Indian Economy: Some Contemporary Perspectives
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Lecture No. 28
Indian Economy - Financial Inclusion

So, welcome you back in this session. So, here we are going to talk about some concept, recent developments in the banking sector. So, in the last session we talked about the NBFC crisis. So now, I think in the contemporary context that our course mentions Indian Economy: Some Contemporary Perspectives. So, I think, I have been able to give you some kind of background about the India's banking sector crisis then NBFC crisis.

Now, we will be focusing on the financial inclusion part. But before that, we have one new topic being discussed, because after the unfolding of the Indian banking crisis, there is a whole lot of talk and there are some new terms which have come up. So, as an economics student and even those who are going to prepare for Civil Services or even competitive examination they should be reading about and they might be doing it. But I will just give you some introduction about the PCA framework.

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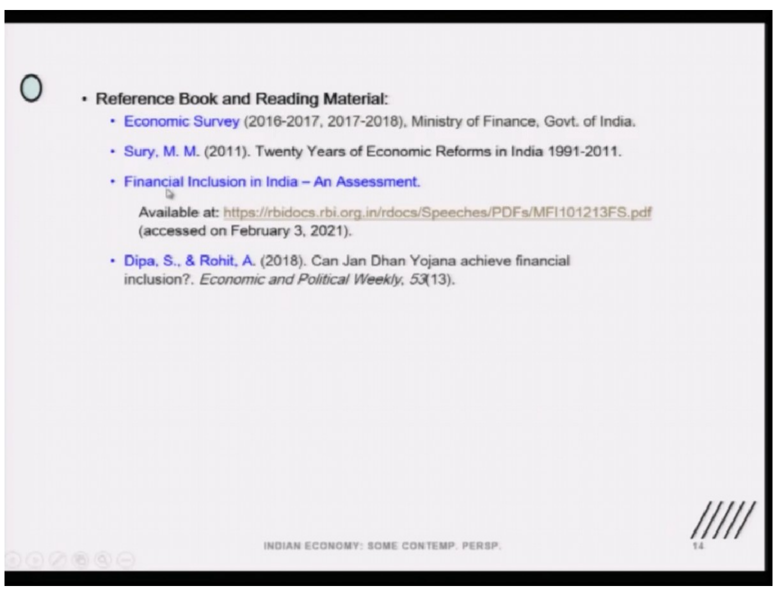

So, these are the references for the financial inclusion that I am going to talk about. So, on financial inclusion, I did not find that much report mentioned. But I found some of the very good report by Deepak Mohanty and he has delivered a lecture on financial inclusion. So, I have mentioned it here it is accessible, you can you can also access it from the RBI website.

Then I have gone through interesting write up it gives an evaluation of the financial inclusion policies that we have, basically the Jan Dhan Yojana and how it can help or what are the concerns, so Dipa and Rohit talks about that. Then I have also gone through the economic surveys. So, in economic survey you will find that one portion sometimes they highlight about these efforts of the government because these are the flagship programs of the Indian government and they are trying. And then I have referred Sury, one textbook that mentions about the financial inclusion.

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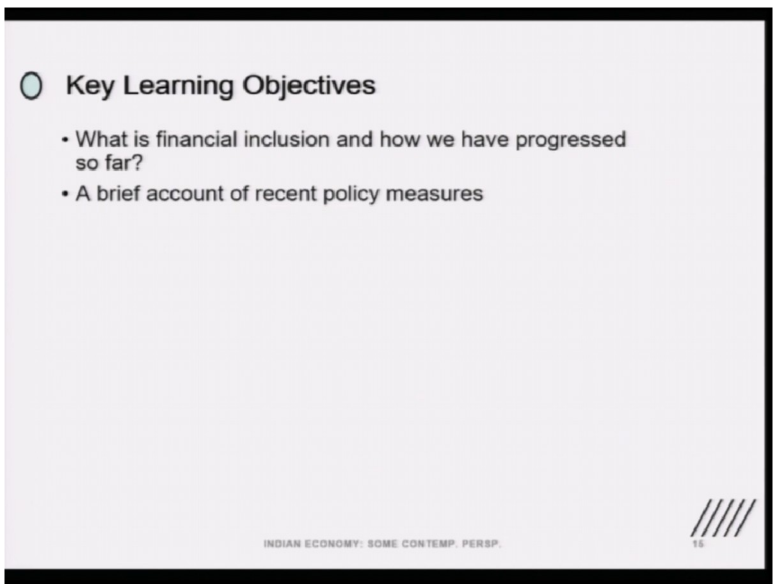

So, key learning our objective is that what is financial inclusion and how we have progressed so far? What we have done? What are the committee's? What are the measures undertaken? So, since, it is a very vast topic and if you get into the macro-finance domain, then it becomes really vast. So, I may not be able to cover up everything in 25 minutes lecture or half an hour lecture.

But I will try to cover as much as possible and I hope that this will be sufficient. If somebody will ask you, what is the financial inclusion process that we have in India at least you will be able to tell something about that. And if you are appearing for competitive examination, then if it is being asked then you will be able to elaborate in detail about this.

