K C Chakrabarty: Banking – key driver for inclusive growth

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the Mint's "Clarity Through Debate" series, Chennai, 10 August 2009.

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Ladies and Gentlemen:

It gives me immense pleasure to be here this evening in front of an august audience for today's Mint debate series on the theme "Banking: Key Driver for Inclusive Growth". I would like to thank the sponsors and all of you for inviting me here to share my views and thoughts on a subject which has become of great significance today for the growth of the Indian economy. The previous Conclaves organized by the Mint brought together the eminent bankers and the corporate leaders on varied subjects and pressing issues. I am sure, today's debate by the eminent panelists on the theme as mentioned earlier will certainly generate and open new vistas for an inclusive growth in India. The timing of today's debate could not have been more apt if one just considers the existence and extent of "financial exclusion" in India and the urgent need for financially including the people from all strata in the mainstream banking system.

Some of the glaring facts about financial exclusion is very much clear from the following figures – 45.9 million farmer households out of a total of 89.3 million households do not have access to credit either from the institutional or non-institutional sources (NSSO, 2008); one branch is catering to the banking needs of 16,000 population (June, 2007); only 17 credit accounts and 54 saving accounts are there per 100 persons with all the institutions (June 2007); only 13 per cent are availing loans from the banks in the income bracket of less than Rs.50,000; and 53 per cent people are still taking loans from the institutional and non-institutional sources only for emergency purposes. These figures do tell us something – the "urgent need" for extending the banking and financial services to every part of the country for achieving the objective of inclusive growth. In this context, the views and various perspectives generated out of today's debate will be of importance in addressing the issue of inclusive growth of India from the banking perspectives.

The "inclusive growth" as a strategy of economic development received attention owing to a rising concern that the benefits of economic growth have not been equitably shared. Growth is inclusive when it creates economic opportunities along with ensuring equal access to them. Apart from addressing the issue of inequality, the inclusive growth may also make the poverty reduction efforts more effective by explicitly creating productive economic opportunities for the poor and vulnerable sections of the society. The inclusive growth by encompassing the hitherto excluded population can bring in several other benefits as well to the economy. The concept "Inclusion" should be seen as a process of including the excluded as agents whose participation is essential in the very design of the development process, and not simply as welfare targets of development programmes (Planning Commission, 2007).[1]

The Eleventh Five Year Plan (2007-12) envisions inclusive growth as a key objective. The Plan document notes that the economic growth has failed to be sufficiently inclusive particularly after the mid-1990s. The Indian economy, though achieved a high growth momentum during 2003-04 to 2007-08, could not bring down unemployment and poverty to tolerable levels. Further, a vast majority of the population remained outside the ambit of basic health and education facilities during this high growth phase. In recent decades, economic and social inequalities have increased alongside high growth rates which have exacerbated

1 TOWARDS INCLUSIVE GROWTH: THE GENDER DIMENSION, Planning Commission, November 15, 2007.

regional inequalities. The latest seventh quinquennial survey by the National Sample Survey Organisation (NSSO) (61st Round) reveals that growth rate of employment increased from an annual 0.98 per cent in the period 1993-94 to 1999-00 to 2.89 per cent in the period 1999-2000 to 2004-05, while the acceleration in the rate of growth of labour force from 1.03 per cent to 2.93 per cent during same period had negative impact on employment rate (Table 1). Similarly, poverty ratio has been declining during the recent period, but it continues to remain at a very high level of 27.5 per cent (Uniform Recall Period) in 2004-05 from 36.0 per cent in 1993-94. The most disturbing fact is that the income inequality as commonly measured by consumption expenditure (Gini coefficient) has increased in India from 32.9 in 1993 to 36.2 in 2004 (Ali, I. and J. Zhuang: 2007).

This made “inclusive growth” the focal point of growth strategy and major concern for the policymakers in India.

Table 1: Employment and Unemployment (UPSS)

	1993-94	1999-00	2004-05	1993-94 to 1999-00	1999-00 to 2004-05
	In million			Point to Point Growth rate	Annualised (CAGR)
Labour Force	381.94	406.05	469.06	1.03	2.93
Workforce	374.45	397.00	457.82	0.98	2.89
Number of Unemployed	7.49	9.05	11.24		
As a Proportion of labour force in per cent					
Unemployment Rate	1.96	2.23	2.39		

Note:

1. Figures for 2004-05 are derived from 61st Round survey on the basis of data provided by NSSO.
2. Employment in 1993-94 and 1999-00 is as per Report of the Task Force on Employment Opportunities (Planning Commission)

Source: RBI, DEAP work paper, 2009

Thus, the Eleventh Plan Document tries to restructure the policies in order to make the growth faster, broad-based and inclusive by reducing the fragmentation of the society. It clearly stated that *“The development of rural India is an imperative for inclusive and equitable growth and to unlock huge potential of the population that is presently trapped in poverty with its associated deprivations”* (GoI, 2007). Huge investments in education and health, and rural infrastructure were the key elements of the inclusive growth strategy as envisaged. Broadly, the policies aim at increasing the income and employment opportunities on the one hand and on the other; it tries to finance programmes which are capable of making the growth more inclusive.

