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# FINANCIAL INCLUSION & ECONOMIC DEVELOPMENT

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**Abstract**

Financial Inclusion is characterized by universal access to financial services and products at a reasonable cost, in well-regulated manner. The paper provides a comprehensive review of how the initiatives towards financial inclusion can impact the economic development of a nation. The connection between financial inclusion and financial stability lies in the fact that it empowers deprived and marginalised sections of the society to participate actively in economic development.

Moreover, universal financial access is a key driver of socio-economic development. The relationship between financial inclusion and economic growth is established by development indicators like savings, credit accounts, per capita income, and insurance. As having equitable access to these financial tools not only households get financial security but also entrepreneurs are encouraged to take expansive infrastructural endeavours.

In India, the concept of financial inclusion came in 2005. After World Bank Report (2006), various committees have been setup to penetrate inclusivity. Policies and regulations for financial inclusion were also endorsed by G20 at global level. Thus, a slew of initiatives have taken by Government of India, RBI, NABARD in order to achieve a comprehensive financial inclusion such as opening of No Frills Accounts, Kisan Credit Cards, etc.

Futhermore, the paper examines the role of technological advancements like digital financial services and mobile banking in promoting financial inclusion and expanding the reach by offering innovative solutions to overcome traditional barriers such as geographical remoteness and high transaction cost.

In conclusion, financial inclusion is an imperative way to achieve sustainable economic growth and inclusive development. By giving more people access to financial services and knowledge, societies can unleash the full potential of their economies and create a fairer and more resilient future. This abstract paper adds to the ongoing conversation on the importance of financial inclusion as a catalyst for economic growth and development.

**Keywords:** Financial, Inclusion, Economic, Growth, Development, Services

## Introduction

Financial inclusion refers to the access by enterprises and households to reasonably priced and appropriate formal financial services that meet their needs. Access to financial services can be defined along several dimensions, including geographic access and socio-economic access. Financial inclusion is a broader concept than microfinance, which often refers to the provision of products to specific groups at the lower end of the market, using specific delivery techniques and institutions. Financial inclusion is part of a broader financial deepening agenda that focuses on ensuring the efficient and sustainable provision of financial services to households, enterprises and governments, while minimizing the risk of fragility.

While an extensive literature has established a positive relationship between financial depth and economic growth in this paper. It is also important to understand that the development and efficiency of financial systems can have an impact not only on aggregate growth, but also on tightening income distribution and helping people out of poverty, even without providing them with direct access to credit services. Financial inclusion has become an important part of the development agenda that aims at reducing poverty levels further. It is therefore critical to analyse what works and what does not work in financial inclusion. This is pivotal for both formulating policy priorities and allocating scarce government and donor resources. Properly measuring financial inclusion and the barriers to it and relating them to real sector outcomes is therefore a priority for research. In this context it is important to stress that financial inclusion is not an objective in itself, but only to the extent that it helps improve individual and aggregate welfare.

This paper focuses primarily on the measurement of financial inclusion while at the same time discussing the role of financial inclusion goals in the broader economic development agenda.

The remainder of the paper is structured as follows. Section 2 discusses the relationship between financial development and economic development. Section 3 emphasises on Financial Inclusion in India. Section 4 presents the progress the Global community has made in financial inclusion. Section 5 talks about COVID-19 situation and Financial Inclusion. Section 6 discusses the role of financial innovation in financial inclusion. Section 7 concludes and looks forward.

**Financial Inclusion and Economic Development Intertwined**

Financial Inclusion is regarded as an essential cornerstone of economic growth. It can impact the economy in various possible ways on both micro and macro level by increasing aggregate demand, improving household's access to credit and to smoothen the consumption, thereby lessening the requirement of precautionary savings. The reforms have led to increase in employment and labour demand by pushing the average wages per worker. Looking at firm dynamics, it has induced bank branch expansion which fosters entrepreneurship. The results reflected in the formal sector is of first importance for economic development.