So, this is the underlying objective of this particular lecture, though financial inclusion, it is still in the in the beginning phase and we have done in some areas, especially the Macro-Financial Institutions have done well. But there are associated concerns and these financial institutions are now in the limelight for not for all good reasons, but sometimes for bad reasons also.

So, we will be discussing all those concerns in the next 25 or 30 minutes. And I will be also giving you some figures or recent data that we are going to talk about.

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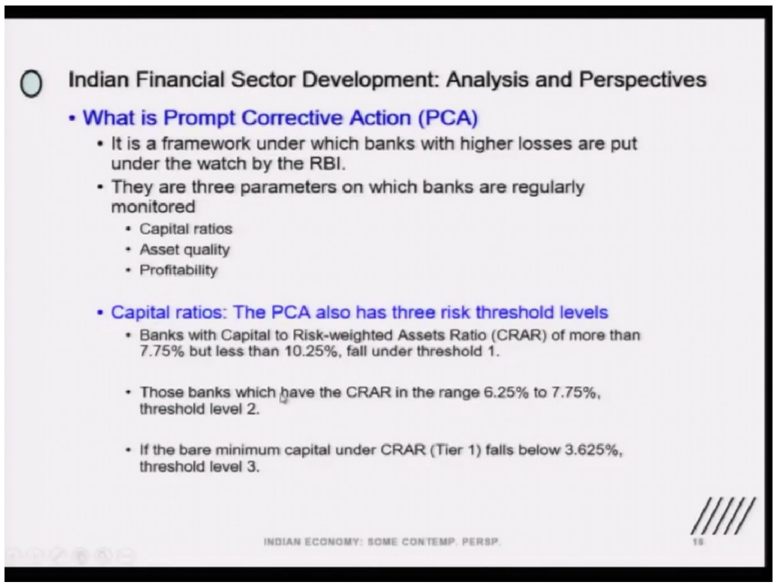

So, let us start. So, this is not part of the financial inclusion. This is one topic, which I thought it is important that you should be knowing so, because you may be asked, what is called prompt corrective action? So, once I say, prompt corrective actions, it is normally called as PCA.

So, once we had the Indian banking crisis in 2016, it started in February 2016. At that time, the regulators had a tough time. Reserve Bank of India had a tough time, because every bank was asking for support from the government, because these banks were mostly from the public sector domain. And public sector banks in earlier segments had the impression that whatever we do, we are going to be safeguarded by the government because that is the safety wall is attached with the public sector banks.

But after 2016, when the overall banking sector outlook was really low, at that time for the Central Bank it became really difficult to give money to every bank. So, they had gone for some kind of standardization, some kind of grading based on the indicators that they thought that it is appropriate to rate. So, they had rated the bank based on certain requirements, certain indicators parameters, and then based on that, they had given the support. So, the banks which had relatively better health then the worst one.

So, in terms of preference this particular bank was given us some kind of a stimulus package relief so that this particular bank can be safeguarded. And then, from the idea then, we had the merger of banks that we have seen in 2020 how we had gone for the merger of banks, Allahabad Bank and all others are being merged. So, I will be spending 2 minutes time.

So, this also resulted in that the banks which are not doing good or there is no hope of recovery. And it also depends upon the size of the bank. So, for example, if SBI is in trouble, then we cannot ignore SBI because then we will be having the systemic risk component. So, that we have discussed. So, the macro prudential risk will come into picture and it will be very difficult to restore the confidence in the banking sector.

So, RBI had rated all these banks on 3 parameters: one was capital ratios, then second was asset quality; and third was profitability; leverage is also added because leverage comes under the Tier 1 capital, so under Basel requirement. So, the norms were that the banks which had the Capital to Risk-weighted Assets Ratio, risk weighted assets means some assets which means that loans and all will be collateralized non-collateralized, so there are different types.

So, there is a weighted as the weights are given based on the risk profile of those exposures, so those advances. So, the Capital to Risk-weighted Asset Ratio CRAR of more than 7.75 percent, but less than 10.25 percent it was categorized as number 1. So, threshold one they had given. Those banks which had the CRAR in the range of 6.25 percent to 7.75 percent, they were rated in threshold level 2. And if the bare minimum, which means that it falls below 3.625 percent then it was rated as threshold 3.

So, all these criteria become important. So, maybe you will be asked that what is the threshold criteria for the banks falling at the capital ratio or CRAR, then you can simply mention that the banks which had the CRAR a ratio of 6.25 to 7.75 percent, it falls in the in the category of capital ratios.

And this can be examined, if you are an economics student and if you want to take a take assignment on this then you can also try and look from the perspective of the Basel-II requirement that what is required and how in other countries it has been done. And then you can also, if you have the data to work out you can also do some kind of empirical analysis finding out that whether this particular indicator is sufficient to cover or to analyze the bank or there are certain other things.

