CHAPTER 1
FINANCIAL INCLUSION: INTRODUCTION AND THEORETICAL FRAMEWORK

1.1. Introduction

Despite rapid economic development and modernization of world economy, gaps in financial access remain severe. More than half the world’s working-age population does not have access to quality, affordable financial services which is about 2.5 billion adults - 2.2 billion of whom live in Africa, Asia, Latin America, and the Middle East countries (McKinsey and Company, 2010). The situation remains almost same until recently as confirmed by the World Bank data as around 50 percent of the world’s adult’s population do not have account at a formal financial institution. The scenario is particularly grim in developing economies, where more than 71 percent of the adult population is excluded. Only around 35 percent of the adults in India have access to account at a formal financial institution¹ (Demirguc-Kunt, Asli and Leora Klapper, 2012). In its report in 2008, McKinsey estimated that out of around 110 million low-income households in India, only 15 million currently have access to microcredit. Exclusion condition is particularly disappointing for other financial products like health insurance as only an estimated 2–3 percent of low-income households have access to some form of community-based or micro-health insurance (McKinsey and company, 2008). Again, World Bank statistics places India in much lower ranks compared to OECD countries with regard to financial access. However, when compared to selected Asian peer group

¹ For details please refer Annexure-i
countries, the access to bank branches and ATMs is lower than Malaysia and Thailand but higher than China and Indonesia as the number of branches and ATMs per 1,00,000 persons in India were 7.13 and 5.07 in 2010 (RBI, 2010).

The broad objectives of financial inclusion for the poor are to address their needs through the formal financial system; transform money lender dependent rural poor into a highly bankable group; eliminate the high-cost interest regime; stop the resource drain from the poor; build up diversified and multiple livelihoods and inculcate a strong savings culture among them. In broader sense the objective of extensive financial inclusion is to offer a wide range of services for achieving holistic set of services for growth and development of the country. In narrow sense financial inclusion may be achieved to some extent by providing access to any one of these services. The goal of financial inclusion is to enable everyone to participate fully in the formal financial system which will ultimately benefit individuals, the commercial enterprises that serve them, and society at large (McKinsey and company, 2010). Financial inclusion provides an opportunity to the poor to secure better life for themselves and for their family. Financial inclusion enables poor to make sustainable improvements in their quality of life at the community level and faster growth and poverty reduction at the national level (ASSOCHAM and Ernst & Young, 2010). Financial inclusion demands higher level of financial penetration of the banking system and access to a bank account combined with deposit, insurance, easy access to credit at an affordable cost (Thorat, 2010). Thus, in India, access to institutional credit is one of the important indicators of financial inclusion (Ramji, 2009). Study conducted in Malaysia by Ang and McKibbin (2005) suggests that an efficient and well-
functioning financial system is the prerequisite before undertaking any financial liberalization program in order to accelerate economic growth. For inclusive financial sector, the first step is to achieve credit inclusion by improving the present formal and innovative credit delivery mechanism for the low income groups; followed by an overall strategy for capacity building\textsuperscript{ii}, developing new models and resorting to technology based solutions (such as mobile banking and branchless banking) to effectively expand banking outreach into unbanked interior areas (Ramakrishnan, 2007).

Financial inclusion facilitates the poor and disadvantaged section of society with a right to access the basic financial services such as savings, credit, insurance, transfer and remittance as well as financial consultancy services\textsuperscript{iii} as and when desired at reasonable cost in a trouble-free manner. Their lack of education or resources should not come in the way of approaching the formal financial system.

1.2. Financial Exclusion

Around 30-35 percent of the total population in India still lives below the poverty line. It is estimated that around 400 million people, still live in absolute poverty defined as less than $1 per day, accounting for more than 36 percent of the total population in India. Around 60 percent people in some pockets of BIMARU states live with less than half a dollar a day (Arunachalam, 2008). Among others, financial exclusion is a significant characteristic of these poorest states. “Financial exclusion means the inability to access necessary financial services in an appropriate form.

\textsuperscript{ii}Capacity Building implies that before providing access to finance to low income clients, they should be provided with some training, to utilise the same such as suggesting measures for improving credit absorption capacity especially amongst marginal and sub marginal farmers and poor non-cultivator households etc. Source: NABARD

\textsuperscript{iii}Financial consultancy becomes all the more important for the poor when the resources are scarce but uses are many. They need to priorities. For example- which need that is whether savings or insurance is more important for them considering their age, family size, nature of work etc.
Exclusion can come about as a result of problems with access, conditions, prices, marketing or self exclusion in response to negative experiences or perceptions” (Stephen P. Sinclair, 2001 as cited in Sarma, 2008). It is the potential difficulty faced by some segments of population in accessing mainstream financial services such as bank accounts/ home insurance and the like (Meadows et al., 2004 as cited in RBI, 2008). Financial exclusion becomes a major concern in the community when it affects lower income consumers and/ or those in financial adversity (Chant Link & Associates, Australia, 2004). In Indian context RBI has come up with a definition of financial exclusion which states that financial exclusion means obstacles in using the financial services, whether the impediments are price or non price barriers to finance (RBI, 2008). The need to eliminate financial exclusion has attracted global attention and the Norwegian Nobel Committee gave a substantial impetus to the objective of financial inclusion by awarding the 2006 Nobel Peace Prize to Prof. Md. Yunus and his Grameen Bank (Sinha, 2006). The United Nations (UN) also advocated a financial sector that ensures ‘access’ to credit for all ‘bankable’ people and firms, to insure all insurable people and firms and access to savings and payments services for everyone. Inclusive finance doesn’t require that everyone who is eligible use each of these services, but they should be able to use them if desired (United Nations, 2006). The financially excluded sections largely comprise of small vendors, marginal farmers, landless labourers, people engaged in self employment and unorganised sectors, urban slum inhabitants, migrants, tribal minorities, socially excluded groups, senior citizens, physically challenged people and women. Financial exclusion is a multi-dimensional
problem, which both the developed and developing countries endeavour to overcome. The reasons being low income, lack of identity proof, illiteracy, distance from bank branches, lack of banking habits, high transaction costs, lack of banking knowledge or insufficient knowledge on banking products and attitude of bankers (Ramji, 2009)\textsuperscript{iv}.