As Financial Inclusion is positioned prominently as an enabler of other developmental goals in the 2030 Sustainable Development Goals, as a target in eight of the seventeen goals. These include SDG 1, on eradicating poverty; SDG 2 on ending hunger, achieving food security and promoting sustainable agriculture; SDG 3 on profiting health and well-being; SDG 5 on achieving gender equality and economic empowerment of women; SDG 8 on promoting economic growth and jobs; SDG 9 on supporting industry, innovation, and infrastructure; and SDG 10 on reducing inequality. Additionally, in SDG 17 on strengthening the means of implementation there is an implicit role for greater financial inclusion through greater savings mobilization for investment and consumption that can spur growth.

Evidence collected by UN Capital Development Fund shows that financial inclusion models can support overall economic growth and the achievement of broader development goals. Digital finance alone could benefit billions of people by spurring inclusive growth that adds $3.7 trillion to the GDP of emerging economics within a decade, according to a recent report by the McKinsey Global Institute. There is also growing evidence of financial inclusion creates more stable financial systems and economies, mobilizing domestic resources through national savings and helping to boost government revenue.

UNCDF's last mile financing models support banks, cooperatives, microfinance institutions, money transfer companies and mobile network operators to extend the reach of financial markets where they would otherwise not go. UNCDF ensures that suitable financial products (savings, credit, insurance, payments, and remittances) are available to individuals – notably the excluded and underbanked – and micro, small, and medium enterprises, at a reasonable cost, and on a sustainable basis. In particular, it targets women based on the growing evidence that access to savings leads to positive economic outcomes for women, including

increasing productivity and profits and greater investment in their businesses. Having savings also makes women less likely to sell assets to address health emergencies, stabilizes their incomes in times of economic shocks, and provides greater control over their funds.

Financial inclusion contributes to economic development taking aspects such as income generation, investment, consumption, resilience and social mobility and in many folds such as-

**1. Facilitating Access to Capital**: One of the primary ways in which financial inclusion fuels economic development is by expanding access to capital for individuals and businesses. By providing savings, credit, and investment opportunities, inclusive financial systems empower entrepreneurs to start or expand enterprises, thereby creating jobs, stimulating innovation, nd driving productivity growth. Access to credit enables smallholder farmers to invest in modern agricultural inputs, leading to higher yields and increased food security. Similarly, microfinance initiatives empower women and marginalized groups to engage in income-generating activities, contributing to poverty reduction and gender equality.

**2. Promoting Household Welfare:** It enhances household welfare by enabling families to manage financial risks, smooth consumption patterns, and invest in human capital development. Access to savings accounts and insurance products helps households cope with unexpected expenses, such as medical emergencies or natural disasters, thereby reducing vulnerability and preventing the depletion of assets. Moreover, access to affordable credit facilitates investments in education, healthcare, and housing, leading to improvements in health outcomes, educational attainment, and overall quality of life.

**3. Enhancing Economic Stability and Resilience**: It contributes to economic stability and resilience by reducing systemic risks, enhancing market efficiency, and promoting inclusive growth. By diversifying sources of income and building financial buffers, individuals and communities become more resilient to economic shocks and fluctuations. Moreover, inclusive financial systems facilitate the mobilization of savings, channeling them into productive investments that support long-term economic development. Furthermore, by promoting financial literacy and consumer protection, financial inclusion initiatives empower individuals to make informed financial decisions, mitigating the risks of over-indebtedness and financial inclusion.

**Financial Inclusion- India's experience**

In India, the significance and role of finance in promoting equitable growth was realized from the first five plan onwards. Nationalisation of banks in 1969 give rise to the process of financial inclusion. The concept of Financial Inclusion was first introduced by RBI in 2005. A committee set up under chairmanship of Dr.C.Rangarajan, Ex-Governor of RBI (2008) defined 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." Many recommendations were given by this committee that are as follows: 1.Business Correspondent Model 2.SHG-Bank Linkage Scheme 3.Micro Finance Institutions- NBFCs 4.Short Term Cooperative Credit System 5.Micro-Insurance One of the major proposal has been the constitution of two funds, with NABARD- The Financial Inclusion Promotion and Development Fund and The Financial Inclusion Technology Fund which was already accepted by Government of India.

The major development to ensure inclusivity is Pradhan Mantri Jan Dhan Yojana (2014) which has been conceived as a national mission on financial inclusion with the objective of covering all the households in the country with banking facilities and having a bank account for each household.

After all these, India adopted many strategies like lead bank schemes, mandatory priority sector lending, kisan credit cards, linking self-help groups with banks, doorstep delivery of banking services through business correspondents etc. to promote financial inclusion.