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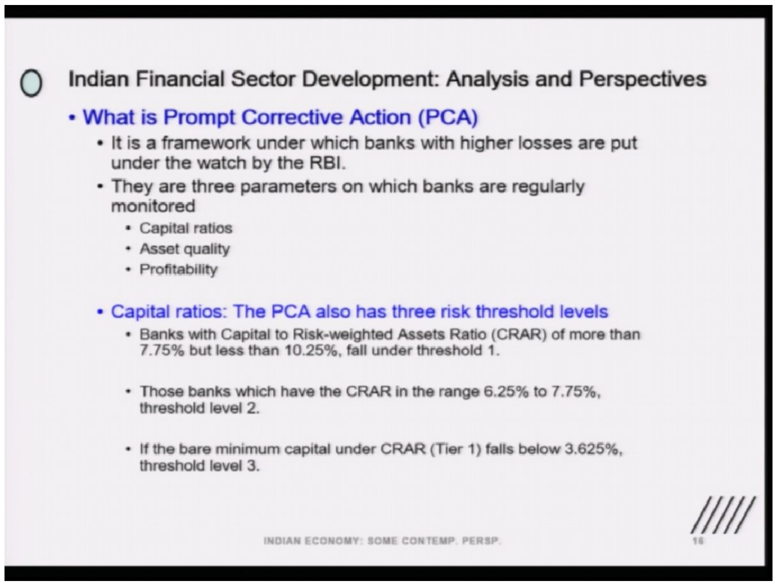

In terms of asset quality, what they had gone for? PCA also has in terms of three threshold levels based on the net non-performing assets. So Net NPAs, the ratio to net advances so that is called net NNPAs. It I mentioned that the banks which had the coverage of I would say greater than 6 percent but less than 9 percent; risk threshold of greater than 9 percent but less than 2 percent. So, these are the threshold at that time in terms of asset quality the Central Bank had decided. So, that is why it becomes really important.

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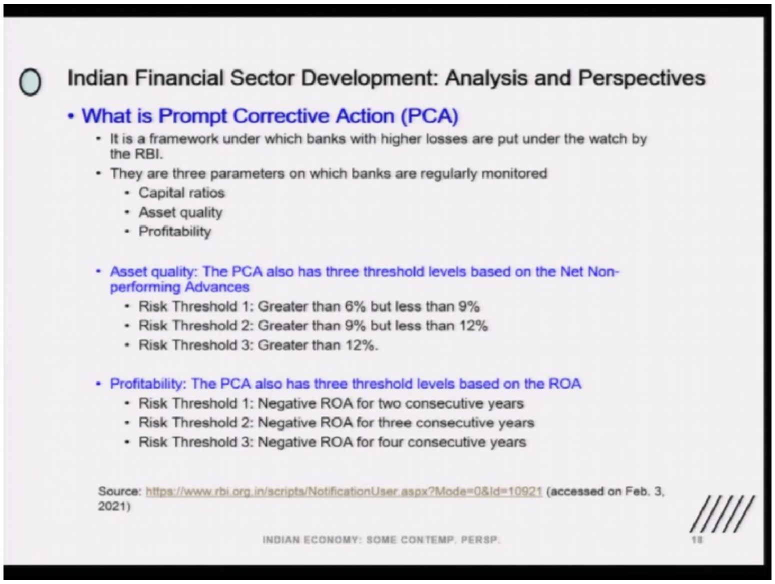

Then in terms of profitability which is nothing but the profit after tax upon the total assets. So, it has also the rule that, if the bank has the negative ROA for two consecutive years, then it falls under this threshold 1; risk threshold 2, if it is going to be negative for 3 consecutive years; and this threshold 3, if it is negative for 4 consecutive years. So, this was a requirement.

So, on this basis, Central Bank had gone for rescuing the banks and they had to go through some parameters, so they have adopted this. So, PCA norms are now being discussed. So, if you read economic survey or if you read any document you will find it mentioned over there. So, in case now if you see anywhere mentioned now then at least you will have the idea that this is some kind of integrating criteria for the banks based on the riskiness.

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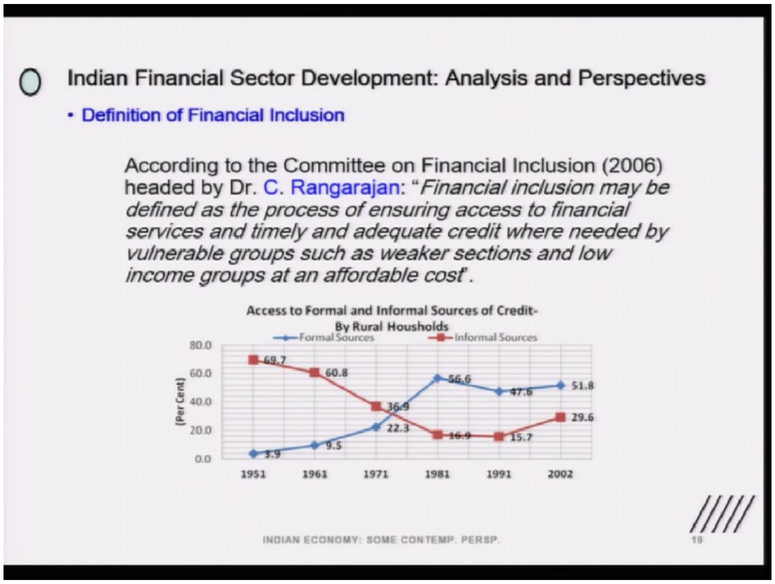