Accessibility of finance among the farmer households is even worse as reported by National Sample Survey Organisation (NSSO). Its 59th Round data revealed that around 51 percent of farmer households are financially excluded from both formal / informal sources and only 27 percent of the total farmer households have access to formal sources of credit; one third of this group also borrow from non-formal sources. Region wise exclusion data revealed that exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64 percent of all financially excluded farmer households in the country. Overall indebtedness to formal sources of finance alone is only around 20 percent in these three regions (MoSPI, NSS 59th Round, 2003).

Even though the exclusion data provided by different agencies differ as the reference period of the data is not uniform the extent of levels of exclusion is severe. To neutralize the effect of financial exclusion, financial inclusion is important. It means making available the necessary financial services such as savings, credit or loan, investment or deposit, insurance and money transfer facilities to the poor and disadvantaged section of society at affordable cost (ADB, 2000 and Leeladhar, 2005) through the formal financial system (Allen et al., 2012). An unrestrained and universal

\textsuperscript{iv} Wrong notion that amount has to be of ‘considerable volume each time’ to be the reason for not opening no-frill accounts. Source: Ramji, 2009, “Financial Inclusion in Gulbarga: Finding Usage in ACCESS”
access to a broad range of financial services at a reasonable cost results into an open and efficient society (Rajan, 2009).

Government of India (GOI) since independence has taken a number of efforts for poverty reduction and empowerment of the poor which includes subsidies, grants and framing and implementation of various schemes. In the 21st century, Reserve bank of India (RBI) initiated the financial inclusion drive in line with the Directive Principles of State Policy\(^v\) aiming at promoting equality of opportunity for all and reducing economic inequality. The drive which was launched in the year 2006 aimed at mainstreaming the marginalised sections of the society by providing them easy and timely access to finance to satisfy their small and frequent needs.

1.3. Theoretical Framework

Since ancient times the issues of equality and justice have preoccupied thinkers, politicians and religions worldwide. Reducing inequality and increasing degrees of inclusiveness can lead to a process of strong and sustained growth. In developing countries, revising the policy approach to inequality ensuring a greater participation of workers of all occupations in overall productivity growth and more social protection for the poor is well recognised not only for alleviating poverty, but also for strengthening the dynamics of domestic markets. UNCTAD survey report says that a comprehensive incomes policy linking wage and productivity growth and including legal minimum wages and a tight social safety net for poorer families would favour investment dynamics and monetary stability in the country. For efficient

\(^{v}\) Directive Principles of State Policy are the guidelines to central and state governments of India, to be kept in mind while framing the laws and policies as an endeavor to promote the welfare of the people and reducing economic inequality and opportunities. These principles are considered fundamental in governance of a country and these principles should be applied in making laws to establish a just society in country. Source: en.wikipedia.org
delivery the social security benefits, the policy could be linked to financial inclusion worldwide (UNCTAD, 2012). India is a welfare state and its twin objectives are growth and social justice as mentioned in the directive policy. The fulfillment of these objectives leads to inclusive growth which calls for reducing inequalities by ensuring equal participation of all in the growth process. Financial Inclusion is a tool to achieve these twin objectives which are vital for inclusive growth (Figure-1.1).

Financial inclusion can be instrumental for poverty alleviation, inclusive growth and social inclusion of the underprivileged sections of the society. Financial inclusion has received increased attention in view of the international initiatives towards inclusive growth of the emerging economies. Financial inclusion is viewed as a device for the new vision of inclusive growth (Chakrabarty, 2009 and Mehrotra, 2009). Inclusive growth may be viewed as a target and financial inclusion as a tool. In cross-country regressions, Beck, Demirgüç-Kunt, and Levine stated that financial development alleviates poverty and reduces income inequality\(^\text{vi}\) (Beck, Demirgüç and Levine 2004). Development of financial sector is crucial for inclusive growth (Ianchovichina and Lundstrom, 2009). It will reinforce financial development which will contribute towards inclusive and economic growth of the country (Mohan, 2006).

\(^{vi}\)Their results indicate that financial development exerts a disproportionately positive influence on the poor and alleviates poverty both by boosting growth and by reducing income inequality.
Figure 1.1: Financial Inclusion: A Holistic Approach

Financial inclusion can be viewed as an intensification and extension of poverty alleviation efforts (Karmakar, 2008). World Bank data reveals that, ‘Higher the population, lower the financial penetration’ (CGAP/The World Bank, 2009) and countries with large proportion of population not having access to financial services shows higher poverty ratios measured by both national and international poverty lines. World Bank data on percent of population with access to financial services reveals that countries like India (48 percent), Bangladesh (32 percent), China (42 percent) and Philippines (26 percent) with large proportion of population not having access to financial services shows higher poverty ratios measured by both national and international poverty lines (World Bank, 2008).