Recently, RBI released the National Strategy for Financial Inclusion 2019-2024 with set forth the vision and objectives of financial inclusion policies in India. It was prepared with inputs from the central government and financial sector regulators (Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India and Pension Fund Regulatory and Development Authority of India). Further, it noted that the bank-led model of financial inclusion adopted by the RBI through issuance of differentiated banking licenses (small finance banks and payments banks) and the launch of Indian Post Payments Bank in September 2018 has helped bridge the gap in last mile connectivity. However, certain critical gaps remain an impediment for financial inclusion, such as: inadequate infrastructure (in

parts of rural hinterland, far flung areas in Himalayan and north-eastern region); poor tele and internet connectivity in rural hinterland; socio-cultural barriers; and lack of market players in payment product space.

For providing universal access to financial services, RBI noted that while schemes such as PMJDY have created the required banking infrastructure to enable financial inclusion, efforts are required to improve access to insurance and pension services. It recommended that every willing and eligible adult who is enrolled under PMJDY should be enrolled under an insurance or pension scheme by March 2020. Similarly, for financial literacy and education, specific modules for target audience (children, entrepreneurs, senior citizens) should be developed through the National Centre for Financial Inclusion and centres for financial literacy should be expanded to reach every block in the country by March 2024.

**Financial Inclusion – Global Level**

Financial inclusion has increasingly moved to the top of the policy agenda in many developing countries, reflected in several G20 meetings, establishment of financial inclusion units in Central Bank and Ministries of Finance and specific financial inclusion targets. The United Kingdom was one of the first country to realize the importance of financial inclusion. It published its strategy of financial inclusion in the report entitled "Promoting Financial Inclusion" along with the Pre-Budget Report of 2004.

In 2007, World Bank had organised a conference and has released a report named "Finance for All".

According to UN, the main goals of Inclusive Finance are as follows:

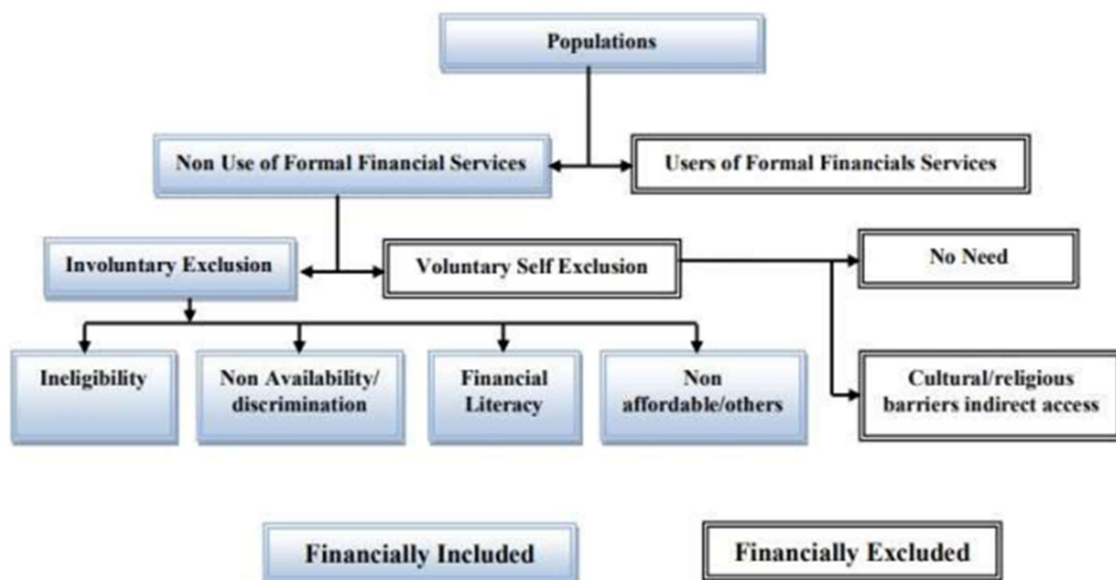
1. Accessing range of financial services at a reasonable cost by all households and enterprises as they are "bankable." The services include savings, short and long-term credit, leasing and factoring, mortgages, insurance, pensions, payments, local money transfers and international remittances.