Now, let us come back to the financial inclusion. So, PCA norms we have discussed. So, now, C. Rangarajan in the famous committee report. So, C. Rangarajan committee report is very famous, it was submitted in 2008 and it was formed in 2006. The definition of the financial inclusion in the context of India by the C. Rangarajan becomes one of the most cited definition.

So, what Doctor. C. Rangarajan writes about the financial inclusion is that, financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit were needed by the one level groups such as weaker sections and low-income groups at an affordable cost.

So here, you have two criteria adequate timely and adequate credit. Then it is for the vulnerable groups, which means that the weaker sections. And then, it is also for the low-income group and the cost is also affordable. So, you should not be so high, or so stringent that these are not affordable.

So, if you trace the history of financing, so that we have discussed in case of agriculture that how during agriculture period we had the formal sources. So, formal sources are normally banking and the affiliated entities, informal sources, you have moneylenders and all other institutions, which are not covered under these formal sources.

So, there you will find that in 1950's their share was 69.7. And then it came down heavily where as we progress for the for facilitation of the financial services through formal sources. So, the formal sources took over in 1971, around 1972. And then since then it has been doing. And after 1991 when we had looked for some kind of globalization process, then it has gone up, but not that much high.

But till 1980, it had done well and it has gone up because at that time we had undertaken majors in terms of going for nationalization of banks. In two phases, we had nationalized the bank and there was preference given to the banks, if they are going to want to provide services in the rural segment or some other segments.

So, that was the portion mentioned. So, I thought, it is important that I should be highlighting this particular chart and that is why. So, I have taken it from the Financial Inclusion Report that I mentioned in the beginning.

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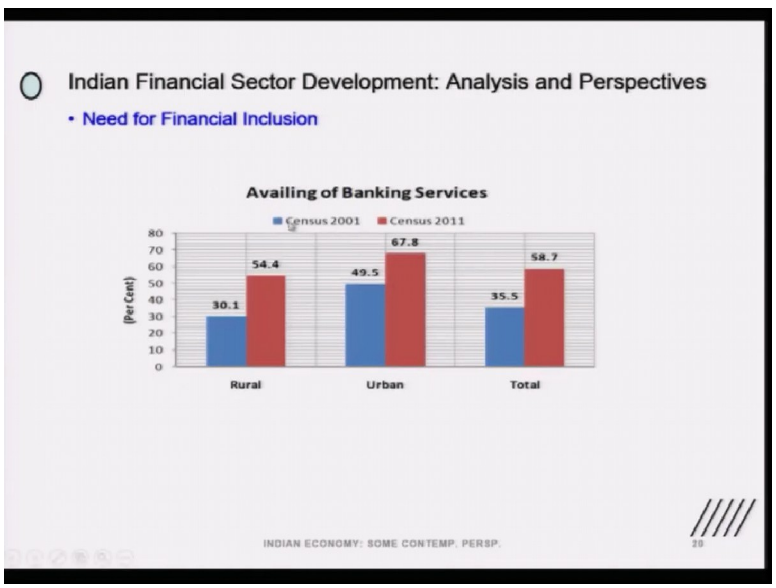

Availability of banking services, so as per the Census 2001 and Census 2011, if you compare then you find that in rural area, it is 30.1 percent. But now, it has gone up by 54.4 percent, whereas in urban area after Census 2011 now the number has gone up and now it is 67.8 percent. So, this is one improvement that we can say that as compared to 2001, it was 49.5 percent, almost 50 percent we had covered the financial inclusion process in the urban areas. But in rural area, it was just around 30 percent.

So, this means that we are now progressing, but progress is not that high. In 10 years of time we have just achieved, we have gone by just 24 percent and here in the case of urban now we are almost 68 percent. So, overall in India, if you see then in terms of banking services, we have 58.7 percent population covered, but not all. So, there is a whole lot of need to focus on the banking services. So, that even the population or the masses which are at the margin, they should also have the access to financial services.