This phenomenon of inclusive growth is endorsed by the Government of India and harmonized with the country’s 11th Five Year Plan to promote “Inclusive Growth” with focus on the most marginalized section of the society (Planning Commission,
2006). Financial inclusion enables the poor to contribute towards and share the benefits of economic growth by equalizing opportunities, reducing inequalities and moving the wealth effect towards a neutral realm (World Bank, 2008 and Thorat, 2008). A World Bank survey reported that in India in the year 2011 around 33 percent of adults living in rural areas as against 41 percent in urban areas do not have access to formal financial institutions (World Bank/ The International Bank for Reconstruction and Development, 2012). The nexus between exclusion and poverty especially in rural parts advocates research for financial inclusion for the rural poor. The present study focuses on the status of financial inclusion of the poor residing in rural areas, hence the methodological debate between poor and poverty is discussed below.

1.4. Poor and Poverty: Methodological Debate

Poverty is a multidimensional and relative concept. An individual or family is considered to be poor if their resources fail to meet their basic needs (Foster, 1998). Measuring poverty is very important for targeting the poor and for effective formulation, implementation and success of poverty eradication programs. Success of poverty eradication programs will make the growth process even, enabling the poor to contribute towards and share the benefits of economic growth which is vital for ‘inclusive growth’ of the country. Therefore, the effectiveness of various socio-economic programs and policies including financial inclusion for promoting economic growth and upliftment of the poor should be considered in terms of their success in achieving the basic objective of raising the standard of living and reducing the inequalities (Sengupta, et al, 2008). Appropriate estimation of poverty in a country like
India is vital, whose policies are always directed for achieving growth with poverty elimination.

As per World Bank (2000) definition “poverty is pronounced deprivation in wellbeing”. Asian Development Bank (ADB) explained poverty as “deprivation of essential assets and opportunities to which every human is entitled…….. Poverty is, thus, better measured in terms of basic education, health care, nutrition, water and sanitation, as well as income, employment, and wages” (ADB, 2006).

According to International Fund for Agricultural Development, there are ten components of multidimensional poverty assessment tools for assessing rural poverty which are broadly classified in two categories i.e. Fundamental needs and Rural Assets, Exposure & Equality (Cohen, 2009).

1.4.1. The dilemma in measuring poverty

As mentioned by United Nations, poverty is a phenomenon reflecting insufficient income for meeting the basic needs. It is measured by estimating a “poverty line” – which is the per capita cost of satisfying basic needs – and comparing it with the actual per capita income of households. Households whose current income is below the poverty line are considered poor (UNCTAD, 2012). Thus, measurement of poverty is based on the assumption that there exist predetermined and well-defined standards of consumption named as "poverty lines” below which a person is deemed to be poor (Ravallion, 1992).

---

vii Wellbeing is a state where a person has access to minimum needs for the life and choices to basic welfare.
viii These components are not fixed and universal as it is not possible to have such a finite list. It is important to note that all these ten components are equally important and the order is arbitrary and is not a ranking. Source: Cohen, 2009, The Multidimensional Poverty Assessment Tool: Design, development and application of a new framework for measuring rural poverty. International Fund for Agricultural Development: Rome
The consideration for household or a person to be regarded as poor largely depends on the method of setting the poverty line. Poverty lines are normally expressed as the per-capita monetary requirements that an individual needs to pay for the purchase of a basic bundle of goods and services. Identifying the poor as those with income (or consumption expenditure) below the determined poverty line ensures clarity and brings efficiency and focus in policy making and poverty evaluation. An unambiguous poverty line helps the policy makers in evaluating the poverty conditions, allocation of resources for poverty eradication, and in monitoring the success of various programmes and policies centreing the poor. A clear poverty line may enable designing nation-wide poverty profiles clearly across states, sectors and also among socio-economic groups (ADB, 2006). It will also enable checking the effectiveness of financial inclusion plan (FIP) in India. Almost all poverty alleviation programs target a particular section of the society and proper identification of poor is important. But the dilemma arises as different people, institutions, countries and school of thoughts define poverty lines differently (Ravallion, 2008). Basically there are two poverty lines - national and international for identifying the poor. Both these poverty lines are measured, determined, updated and changed with the passage of time considering the dynamism in the world scenario. The dilemma arises while selecting a yardstick for identifying the poor household in a particular area. The issues pertaining to adoption of both national and international poverty lines are discussed below:
1.4.2. International Poverty Line

World Bank defines and provides estimations of poverty from time to time at international level. The poverty line does not change with the passage of time (except to adjust for inflation). It facilitates authentic and valid comparison of present poverty level estimates with a decade old poverty level estimates; as well as the effectiveness of anti-poverty policies over a period of time. Such comparison acts as a guideline in choosing the areas where to channel resources for removing poverty (Haughton and Khandker, 2009). Thus, absolute poverty lines are vital. The most commonly used definition/estimates of global poverty line in absolute terms are provided by the World Bank based on Purchasing Power parity (PPP) for low income countries. Accordingly, a poverty line of $1 per day\textsuperscript{ix} at 1985 PPP for low-income nations was proposed by Ravallion, Datt and Van de Walle in the World Development Report 1990 compiling data on national poverty lines across 33 countries (Chen and Ravallion, 2008). It became the focus of the first Millennium Development Goal\textsuperscript{x} (United Nations, 2010). Further, in 2000/01 World Development Report (World Bank, 2000) used an international poverty line of $1.08 a day, at 1993 PPP (Chen and Ravallion, 2007)\textsuperscript{xi}. Again, the revised estimate determined the international poverty line of $1.25 a day in 2005 prices (Ravallion and Chen, 2008)\textsuperscript{xii}.