2. Establishing Sound institutions guided by appropriate internal management systems, industry performance standards, and performance monitoring by the market as well as by sound prudential regulation wherever required.

3. Providing sustainable Financial and institutional services as a means of providing access to financial services over time.

4. Creating an environment of multiple financial service providers wherever feasible, so as to bring cost-effective and a wide variety of alternatives to customers (which could include any number of combinations of sound private, non-profit and public providers)

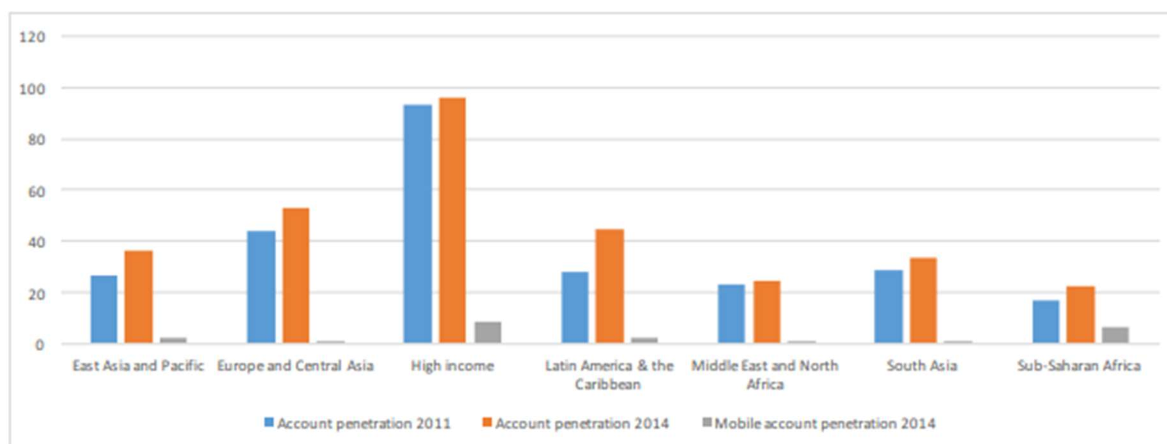
The Global Financial Development Report on Financial Inclusion, 2014, defines Financial Inclusion as “the proportion of individuals and firms that use financial services. It has a multitude of dimensions, reflecting the variety of possible financial services, from payments and savings accounts to credit, insurance, pensions and securities markets. It can be determined differently for individuals and for firms.”




Source: World Bank Report, 2008

The World Bank, with support from the Bill and Melinda Gates Foundation, has undertaken over the past years a broad cross-country exercise – Global Financial Inclusion Survey - by including financial questions in an existing Gallup global poll to generate baseline data on financial inclusion levels across 150 countries, using samples of 1,000 persons per country. The survey is to be undertaken every three years to measure and track specific data on people's use and access to formal and informal financial services; the first wave was conducted in 2011, the second wave in 2014, with a third wave planned for 2017.

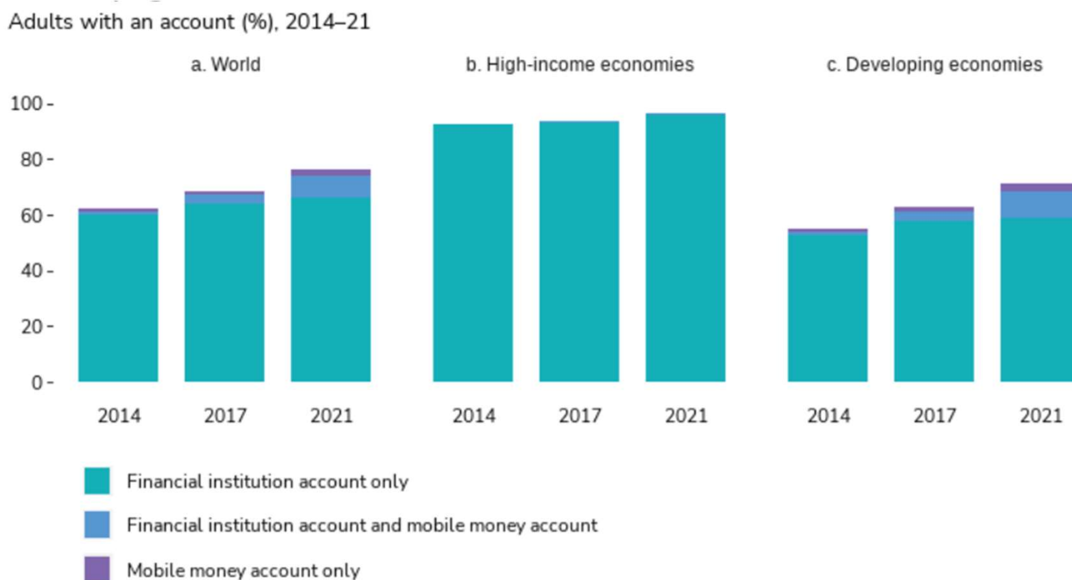
This graph shows the median value across the six regions of the developing world (as classified by the World Bank) and the high-income country group. There has been a general increase in financial inclusion, as measured by this variable across most regions, with the notable exception of the Middle East and North Africa region. The increase in Latin America has been especially notable. The one dimension where Sub-Saharan Africa stands out is the share of population with a mobile-phone based account, where the median is significantly higher than in other regions except for high-income countries.