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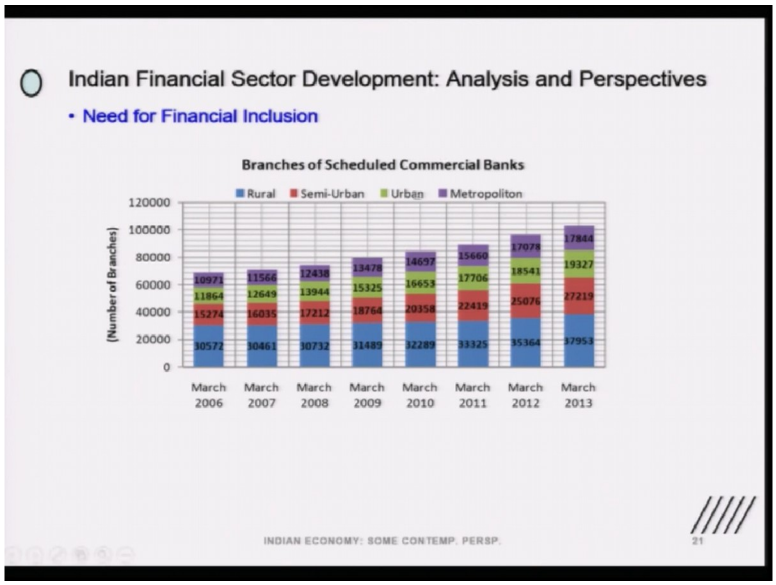

Branches of scheduled commercial banks, if you see in terms of rural or semi-urban, urban and the metropolitan, you will see that in March 2006 it was 10,971 in case of metropolitan, now it has gone to 17,844. Then we had 11,864 for the urban, now we have 19,000. But for the rural we have 30,000 by March 2006, now it has gone only by 37,000. So, there is not much improvement.

But whereas, in this case, we see around 10,971 to 17,000 and this rise that we see post 2012 we see a quiet faster change compared to what we were experiencing in March 2006 because after March 2006 there was a lot of emphasis on the financial inclusion, the banking sector was given incentives that if they will be opening branches and they will be providing financial services. And banks were directed by the government that they have to now go and spread the banking services in the rural segments.

So, because of that, since 2006, we are seeing a somewhat upward movement. The semi-urban area has seen the best change, which means that in 2006 March it was 15,274. But now, in March 2013, it has reached to 27,219. So, that shows that in semi-urban areas, there is a whole lot of emphasis on expanding, but in rural area it is more or less constant. And in rural areas are mostly will be also because of the RRBs and all other institutions that are covered under the schedule of the commercial banks.

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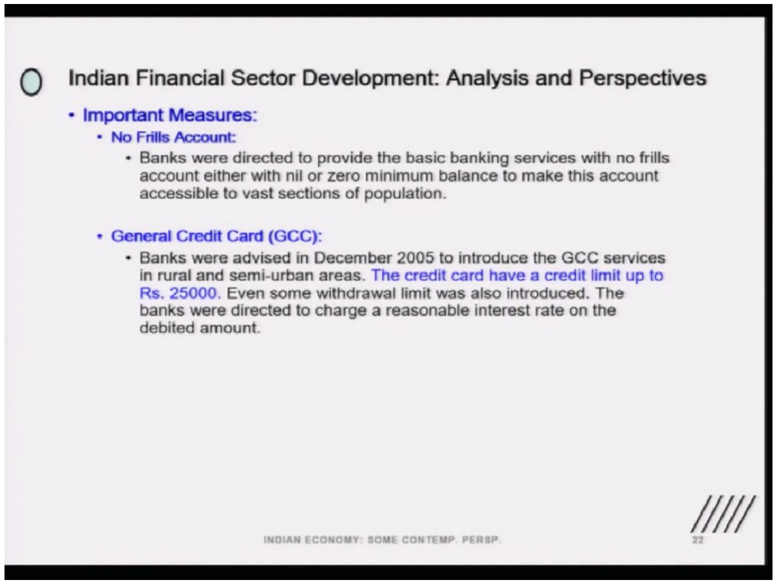

Now, in terms important majors if you find it out then the financial inclusion has started with the no frills account were first open for the masses and it was also mentioned that even if there will not be any minimum amount requirement with these accounts and it will be also given at the zero minimum balance and at least they will be having the feel of the financial services they will should be attached.

In December 2005, there was issuance of something called General Credit Card, GCC and under this card, there was a credit limit of rupees 25,000 with some withdrawal option. And banks were directed that they should be charging only a nominal amount. So, this also became one of the important majors for the financial inclusion.

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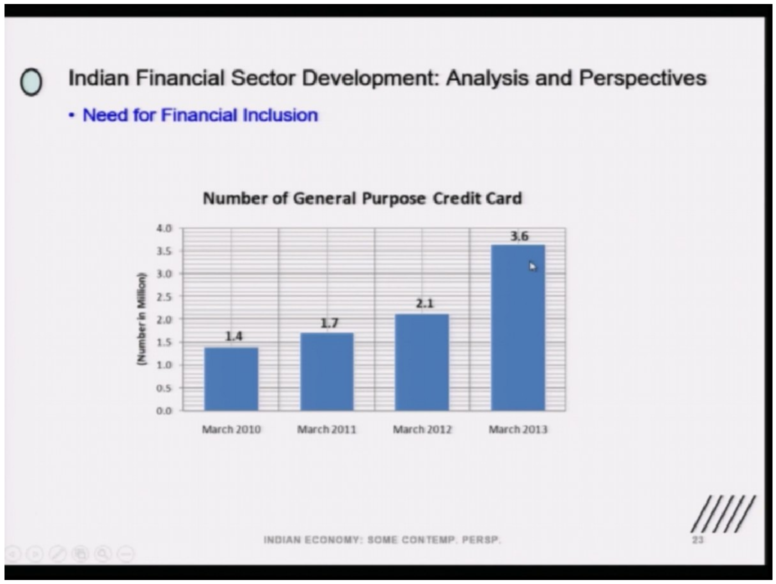

So, here you have the general-purpose credit card. So, in March 2010, it was 1.4 but in terms of number of millions in a by March 2013 in the time period of 3 years it just doubled. And now more than double it is now 3.6 million, so which means that people are now going for the financial services. But whether it is rural or urban that we are not very sure hear about.