A deliberately conservative standard has been used by the Bank, anchored to what “poverty” means in the world’s poorest countries (Chen and Ravallion, 2008), the World

---

\textsuperscript{ix}The World Bank’s “$1 a day” measures have aimed to apply a common standard and measure the poverty in the world as a whole in such a manner that any two people with the same purchasing power over commodities are regarded as same i.e. either both are poor or not poor, despite they live in different countries.

\textsuperscript{x}which calls for eradicating the poverty by 50 per cent between 1990 and 2015, the proportion of people whose income is less than $1 a day.

\textsuperscript{xi}In 2004, about one in five people in the developing world—slightly less than one billion people—were deemed to be poor by this standard (Chen and Ravallion, 2007)

\textsuperscript{xii}The revised estimates for 2005 reveals that 1.4 billion people (one in four) of the developing world, lived below the international poverty line of $1.25 a day in 2005 prices (Ravallion and Chen, 2008)
Bank have tried to resolve the difficulties in comparing the poverty rates among countries by computing the proportion of the population in different countries living on less than US$1.25 per person per day (in 2005 U.S. dollars) in 2005 prices\textsuperscript{xiii}.

There are some issues related to adoption of international poverty lines. Firstly, the socio-economic status of residents of different countries differs so adopting a universal benchmark might not be appropriate and hence these lines are not accepted by governments of many countries. Secondly, the idea and concept of basic needs may vary from country to country, and a common benchmark might fail to estimate the poverty at international level. Again, international poverty lines measure poverty in its absolute terms. It is set in a way to represent the same purchasing power year after year but this fixed line might be different from country to country or region to region. Hence, although it provides data for comparing the level of poverty at international level or among countries but it might not serve the purpose of targeting the poor for implementing various programmes. The detailed destitution data entirely collected at national level is vital for the same.

\textsuperscript{xiii} The international poverty line is converted to local currencies in the ICP benchmark year and is then converted to the prices prevailing at the time of the relevant household survey using the best available Consumer Price Index (CPI) for that country. (Equivalently, the survey data on household consumption or income for the survey year are expressed in the prices of the ICP base year, and then converted to PPP $). Then the poverty rate is calculated from that survey. All inter-temporal comparisons are real, as assessed using the country-specific CPI. They make estimates at three-year intervals over 1981-2005. Interpolation/extrapolation methods are used to line up the survey-based estimates with these reference years, including 2005. They also present a new method of mixing survey data with national accounts (NAS) data to try to reduce survey comparability problems. For this purpose, they treat the national accounts data on consumption as a Bayesian prior for the survey mean and the actual survey as the new information (Chen and Ravallion 2008).
1.4.3. National poverty line: Methodology for Identifying the Poor Households in India

Ravallion says “The new international poverty line is not intended to replace national poverty lines,” and to measure poverty and chalk out appropriate policies in a particular country one should naturally use a national poverty line and it should not essentially accord with the international line. National poverty lines are not comparable across nations. These are mostly based on the estimated cost of a set of basic consumption needs, normally based on calorie intake or nutritional requirements for good health (Ravallion, Chen & Sangraula 2008).

In India, the concept of poverty and norm for its definition has developed over time on the basis of available information, prevailing requirements, policy imperatives and priorities. The measurement of poor or commonly referred to as Below Poverty Line (BPL) households has long been a controversial issue. Different committees were constituted for the purpose and their results vary which created problem for the researchers at field level and for the policy makers at the top level.

In India BPL card/ Family Identification Card (FIC) or Antyodaya Anna Yojana (AAY) Cards are issued to the beneficiaries of the Public Distribution System (PDS) which are often also used as proxy criteria for identifying the poorxiv. However, the NSS 61st round (2004-05) revealed the discrepancies in distribution of these Cards xv.

xiv A study examining the financial inclusion drive in Gulbarga district in Karnataka identified low income households on the basis of state-issued ration cards. The study admits that the methodology has a primary weakness of misrepresentation in the classification of households as BPL giving benefit to households above poverty line (APL). However, the study claims that the method was the most objective method of identifying low-income households easily and efficiently (Ramji, 2009).
xv Initially, these cards were meant to be distributed to the poor whose energy intake was below 2400 kcal per person per day in rural areas and as the level of physical activity is low in urban areas so below 2100 kcal per person per day. This definition faces severe criticism due to difficulty involved in measuring the calories (contained in different food items) consumed by people per day and then converting it in terms of money. Further, the calculation of calorie norms or requirements is a complex task as the daily calorie needs for
Possession of these cards should not be regarded as the basis for identifying the BPL households as they are identified and included in the BPL list as per the Census conducted by the GOI.

