Financial Inclusion for Inclusive Growth An Indian Experience

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I. Introduction

The sustainable economic growth in a developing economy depends on its ability to raise rates of accumulation of physical and human capital and efficient use of the productive assets. The investment process needs to be supported by ‘financial intermediation’ through mobilization of savings as well as ensuring funds are allocated to the most productive use. Financial intermediation has strong externalities, which are generally positive, but can also be negative reflected in the systemic financial crises, which are deleterious to the operation of the market systems. Thus, financial development and economic growth are closely interrelated, although the channels and even the direction of causality have remained unresolved in both theory and empirics.

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The focus on financial inclusion needs to be viewed in the above perspective wherein it becomes extremely crucial for inclusive growth both in terms of widening its coverage as well as to make it more equitable. It has been recognized that achieving the goal of ‘inclusive growth’ requires recourse to using both ‘State’ based interventions and ‘Market’ based instruments and both needs to be seen as supplementary and complementary to each other. Market based instruments are considered largely gender, region and caste neutral and this aspect makes them “inclusive” in the sense that they do not discriminate. However, an important limitation of ‘market’ as an institution is that it is “not wealth neutral”. In this context, financial Inclusion has been seen as an instrument that strives to make the wealth effect move towards neutrality domain than otherwise. Financial Inclusion has the potential, if implemented in the right earnest, to contribute substantially towards ‘inclusive growth’.

Credit, one of the major interventions of financial inclusion, has played a critical role in productivity enhancement, influencing the latter set of reasons through facilitating capital formation and assured control over other inputs in adopting improved technology in production. The skewed access to credit, it is argued, can also dampen employment generation, and worsen the income equality, in addition to impede agriculture growth, thereby threatening food security.

The ability of agriculture enterprises and rural households to invest for the long term and make calculated decisions for risky and time-patterned income flows is shaped by a country’s financial services. Broader access to financial services such as savings and credit products, financial transactions and transfer services for remittances would expand their opportunities for more efficient technology adoption and resources, based on the assumption of the agricultural sector achieving the expected growth rate. It is, therefore financial inclusion has been considered as one of the pre-conditions for inclusive growth.

Credit constraints represent particularly high barriers to the ability of the poor