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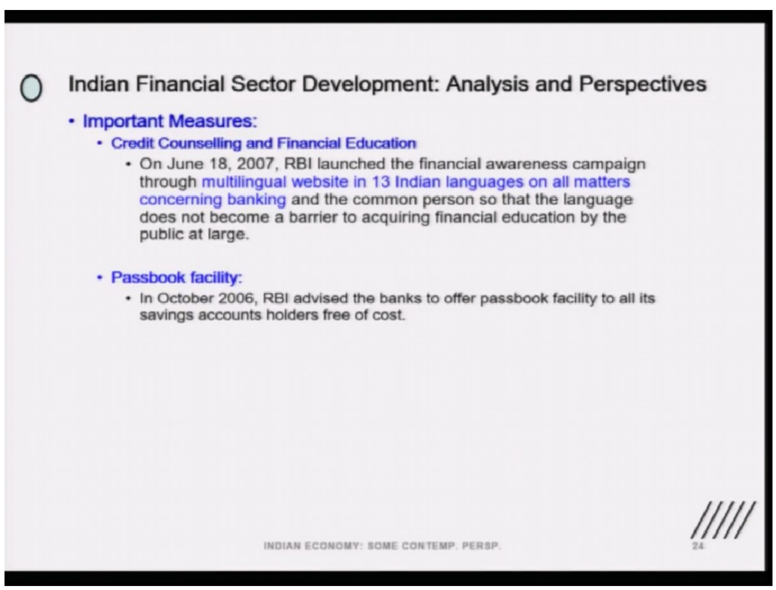

On June 18, 2007 RBI launched the financial awareness campaign because they thought that since people are still reluctant to participate in the banking domain in utilizing the financial services. So, RBI had to go for interpretation of simple banking rules, the benefit of banking rules in different languages and for the first-time multilingual website was developed in 13 regional languages, Indian languages. And then it also highlighted the major concerns that the commoners were having about the banking services and it was a simple financial education and awareness program, so that is what is important.

In October 2006, RBI advised the banks to offer passbook facility to all its savings account holders free of cost. So, which means that this passbook facility become really important. So, in October 2006, RBI advised the banks to offer passbook facility to all his savings accounts holder free of cost.

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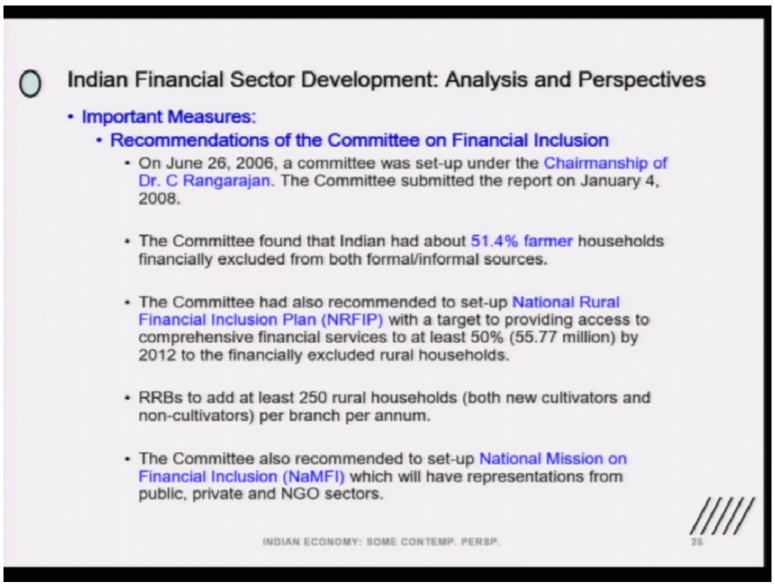

Then we had in June 26, 2006 some major development was taken and then at that time, we had set up a committee and this committee was set up under Dr. C. Rangarajan and it is also known as the Financial Inclusion Committee of C. Rangarajan and because this committee well for the first time had gone for complete overhaul of the financial inclusion process and it has given new guideline for the for the expansion of the financial inclusion.

So, the committee found that Indian had about 51.4 percent households financially excluded from both formal informal sources. Committee had also recommended to set up Indian rural finance inclusion plan, which means that if you want bring the rural masses into the banking and financial services then it is better that you should have some kind of exclusive plan covering only those segments with a target to providing access to comprehensive financial services to at least

50 percent which means that about 55.77 million by 2012 to financially excluded rural households.