The Planning Commission has been functioning as the Nodal agency in the GOI for estimating the number and percentage of poor at national and state levels using the Expert Group Method (Expert Group on Estimation of Proportion and Number of Poor) (http://planningcommission.nic.in). The official estimates for poverty released by Planning Commission are the absolute poverty lines which are fixed over time and space. While poverty is estimated by Planning Commission, a Census to identify the BPL households in rural areas has been conducted by the Ministry of Rural Development of the Government of India three times in 1992, 1997 and 2002. A new methodology was proposed for 2009 census under the chairmanship of Saxena Committee the highlights of which are discusses below:

1.4.4. Saxena Committee Report on the methodology for the BPL Census 2009

The Ministry of Rural Development constituted an Expert Group in August 2008 under the chairmanship of N.C. Saxena to recommend simple and suitable methodology for 2009 BPL Census and to suggest an institutional arrangement for the same. The committee was to address the issue of estimation and identification of poor and to put a limit on the total number of households to be included under the category of BPL

healthy life depend upon age, sex, and the nature of work performed. This nutrition based norm was recommended by the ‘Task Force on Projection of Minimum Needs and Effective Consumption Demand’ constituted by Planning Commission, GOI. As calorie requirements decreases when the income increases as people tend to shift to sedentary lifestyle and the required average calorie for the whole society may decline. On the other hand, it may increase with the increase in working population due to demographic shift. Further, as the growth process is not even in India, hence the slight decline in the amount of hard work done by the poor in some prosperous regions does not justify reducing the calorie norm to far below 2400 (http://planningcommission.nic.in).
families (GOI, 2009). The committee submitted its report in August 2009. The committee highlighted several demerits of calorie-based BPL estimation. Since 1987-88, the calorie consumption of the poor has been decreasing because of increasing income resulting in sedentary lifestyle and change in the pattern of expenditure. As a result, the proportion of people living below the national poverty line has declined over a period of time but the number of people consuming less calories than the minimum norms has not declined. Thus, there is undeniable need for re-estimating the poverty lines (http://planningcommission.nic.in). The Saxena committee recommended completely revised set of criteria for identifying the poor households in rural areas. For making the identification process simpler and faster, the ‘Automatic Inclusion’ and ‘Automatic Exclusion’ criteria were included for certain sections of society and rest of the households were to be surveyed on a 10 points scale on the proposed selected five indicators which include Caste/Community/Religion, Occupation, Adult literacy, Disability and Old person headed households. The households with highest ranking is to be included first, to be followed by the next high score, and so on, till one reaches the number to be identified by the respective Panchayats as the cut off.

Issues pertaining to Saxena Committee methodology includes requirement of large manpower. Further, the cut off scores vary from Panchayat to Panchayat. Again, the

---

xvi The share of food in total expenditure has declined whereas expenses on non food items like health, education, transport, fuel and light has increased. The number of people below the calorie norm has been continuously increasing and more than three quarters of the population live in households whose per capita calorie consumption is lower than the norm. However, Planning Commission has failed to recognize this fact (http://planningcommission.nic.in).

xvii To be fixed by the Panchayats against which the scores/points obtained by a household during the survey will be compared and the problem relates to “How to know the different cut-offs fixed by each Panchayat”. Further, this criterion discloses the methodology of Saxena committee, resembles the characteristics of relative poverty lines (not fully but partially) specially while comparing the land holdings and deciding the cut-offs by Panchayats. However, most of the things do not happen practically because of concentration of decision making power in the hands of the few and practical social affiliation also plays an important role.
methodology has not been approved yet by the Ministry and hence could not be adopted for identifying the BPL households for the present research.

1.4.5. **Tendulkar Committee Report to review the poverty line and estimates**

Planning Commission of India constituted an expert group in December 2005 under the chairmanship of S. D. Tendulkar to examine the issue and suggest new poverty line and estimates. The group submitted its report in November 2009. The report suggested a new methodology to arrive at state wise and all India rural and urban poverty thresholds for 2004-05. The final poverty lines and Head Count Ratio (HCR) for 2004-05 revealed that the all-India average rural and urban poverty line was estimated at a per capita expenditure of Rs 446.68 and Rs 578.8 per month respectively. Rural poverty line was highest in Nagaland (Rs.687.30) and lowest in Pondicherry (Rs.385.45). Orissa and Bihar had the highest number of poor whereas Nagaland, Delhi and Jammu and Kashmir had the least number of poor. Poverty Head Count Ratio (PHR) in rural and urban areas stood at 41.8 percent and 25.7 percent respectively and the all India PHR stood at 37.2 percent. For Assam, per capita per month expenditure was Rs. 478 and Rs. 600 for rural as well as urban areas (Table-1.1). The cut off score of Assam has been used in the study for identifying the poor households in rural areas and accessing their status of financial inclusion.
Table-1.1: Final Poverty Lines and Poverty Head Count Ratio for 2004-05