Source: Global Findex Survey, World Banks and calculation by author. The graph shows the median in account penetration across the six World Bank regions and the group of high-income countries.

While figure shows the overall share of population that has an account, the Global Findex data also allows digging deeper into the distribution of formal financial usage across geographical units, income strata, educational groups, and gender. It thus allows to answer the questions of where the underserved or excluded are located, in geographic and socio-economic terms and thus identify policy priorities.

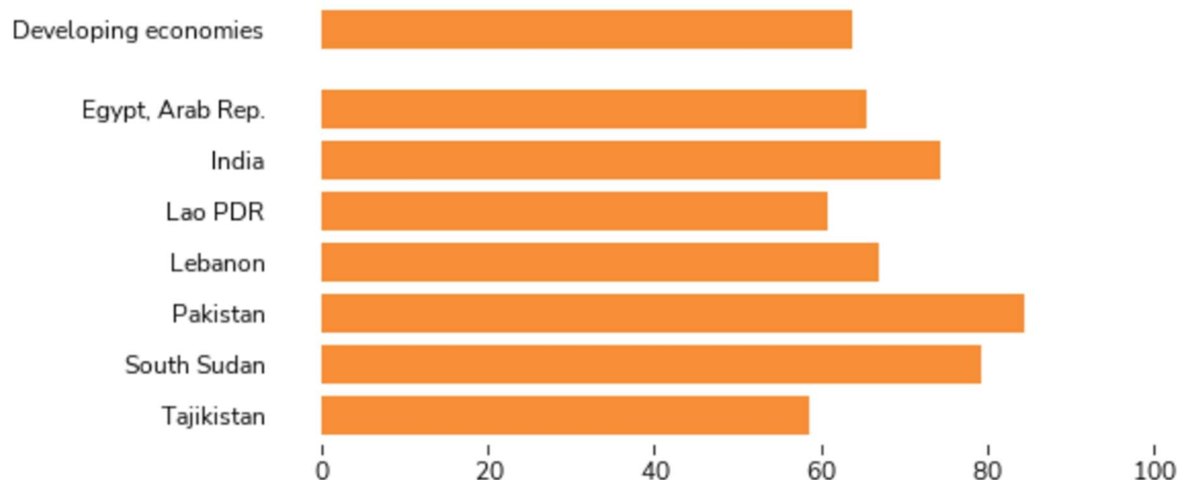
According to World Economic Forum: Centre for Financial and Monetary Systems, 76% of adults now have a bank or mobile account, up from just 51% in 2011. This following graph shows this all-




**COVID-19 has accelerated digital account adoption**

The COVID-19 pandemic led to increased working from home, the temporary shutdown of banks, shops and restaurants, and some merchants refusing cash payments. All of that accelerated the uptake of digital accounts.

Over 80 million adults in India and more than 100 million in China made a digital merchant payment for the first time after the onset of the pandemic. In developing economies, 40% of adults made transactions using a card, phone, or the internet for the first time, Findex found. Fintech adoption was 50% higher in countries with strict lockdown measures than those without such restrictions, according to the World Economic Forum.