So, National Rural Financial Inclusion Plan was there. And this regional rural bank, that we have already mentioned about the RRBs that were set up in 1975. It was also recommended that they should at least add 250 rural household per annum and if the RRBs will add 250 unbanked people in per branch and per year then that will also give boost to what is called National Rural Financial Inclusion Plan.

The committee also recommended to set up a National Mission on Financial Inclusion, so this was the NAMFI, which will have representation from the public, private, NGOs. So, the first time the self-help groups were given importance. Micro financial institutions were given importance that how they can become part of the financial inclusion process. So, C. Rangarajan committee is one of the important committees which has given a proper shape to the financial inclusion process that India was trying to implement and that is why it is important that we should be focusing on this report.

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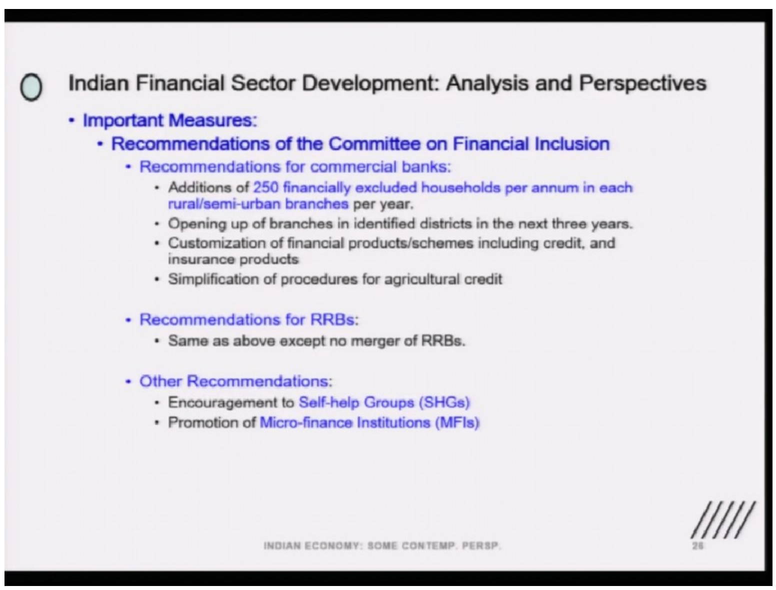

Then there were recommendations for commercial banks. So, additions of 250 financially excluded household per annum in each rural, semi-urban branch per year. They had also gone for opening in whatever the bank branches that they were opening in different districts that was also there in the next 3 years.

Customization of financial product because this financial inclusion product is not or in the financial inclusion process, we are going to mainly cover the low-income class or low mid income class. So, it is better that we should customize the financial product according to their need and requirement, so that the banking services there will be easy accessibility of the banking services and the rate of interest and certain extra costs that we have it should be attached with that.

So, that it should it should at least look like that there is a facilitation process and it should not be somewhat exploitative process that they are being misguided or cheated in the name of some innovative products. So, that was the important recommendation of this committee.

Simplification of the agriculture credit, whatever rules and regulations we have. So, this committee had recommended that there should be simplification of rules for agriculture credit. If the farmer is coming and they have some concerns about the agriculture credit, then the financial institutions should be able to help. They should also have a different set of products customized according to their need short-term, long-term for 1 or 2 months and if they feel that it is going to be a time consuming then they should think about how they can reduce and provide the timely financial support to the farmers.

Recommendation for RRBs was that you should not be merged to a commercial bank or any Bank. They should have their own identity because their penetration rate is quite high. In the rural segment people have experienced their services, they have better faith and the mechanism is also sorted and accepted. So, it is better that RRB should continue and these schemes that were recommended for commercial bank RRB should also take over and provide services to the rural masses.

Other recommendations where in terms of encouragement of the Self-help Groups. So, SHGs that we call it, Self-help Groups these are the voluntary organizations operating in different parts of the country, especially the semi-urban and the rural areas. So, there if you have a group of male and female participating in certain activities and if they need some amount of cash then in the name of society or something it can be facilitated. Then there is also a special provision a recommendation for the promotion of Macro Financial Institutions. So, for the first time, MFIs were given importance.