<table>
<thead>
<tr>
<th>State</th>
<th>Poverty Line (Rs)</th>
<th>Poverty Headcount Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>Urban</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>433.43</td>
<td>563.16</td>
</tr>
<tr>
<td>Arunachal Pradesh</td>
<td>547.14</td>
<td>618.45</td>
</tr>
<tr>
<td><strong>Assam</strong></td>
<td><strong>478.00</strong></td>
<td><strong>600.03</strong></td>
</tr>
<tr>
<td>Bihar</td>
<td>433.43</td>
<td>526.18</td>
</tr>
<tr>
<td>Chhattisgarh</td>
<td>398.92</td>
<td>513.70</td>
</tr>
<tr>
<td>Delhi</td>
<td>541.39</td>
<td>642.47</td>
</tr>
<tr>
<td>Goa</td>
<td>608.76</td>
<td>671.15</td>
</tr>
<tr>
<td>Gujarat</td>
<td>501.58</td>
<td>659.18</td>
</tr>
<tr>
<td>Haryana</td>
<td>529.42</td>
<td>626.41</td>
</tr>
<tr>
<td>Himachal Pradesh</td>
<td>520.40</td>
<td>605.74</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>522.30</td>
<td>602.89</td>
</tr>
<tr>
<td>Jharkhand</td>
<td>404.79</td>
<td>531.35</td>
</tr>
<tr>
<td>Karnataka</td>
<td>417.84</td>
<td>588.06</td>
</tr>
<tr>
<td>Kerala</td>
<td>537.31</td>
<td>584.70</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>408.41</td>
<td>532.26</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>484.89</td>
<td>631.85</td>
</tr>
<tr>
<td>Manipur</td>
<td>578.11</td>
<td>641.13</td>
</tr>
<tr>
<td>Meghalaya</td>
<td>503.32</td>
<td>745.73</td>
</tr>
<tr>
<td>Mizoram</td>
<td>639.27</td>
<td>699.75</td>
</tr>
<tr>
<td>Nagaland</td>
<td>687.30</td>
<td>782.93</td>
</tr>
<tr>
<td>Orissa</td>
<td>407.78</td>
<td>497.31</td>
</tr>
<tr>
<td>Pondicherry</td>
<td>385.45</td>
<td>506.17</td>
</tr>
<tr>
<td>Punjab</td>
<td>543.51</td>
<td>642.51</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>478.00</td>
<td>568.15</td>
</tr>
<tr>
<td>Sikkim</td>
<td>531.50</td>
<td>741.68</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>441.69</td>
<td>559.77</td>
</tr>
<tr>
<td>Tripura</td>
<td>450.49</td>
<td>555.79</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>435.14</td>
<td>532.12</td>
</tr>
<tr>
<td>Uttarakhand</td>
<td>486.24</td>
<td>602.39</td>
</tr>
<tr>
<td>West Bengal</td>
<td>445.38</td>
<td>572.51</td>
</tr>
<tr>
<td><strong>All India</strong></td>
<td><strong>446.68</strong></td>
<td><strong>578.8</strong></td>
</tr>
</tbody>
</table>


1.4.6. Evolution of Financial Inclusion with special reference to India

The evolution of the concept of financial inclusion dates back to 2003 when UN Secretary General Kofi Annan emphasized on building of an inclusive financial sector for providing access to sustainable financial services including savings, credit and insurance to the poor and regarded financial inclusion as a precondition to inclusive growth (United Nations, 2006). The Summit for the Monterrey Consensus of the International Conference on Financing for Development highlighted that a range of financial institutions can make great contribution in providing financial access to all. It advocated for public and private institutions and firms to work collaboratively to provide
financial access to all. It also laid emphasis on strengthening domestic financial segment to include women and underserved markets, such as rural areas. In this backdrop, UN declared 2005 as International Year of Microcredit to build an inclusive financial system xviii (www.yearofmicrocredit.org).

In India, since the colonial period, literature reveals the story of exploitative money lenders. One of the associated Provincial reports of the Central Banking Enquiry Committee (CBEC) (1929), the ‘Madras Provincial Banking Enquiry Committee (MPBEC) report’ which is considered as a classic report explained the status of vicious circle of poverty in rural areas in the following words:

"Frequently the debt is not repaid in full and a part of the loan persists and becomes a pro-note debt. In the course of time, it may with a lucky year be paid off or it may become a mortgage debt. By the existence of this heavy persisting debt, the creditor takes the bulk of the produce and leaves the ryot unable to repay short-term loans. But equally, the short-term loan has produced long-term debt and there is a vicious circle. The ryot cannot clear his short-term debt because of the mortgage creditor and he cannot cultivate without borrowing because his crop goes largely to the long-term creditor. If he pays his long-term creditor his current debts swell and overwhelm him” (http://www1.ximb.ac.in).