There are supply side and demand side factors driving Inclusive Growth. Banks largely are expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. Apart from the supply side factors, demand side factors, such as lower income and /or asset holdings also have a significant bearing on financial inclusion. 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.

Agriculture not only plays the central role for achieving high growth but also inclusive growth for the economy as a whole (generates about 20 per cent of India’s GDP and provides employment to nearly two-third of its population). Out of 119 million farmers, small and marginal farmers account for 82.1 per cent at 97.7 million. Targeted Eleventh Plan growth (at 8.5 per cent) warrants a growth of at least 3.9 per cent in the agriculture sector, which would presuppose private sector investment and credit flow to agriculture. The Ground Level Credit requirements for the agricultural sector has been worked out at Rs.16,40,000 crore for the Eleventh Five Year Plan, indicating an annual compounded growth of 17.0 per cent as compared to Rs.6,39,330 crore of expected GLC during the Tenth Plan period. The role of state governments is of high importance in achieving the target especially in providing suitable infrastructure/extension support for facilitating enhanced credit flow to agriculture.

The draft 11th Plan recognizes the importance of **small-scale industries** (SSI). It has a share of over 40 per cent of the gross industrial value added in the economy. About 44.0 per cent of the total manufactured exports of the country are directly accounted for by the SSI sector. In terms of employment generation, this sector is next to agriculture sector, employing approximately 295 lakh people. For the Small and Medium Enterprises (SME) sector, the estimated incremental working capital provided by the scheduled commercial banks during the Eleventh Five Year Plan would be at Rs.1,67,989 crore, which amounts to a growth rate of an average 16.8 per cent per annum. The incremental flow of term loan to the SME sector is estimated at Rs.1,48,720 crore, which translates into a growth rate of an average 24.1 per cent per annum for the Plan period (GoI, 2006). Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth.

Role of financial inclusion in achieving inclusive growth

The Committee on Financial Inclusion (Chairman: C. Rangarajan, 2008) defines financial inclusion 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". 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 (Thorat, 2008).

It has been the endeavour of both the Government and the Reserve Bank to expand banking sector across the length and breadth of the country to ensure reasonably priced credit in a timely manner to all the deserving borrowers. Notwithstanding the significant expansion in bank network in unbanked areas after bank nationalisation in India, there are still large segments of the society that remain outside the financial system. A quick look at the data on the sources of loans and also percentage of persons having annual income less than Rs. 50,000 show that 28.3 per cent had bank accounts and only 13 per cent had availed of bank finance and even in higher income bracket exclusion existed (Tables 2 and 3). Hence, the recent focus has been on providing access to affordable banking services to every person.

Table 2: Earners Having a Bank Account – 2007

Annual Income (Rs.)	Urban	Rural	Total
<50,000	43.1	26.8	28.3
50,000 – 100,000	75.5	71.2	73
100,000 – 200,000	91.8	87.4	89.9
200,000 – 400,000	95.5	93.6	94.9
>400,000	98.0	96.3	97.6
All	61.7	38.0	44.9

Source : Report on Currency and Finance 2006-08(IIMS, 2007)

Table 3: Sources of Loans (Per cent of Indebted Earners)

Annual Income	Banks	Money Lenders	Other Institutional & Non Institutional Sources	Total
<50,000	13.0	34.0	52.1	100
50,000 – 100,000	34.5	19.6	45.9	100
100,000 – 200,000	49.3	12.0	38.7	100
200,000 – 400,000	51.6	11.8	36.6	100
>400,000	62.8	5.5	31.7	100

Source: Report on Currency and Finance 2006-07 (IIMS Survey, 2007)

The process of financial inclusion in India can broadly be classified into three phases. During the First Phase (1960-1990), the focus was on channeling of credit to the neglected sectors of the economy. Special emphasis was also laid on weaker sections of the society. Second Phase (1990-2005) focused mainly on strengthening the financial institutions as part of financial sector reforms. Financial inclusion in this phase was encouraged mainly by the introduction of Self- Help Group (SHG)-bank linkage programme in the early 1990s and Kisan Credit Cards (KCCs) for providing credit to farmers. The SHG-bank linkage programme was launched by National Bank for Agriculture and Rural Development (NABARD) in 1992, with policy support from the Reserve Bank, to facilitate collective decision making by the poor and provide “door step” banking. During the Third Phase (2005 onwards), the “financial inclusion” was explicitly made as a policy objective and thrust was on providing safe facility of savings deposits through “no frills” accounts. A Synoptic View of Financial Inclusion is as under:

- Number of No-Frill Accounts – 3,30,24,761 at end-March 2009
- Number of rural bank branches – 31, 727 constituting 39.7% of total bank branches (as on June, 31, 2009)
- Number of ATMs – 44,857 (as on May 31, 2009)
- Number of POS – 4,70,237 (as on May 31, 2009)
- Number of Cards – 167.09 million (as on May 31, 2009)
- Number of Kisan Credit Cards – 76 million (Source: CMIE publication 2007-08)
- Number of Mobile phones – 403 million (as on Apr.30, 2009)
    - out of which 187 million (46%) do not have a bank account (Source : Cellular Operators Association of India)

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 4). 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 4: 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

*: Provisional.

Source: 1. Report on Trend and Progress of Banking India – 2007-08.

2. Data for 2008-09 are received from banks.

Since micro finance has been accepted as the main vehicle to address the issue of lending to small borrowers dispersed over vast expenses of geographical areas involving high transaction costs and also as a business opportunity, it would be worthwhile to devote some time to this.

There are over 3 million SHGs in India, many of which are already undertaking individual group micro-enterprises. A large number are also doing advocacy work and many especially in south India have formed federations. For economic viability and greater effectiveness, however, SHGs should be provided means to start group enterprises, especially in the rural areas, and provided access to land and other means for this purpose.

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 5). 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 5: Physical Progress under SGSY since Inception

(thousands)

Years	Self-help Groups (SHGs) Formed	No. of SHGs Passed Grade–I	No. of SHGs Passed Grade–II	SHGs Taking up Economic Activities	SHG Swaroz-garis Assisted	Individual Swaroz-garis 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	412
2003-3004	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 (up to October 2008)	298	201	62	46	557	117
Total	3134	2014	948	685	6869	3772

Source: Ministry of Rural Development, Government of India, 2008.

Even in the better performing State of Andhra Pradesh, the income gain to a *swarojgari* from enterprise activities under SGSY was a mere Rs.1,228 per month (Purushotham,2008). Government's proposal for universalizing the SHG coverage of all poor households by 2013 and increasing the proportion of assisted persons among swarojgaris to 50 per cent from the existing 22 per cent is a welcome initiative in this direction. Ill-trained groups in SGSY would be a severe handicap in moving towards the Eleventh Five Year Plan goal of inclusive growth. The proposal to cover 1.7 crore BPL households by 2015 under skill development and placement is to be seen as an encouraging step (GoI, 2008).

Well designed poverty alleviation programmes, if effectively implemented, not only supplement the poverty reducing effects of growth but also could promote pro-poor growth. There is need to design financial instruments that would help people to reduce their risk and vulnerability whether it is for smoothening incomes or ensuring higher education for family members or reducing exposure to health shocks.

Some of the other measures under implementation are as under:

(i) Increasing the branch network by scheduled commercial banks and Regional Rural Banks (RRBs), particularly in un-banked blocks;

(ii) Introducing agency banking (Business Facilitators and Business Correspondents;

(iii) Increasing coverage under mobile banking and satellite banking;

(iv) Augmenting agency arrangements between commercial banks and primary cooperatives as well as with postal authorities;

(v) Making effective use of Information Technology (IT) solutions; and

(vi) Reinvigorating the Lead Bank Scheme (LBS) for promoting various banking activities in individual districts.

To address the problem of high transaction cost and outreach, the banks can increasingly use Information Technology based solutions, such as mobile phones and smart cards, create data base for credit risk management and pricing. There are over 403 million mobile phone users today of which around 187 million (46 per cent) do not have a bank account. The Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF) can be used to (i) fund support for capacity building of BCs and BFs and render promotional support for SHGs and other grass root level institutions; and (ii) financial support for rural kiosks, IT and such other technological solutions for financial services in rural India in general and excluded groups/regions in particular (GoI, 2009).

Concluding remarks

Financial inclusion, though well recognised as a means for inclusive growth, is constrained by several factors in India. The banks are faced with high operating cost in extending the financial services to the remote areas. High maintenance cost of these accounts as well as small ticket size of the transactions is also adding to the problem. Further, reaching out to the illiterate people or people who can handle only the regional languages is also difficult without developing a suitable communication mode. The challenge also lies in offering a single loan product which is not based on or linked to the purpose of the loan, the collateral or assets held or income earned by the household but is purely based on cash flow and credit record of the household (Thorat, 2008).

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. 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.

Thank you.

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