Although financial inclusion has widened, users with less experience using banking services struggle to benefit without assistance. About two-thirds of unbanked adults said they would need help using an account if they opened one at a financial institution, the Findex report found. These less experienced users may also be vulnerable to fraud and higher bank fees, the report warned. Governments and policymakers must "invest in regulations and governance to ensure that safe, affordable, and convenient products and functionality are available and accessible to all adults in their economies."

**Digitalisation on Financial Inclusion**

Technological developments are changing the way people access financial services. Digital financial services are faster, more efficient, and increasing reach to lower-income households and MSMEs. Beyond promoting digital financial services, it can also provide impetus to growth and employment. The services are growing rapidly and at varying speeds across regions and countries.

There are two indices to measure impact of digitalization on financial inclusion. One, The "digital" Financial Inclusion Index which aggregates financial inclusion facilitated by digital payments services provided through mobile phone and the internet, combining indicators of both access and usage. Another being "traditional" Financial Inclusion Index which captures financial inclusion driven by access and usage of traditional financial services provided by banks (including debit cards). These two indices are then combined into a comprehensive financial inclusion index using three-stage principal component analysis. The value of the indices ranges between 0 and 1, with 1 being the highest level of digital financial inclusion.

They further calculate male and female financial inclusion indices using the same method, based on gender disaggregated underlying indicators. Gender gaps in financial inclusion are measured as the percentage difference of the respective female-to-male indices.

Evidence also suggests that digital financial services can help close gender gaps faster in India. Digital financial services are helping address constraints that affect women in particular- such as mobility and time constraints- by allowing them to access mobile banking accounts from home and having minimum balance requirements that may be more binding for women, among others. Gender gaps have been narrowing and have declined more in fintech-based financial inclusion.

Information, Communication, and Technology (ICT) encompasses technology beyond mobile phone technology and offers various benefits to the clients of microfinance institutions in various countries. Various benefits have identified- access to banking facilities, increased outreach, faster loan processing, improved quality of information, reduction in transaction and operational costs, and increase in customer satisfaction. ICT has been used to create “branchless banks” through mobile banking, automated teller machines (ATM), point of sale (POS) networks, and so on. It promotes the dual objectives of microfinance- sustainability and outreach to the poor people. Although ICT can help microfinance institutions to reduce transactional costs, expand their market, and provide affordable and flexible services to customers, many of them continue to rely on inefficient manual data processing systems that create disorganisation, waste time, and leads to inefficiency.

**Conclusion**

Inclusive growth attainment depends on a great deal on equitable distribution of growth opportunities and benefits. And financial inclusion is one of the most crucial opportunities which need to be equitably distributed in the country in order to attain comprehensive growth. It facilitates speedier, safer, and less costly remittance flows and allows for more options to leverage these funds as sources of productive investment. Available, affordable, and accessible financial services contribute to the empowerment of the most vulnerable groups, which include women, youth, the poor, people in rural areas, informal workers, migrant workers, and micro, small and medium enterprises.

While progress in financial inclusion has been significant in recent years, many remain excluded, particularly in developing countries. Access to financial services can be obstructed by factors ranging from insufficient demand for such services by potential users due to lack of disposable money, high costs of services, physical distance to service providers, burdensome requirements, and lack of trust. Policymakers and regulators need to assess these underlying challenges to maximise the effectiveness of their strategies to foster financial inclusion. Policy to expand the demand for financial services, such as through financial education and consumer empowerment, may also be pursued.

Another key factor in designing financial inclusion policies is the ecosystem that underlies the provision of financial services. Adequate access to financial services depends on the existence of a regulatory and supervisory framework and of supporting infrastructure such as energy and ICT services. This highlights the need for a policy mix that creates the conditions to strengthen both the provision of financial services and the enabling environment such services require. Direct measures to enhance universal access would include support to infrastructure provision and incentives to increase supply of affordable financial services. Other indirect measures, such as the prohibition of exclusion of particular geographic areas perceived by providers as being less profitable, may need to be paired with direct measures.

Openness to trade in services to allow more financial providers may be an important policy for improving efficiency and competition, when backed up by appropriate regulatory frameworks. However, liberalization in trade in financial services can have an impact on the effectiveness of measures that specifically support financial inclusion. Policymaking on trade openness and financial inclusion require a coherent approach to ensure potential benefits of both measures in improving access to financial services.

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