---

xviii The objective of the Year of Micro credit is to unite the Member States, UN Agencies and Microfinance Partners in their shared interest to build sustainable and inclusive financial sectors and successful achievement of the Millennium Development Goals (MDGs). The objectives include access and promotion of the contribution of microfinance and microcredit to the MDGs by increasing public awareness and understanding of the same as a crucial part of the development equation and promote inclusive financial sectors by supporting sustainable access to financial services and encouraging innovation and new partnerships to build and enhance the outreach and success of microcredit and microfinance. Source: http://www.yearofmicrocredit.org/pages/whyayear/whyayear_learnaboutyear.asp
The ‘All India Rural Credit Survey for 1951’ revealed that Moneylenders accounted for 68.6 percent of total Rural Household Debt in India. The share of all institutional agencies constituted merely 8.8 percent whereas all Non-Institutional Agencies had a share of 91.2 of Rural Household Debt in India as per the survey (Table-1.2).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cooperatives and Commercial Banks</td>
<td>5.7</td>
<td>10.3</td>
<td>24.4</td>
<td>58.6</td>
<td>58.8</td>
</tr>
<tr>
<td>Government and other formal sources</td>
<td>3.1</td>
<td>5.5</td>
<td>7.3</td>
<td>4.6</td>
<td>7.5</td>
</tr>
<tr>
<td><strong>All Institutional Agencies</strong></td>
<td><strong>8.8</strong></td>
<td><strong>15.8</strong></td>
<td><strong>31.7</strong></td>
<td><strong>63.2</strong></td>
<td><strong>66.3</strong></td>
</tr>
<tr>
<td>Professional and Agriculturist Moneylenders</td>
<td>68.6</td>
<td>62.0</td>
<td>36.1</td>
<td>16.1</td>
<td>17.5</td>
</tr>
<tr>
<td>Traders</td>
<td>7.2</td>
<td>8.4</td>
<td>3.1</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>Landlords</td>
<td>7.6</td>
<td>8.6</td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Relatives &amp; Friends</td>
<td>14.4</td>
<td>6.4</td>
<td>13.1</td>
<td>11.2</td>
<td>4.6</td>
</tr>
<tr>
<td>Other sources</td>
<td>8.2</td>
<td>0.8</td>
<td>2.1</td>
<td>2.4</td>
<td>2.3</td>
</tr>
<tr>
<td><strong>All Non-Institutional Agencies</strong></td>
<td><strong>91.2</strong></td>
<td><strong>84.0</strong></td>
<td><strong>68.3</strong></td>
<td><strong>36.8</strong></td>
<td><strong>30.6</strong></td>
</tr>
<tr>
<td>Source not specified</td>
<td>0.0</td>
<td>0.2</td>
<td>0.0</td>
<td>0.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: In 1951, landlords and traders are lumped together within “other sources”

Source: All-India Rural Credit Survey for 1951, All-India Debt and Investment Survey for the other years cited in “Rural Credit in 20th Century India An Overview of History and Perspectives”, By Mihir Shah, RanguRao and P.S. Vijay Shankar; Available at http://www1.ximb.ac.in/users/fac/Shambu/Sprasad.xls/ viewed as on April 7, 2011

One of the landmark steps in the area of providing institutional finance for rural development was Bank Nationalisation & Public Sector Banking. Before nationalization, all the banks were set up and run privately by individuals and/or industrial houses which collected deposits from individuals and used them for their own purposes till 1935. In the absence of any regulatory agency/ framework, the private owners of banks used to utilize the funds as per their liberty in any manner, they deemed appropriate and as a consequence the bank failures were frequent. After nationalisation and passing of Banking Companies Act 1949 state ownership of banks was started. Imperial Bank of India was transferred to SBI by enacting SBI Act in
1955 as per the recommendations of All India Rural Credit Survey Committee. Similarly, the conversion of 8 State-owned banks (State Bank of Bikaner and State Bank of Jaipur were two separate banks earlier and merged) into subsidiaries (now associates) of SBI during 1959 took place. The scheme of ‘social control’ was initiated during 1968, which was closely followed by nationalisation of 14 major banks in 1969 and another six in 1980.

Considering the objectives of nationalisation, Public Sector Banks (PSBs) undertook expansion of reach and services. As a result the number of office of scheduled commercial banks (SCBs) increased by around 11 fold from 8262 in June 1969 to more than 90000 in March 2011 with increase in rural areas by around 18 times, in semi-urban areas by around 7 times, in urban and metropolitan areas by around 11 times each. Population per branch office came down from 64000 in 1969 to around 13400 in March 2011. Thus, most of the branches were opened in rural areas. The expansion is important in terms of geographical distribution. The states which were ignored by private banks before 1969 presently have a vast network of public sector banks. SCBs including Regional Rural Banks (RRBs), account for more than 97 percent of bank offices in India as on March 2011 (RBI, 2012).

Even after more than six decades of independence, and several initiatives for strengthening the financial sector in the country including nationalization of major commercial banks, a vast section of population was unbanked. After fifteen years of financial sector reforms (1991), initiatives for financial inclusion were emphasized. RBI directed different public and private sector banks to offer and issue certain specific
products which can be termed as ‘financial inclusion products’ specifically designed to cater to the needs of weaker sections of the society. Thus the year 2005 can be considered as a landmark in the era of financial inclusion. The process of financial inclusion in India can be discussed in four phases which are as follows:

- **Phase 1 (1950-70):** This was the phase of consolidation of the banking sector and facilitation of industry and trade. The second five year plan laid emphasis on industrialization and development of the industrial sector which necessitated advancement of financial sector.

- **Phase 2 (1970-90):** After nationalization of banks focus was shifted to channel the credit flow to neglected and weaker sections of the society. During these two decades emphasis was on expanding the bank branch throughout the country.

- **Phase 3 (1990-2005):** After financial sector reforms in early nineties the focus was on strengthening the financial institutions. The other initiatives are liberalisation/opening of economy, deregulation, increased competition and strengthening of banks through recapitalization and prudential measures. The Indian policy approach towards financial inclusion since early 2000s has been on ensuring inclusion at the individual and household level (RBI, 2010).

- **Phase 4 (2005-onwards):** Since 2005 onwards recognizing the need of a variety of financial services for the poor and disadvantaged, financial inclusion was explicitly made a policy objective. Keeping in view the broad objective of financial inclusion, GOI has constituted a number of committees from time to time\textsuperscript{xix}.

