual banking transactions.
  - All such activities incur costs on the institutions, and thus, huge operative costs only proved to be detrimental to the actual objective.
  - To avoid these counterproductive outcomes, it is important that all stakeholders participate in such programmes with proper intent and not just for the sake of it.
- **Informal and Cash-Dominated Economy**
  - India is the heavily dominated cash economy, this poses a challenge for digital payment adoption.
  - Also, according to the International Labour Organization (ILO), about 81% of the employed persons in India work in the informal sector.
  - The combination of a huge informal sector along with a high dependence on cash mode of transaction poses an impediment to digital financial inclusion
- **Gender Gap in Financial Inclusion**
  - According to the 2017 Global Findex database, 83% of males above 15 years of age in India held accounts at a financial institution in 2017 compared to 77% females.
  - This is attributed to socio-economic factors, including the availability of mobile handset and internet data facility being higher among men than women.

- **Lack of Credit Penetration**
    - One of the main constraints in providing credit to low-income households and informal businesses is the lack of information available with formal creditors to determine their credit worthiness. This results in a high cost of credit.
    - Due to this, in 2016, the number of loan accounts per 1,000 adults was 154 in India. This is quite low when compared to similarly placed economies like BRICS nations.

Steps to be Taken

- **Reviving Banking Correspondent Model**
    - Given the infeasibility of locating branches in every nook and corner of the country, bank correspondents are used to reach out to prospective clients. However, an inadequate compensation structure makes correspondent banking unattractive.
    - Thus, there is a need to create better monetary incentives for banking correspondents as well as to provide them better training.
- **Leveraging JAM Trinity**
    - Technology should be used to improve the assessment of credit-worthiness for households and informal businesses.
    - With the adoption of appropriate technology a new data-sharing framework (using Jan Dhan and Aadhaar platforms), to enable easier access to credit, with adequate safeguards for maintaining data privacy.
- **Need For Data Protection Regime**

    In addition to greater digitization, there is also a need to strengthen cyber security and data protection regime in the country.
- **Leveraging Differentiated Banks**

    Differentiated Banks like Payment banks and small finance banks can be leveraged to scale up payments systems in underserved areas.
- **Promoting USSD for Rural Areas**
    - Payments through the USSD channel should be promoted (by reimbursing the charges incurred in the USSD process), as they have an advantage over the internet in that it can also cover a large proportion of non-smartphone users.
    - In India, USSD can be particularly useful in rural areas where some segments still do not have reliable access to the internet.

Conclusion

For the success of financial inclusion in India, there has to be a multidimensional approach through which existing digital platforms, infrastructure, human resources, and policy frameworks are strengthened and new technological innovations should be promoted.

If adequate measures are taken to tide over the existing problems, financial inclusion has the potential to amplify the benefits of economic growth to the poor.

Drishti Mains Question

Financial inclusion is one of the most important cornerstones of an economy. Discuss its implications and challenges faced by India in the path of financial inclusion.

Watch Video At:

https://youtu.be/UF7ixCcKiHA

This editorial is based on **“Toxic disaster”** which was published in The Hindu on May 8th, 2020. Now watch this on our Youtube Channel.