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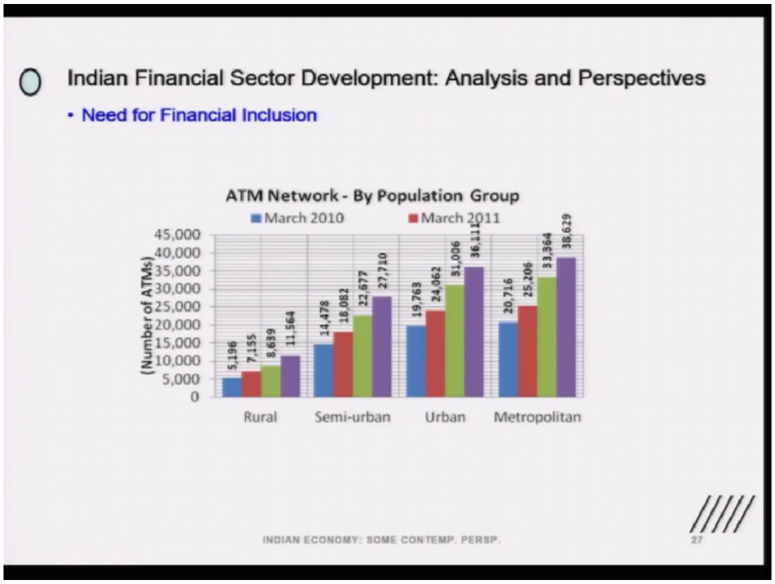

And if you see in terms of the ATM networks by population group then you find that rural, semi-urban, everywhere we see some kind of movement from March 2010 to March 2011 and that is why it shows that the financial inclusion process has a progress well and there is a whole lot of effort to improve the services provided by these institutions.

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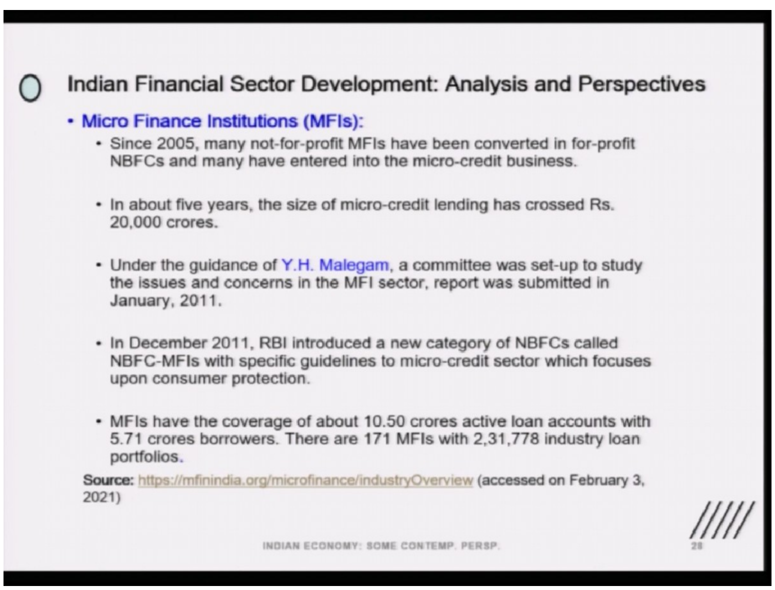

Then we had a Micro Finance Institution. So, (Mi) Micro Finance Institutions had played a very important role and they are also part in terms of growth process, I would say. So here, in terms of growth process Micro Finance Institutions are important because Micro Finance Institution started in some part of Andhra, Karnataka and even some other states. Recently I read in News Paper that in certain parts of the country mostly Karnataka and even in even in Assam people are not very happy with the Micro Finance Institution.

So, since 2005, this non, so Micro Finance Institutions were functioning in a in a not very formal way, but in formal way. And in most of the cases it was found that is not for profit. So, most of the not for profit MFIs were converted into for profit NBFCs meaning non-banking financial companies. And many had entered into the micro-credit business which means that if a small shopkeeper or a small business manager is looking for some small financial help, then these institutions will be involved in facilitating those service demand.

Now in about 5 year's time, the size of micro-credit lending had crossed almost 20,000 crore rupees. Then in a micro financial industry trouble is started when there were high defaults reported in the event of the domestically driven situations and in certain part of the rural segments, especially in Andhra and even in Karnataka to some extent, there were a lot of default cases. And as a result, these financial Micro Finance Institutions were found involved in exploitative behavior. And as a result, this became one of the important issues to be discussed at that time.

So, the government had at that time set up a committee. So, RBI had set up as a subsequently-committee under the chairmanship of Y. H. Malegam and this committee had gone for the specific recommendation, the report was submitted. And in December 2011, so this committee had gone for the overall the new generation changes that were absorbed and some kind of recommendations were made for the micro small industries industry.

So, in the December 2011, so it was introduced that, RBI had introduced one more category called the NBFCs and these NBFCs were called as NBFCs MFIs and this is what is called the micro-credit sector. And now, if you find as per the website, which is having the MFI website, it has covered in 10.5 crores active loan account it has and it has almost 177 MFIs working. So overall, the financial inclusion process is having a lot to say.

So, just to summarize, what we have covered so far is in terms of financial inclusion that how the Indian government has gone for introduction. C. Rangarajan committee reference is one important difference. Malegam committee report will give you the complete idea that what were the problems and as I mentioned about the Assam case and Karnataka, there is still a lot of resentment in the rural masses about the exploitative behavior of the Macro-Financial Institutions. And it has not been accepted everywhere in the same way that we see in terms of progress.

So, this is what I wanted to say in this class. In some of the segments of this Micro Finance Institution, I will be covering in the next session. Thank you. Thank you so much.