\textsuperscript{xix} These are:

i. Committee on Financial Inclusion (Chairman: C. Rangarajan) in June 2006
To have an insight into the issues involved and suggest measures for providing access to finance to the excluded groups GOI constituted a Committee on Financial Inclusion under the chairmanship of C. Rangarajan in the year 2006. After analyzing the data presented by the National Sample Survey Organisation (NSSO) 59th round and supplementing it with information on credit flow from RBI / NABARD, the committee recommended that 50 per cent of the excluded rural households (55.8 million) should have access to financial services by 2012, and 100 percent by 2015. The Committee proposed the constitution of two funds with NABARD namely the Financial Inclusion Promotion & Development Fund and the Financial Inclusion Technology Fund with an initial corpus of Rs. 500 crore each to be contributed in equal proportion by GOI / RBI / NABARD. The other major recommendations for enhancing financial inclusion included- formation of National Rural Financial Inclusion Plan (NRFIP); promotion of customized savings, credit, insurance, products for serving the needs of the excluded; give attention to demand side impediments; to expand the coverage of Business Correspondents (BCs) and Business Facilitators (BFs); reorientation of RRBs; evolve specific SHG model for NER; extend SHG-bank linked microfinance facility to the urban poor as well; adoption of Joint Liability Group model as an innovative model;

ii. Committee on Financial Sector Reforms (Chairman: Raghuram Rajan)
iii. A High Level Committee (Chairperson: Smt. Usha Thorat) was constituted in November 2007, to review the Lead Bank Scheme (LBS) and improve its effectiveness, with a focus on financial inclusion and recent developments in the banking sector
iv. Committee on Financial Sector Plan for North Eastern Region (Chairperson: Smt. Usha Thorat)
v. Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households (Chairperson: Nachiket Mor) in September 2013

Under NRFIP initiative, the committee recommended that the commercial banks including RRBs should be given a target to bring at least 250 excluded households every year under the banking net in rural and semi-urban branches.
creation of NBFCs; reorganizing the structure of co-operatives; link microcredit with micro insurance; NABARD to play active role in financial inclusion by strengthening SHGs and MFIs; launch of e-kiosks in villages to serve the remittance needs of the poor; establishment of micro-bank in every village; the creative use of the NREGP payments via bank accounts and infrastructure support (Rangarajan, 2008).

The committee constituted to give recommendations for financial sector reforms under the chairmanship of Rajan highlighted that a large proportion of population is excluded from the formal financial system in India, leading to greater dependence on the informal and exploitative sources of credit. Three most important factors highlighted for next financial sector reforms were - to include more Indians in the growth process to make it more inclusive; to promote growth itself; and to enhance financial stability, flexibility, and resilience to protect against the turmoil. As the average annual income increases, percent of population with bank account also increases. Further, efficiency, innovation and cost-effectiveness are the key to serve the financial needs of the poor. Appropriate organizational structure facilitating financial inclusion; focus on risk management, subsidies and public goods, use of technology, improving infrastructure and financial literacy were the major suggestion of the committee (Rajan, 2009).

Considering the background of financial exclusion in North Eastern Region (NER), the RBI initiated a special focus on NER with formulation of the Committee on Financial Sector Plan. The committee highlighted poverty, ignorance and environmental issues as the main impediments and efficiency, innovation and cost-effectiveness as the key to serve the financial needs of the poor. It also proposed need for appropriate organizational
structure; focus on risk management, subsidies and public goods, use of technology, improving infrastructure and financial literacy for enhancing financial inclusion in NER. The committee advised major banks having more than five branches in the NER to formulate a special Scheme for financial inclusion. It constituted ‘State Specific Task Forces’ for every state in the NER to deal with state specific issues and task force constituted for Assam, highlighted need for branch expansion in the under banked districts of Assam; improving Credit Deposit Ratio (CDR); strengthening Regional Rural Banks (RRBs) & Assam State Cooperative Apex bank (Thorat, 2006).

1.5 Conclusion

Financial inclusion can play a crucial role in poverty alleviation, inclusive growth and social inclusion of the underprivileged sections of the society. The situation of financial exclusion is grim worldwide more particularly in developing economies. India also occupies much lower rank in terms of provision for financial access as per World Bank data. However, the problem of financial exclusion has attracted global attention and both national and international agencies are taking adequate policy measures for greater financial inclusion and inclusive growth. To address the issue of financial exclusion, RBI directed different public and private sector banks to offer and issue certain specific products which can be termed as ‘financial inclusion products’ purposely designed to cater to the needs of weaker sections of the society. Accordingly financial inclusion drive was intitiated in the year 2006 for making available the basic financial services to the poor and disadvantaged section of society at an affordable cost. Measuring poverty is very important for targeting the poor and for effective formulation, implementation and success of financial inclusion plans and to ensure equall participation of all in availing the banking facilities. The
dilemma arises as different people, institutions, countries and school of thoughts define poverty lines differently. Both national and international poverty lines have been determined for estimating the poor households in a country. International poverty lines are estimated by World Bank. In India, the Planning Commission has been functioning as the Nodal agency for estimating the number and percentage of poor at national and state levels.

In India, the government has taken a number of initiatives and formed several committees for greater financial inclusion in the country since independence. However, despite these initiatives, a vast section of population is still unbanked in the country.
References


HYPERLINK “http://planningcommission.nic.in" http://planningcommission.nic.in


(n.d.).

http://www1.ximb.ac.in/users/fac/Shambu/Sprasad.nsf/ Date Accessed on April 7, 2011


