The Impact of Financial Inclusion on Poverty Reduction

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Abstract

A key objective in the poverty reduction strategy therefore hinges on accessibility to funds and credit in a context where a relatively huge population in the developing world remains socially excluded from the banking system. While governments and institutions have undertaken measures to enhance the financially excluded 's access to capital or credit, hurdles such as, knowledge gap, culture, or costs including ongoing maintenance of products that the financially excluded own and use regularly, remain a hurdle to progress for the financially excluded especially from the BPC and informal sector. This paper aims to involve the current state of financial inclusion in Indian scenario by especially exploring its impact on poverty reduction concerning its restrictions and government efforts. Hence we establish the existing difficulties inherent in the study of factors and tasks dependent on the significance of financial literacy and suggest the practices for extending the access and effectiveness of an inclusive financial system. Finally, this research aims at filling the gap in the current body of knowledge on how financial inclusion can act as an escape from poverty and can contribute to the economic development of India in particular.

Key words: Financial Inclusion, Poverty, Financial Literacy

INTRODUCTION

The concept of financial inclusion may be described as a process of extending effective access to a range of financial services to those living in the developing world who have hitherto had very little if any access to such services.

In India, therefore, making people access financial services is important in promoting economic growth and fight poverty bearing in mind that it has the world's largest population with over 1.3 billion individuals. However, even today a large part of population of India is still unbanked, though there have been remarkable improvements in last few years. Barriers like low level of financial literacy, high cost of transactions and poor physical infrastructure limits the acquisition of basic financial solutions. The Digital India Programme and government led schemes such as the Pradhan Mantri Jan Dhan Yojana (PMJDY) , Pradhan Mantri Suraksha Bima Yojana(PMSBY) have endeavored to fill these gaps through encouraging banking via digital interfaces as well as ensuring access to fundamental financial services. But, unfortunately, many people, especially the population of rural areas, still use informal credit sources while the interest rates and loan conditions offered are very high. It sustains poverty and reduces the chances of improving one's status in the society and limits opportunities for economic advancement.

Evolution of Financial Inclusion in India started with bank nationalization (1950s-1969) that included the extension of banking facilities to the rural areas. In 1969, During the time of prime minister Indira Gandhi, 14 large commercial banks were nationalized for improving credit facilities for agriculture and for small scale industries, as the main aim of operation was to eradicate the problem of poverty and unemployment. This was succeeded by the Lead Bank Scheme availing district level credit with credit services and Regional Rural Banks (RRBs) in 1975 to meet the credit demand of rural area. In the 1980s and 1990s RRB was expanded and Self Help Groups (SHGs) which were small savings and loans were introduced. The Kisan Credit Card introduced in 1998 offered a composite credit facility for farmers and Agricultural laborers.

Since the year 2000 to the year 2016, financial inclusion has recorded progress through including program such as Pradhan Mantri Jan Dhan Yojana launched in the year 2014. Subsidies were made even more straightforward through the other campaign of Direct Benefit Transfer (DBT). The period from 2016 to 2024 witnessed widespread adoption of digital platforms like UPI and Aadhaar-enabled payments, enhancing rural access. Small Finance Banks and Payments Banks were introduced to reach underserved areas. Today, financial literacy programs continue to support informed financial decision-making, advancing India's goal of inclusive growth.

India has made remarkable strides in poverty alleviation over the past few decades, but it still faces significant challenges due to its vast population, diverse economic conditions, and persistent inequalities. The country's poverty reduction journey has been marked by notable improvements in living standards and access to basic services, yet millions continue to struggle with limited resources and opportunities. In 2024, approximately 129 million Indians continue to live in extreme poverty, subsisting on less than $2.15 (approximately Rs.181) per day. This marks a significant decline from the 431 million individuals facing similar conditions in 1990.

An individual is considered below the poverty line when they live on less than the minimum income required to meet basic needs. In India, the poverty line differs between urban and rural areas due to variations in living costs. For urban areas, the poverty line is set at 1,286 rupees per month, reflecting the higher expenses in cities. In contrast, the poverty line in rural areas is lower, at 1,059.42 rupees per month. Measuring poverty in India requires a multifaceted approach that encompasses various economic, social, and infrastructural factors. Some of the key parameters to assess poverty include

1. Income and Consumption Levels: Most measured of poverty has been done in terms of income or consumption levels such that a household regarded as living in poverty does not have adequate access to desired commodities.

2. Multidimensional Poverty Index (MPI): Unlike other measures, the MPI measures poverty in three dimensions apart from income which are health, education and standard of living.

3. Employment and Livelihood Indicators: Unemployment, informal employment, and agriculture that is dominant in the rural areas are linked with high poverty raised in crises.

4. Access to Basic Services: Lack of water, sanitation, electricity and health care makes poverty worse as people cycle through a section of the life of squalor.

5. Education and Nutrition: A feature of poverty in the United States include low literacy, high school's dropout rates and child malnutrition which hampers socio-economic mobility.

6. Inequality Indices: Social inequalities, such as income inequality (Gini Coefficient) and gender disparities (Gender Inequality Index), contribute to and deepen poverty.

Statement of the problem

Despite efforts to improve financial inclusion in India, barriers like lack of awareness, cultural resistance, and high account maintenance costs still limit access for marginalized groups. The informal sector analysis also provides influence on the poor people and they are locked out from formal financial systems which in turn lead to poverty and limited economic opportunities. The goal of this paper is to analyze the connection between financial inclusion and poverty alleviation in India with an emphasis on best practices and current issues regarding the inclusive financial system's development.

Objectives of the study

- Assess the Current State of Financial Inclusion
- Analyze the Relationship Between Financial Inclusion and Poverty Reduction
- Identify Barriers to Financial Inclusion
- Examine the Role of Government Initiatives
- Evaluate the Impact of Financial Literacy.

LITERATURE REVIEW

- (Park & Mercado, 2018) There is evidence that demonstrates financial inclusion positively impacting on the economic values, especially with the poverty levels when seen in relation to the initiatives where members of the high, middle and developing income countries have gained access to these financial tools.
- (Ajide & Ajide, 2015) Financial inclusion in rural Nigeria had positive impact on poverty reduction mainstream but with caution due to high interest rate on borrowings and little formally financial literacy.
- (Khaki, & Sangmi, 2016) In their scud Social and Behavioural Effects: Access to Financial services can have positive effects on women and enhance social capital but these affects depend on the structure of the programs and the area of need.
- (Duvendack, & Mader, 2019) But even more significantly, there is little, in terms of behaviour change that is postulated and good evidence on the sustainability of transformation which leads to poverty reduction as a result of financial inclusion only.
- Challenges and Limitations Currently in many sub-Saharan African countries efforts by financial institutions especially micro finance institutions are often restricted to the lower end and therefore the poor cannot get access to other financial products, where by financial inclusion cannot effectively enhance poverty reduction as expected (Kuada, 2019).

RESEARCH METHODOLOGY

Research Design

This research work will adopt an empirical approach towards analysing the done intractable issue of how financial inclusion can enhance poverty reduction in India. The use of quantitative data will entail gathering of numbers that can be tabulated and analysed to determine coherent relationships that might exist in the research study. In particular, this design is suitable for calculating the degree of financial intermediation and the effects of financial intermediation on different indicators of poverty levels among the population by different age groups.

Data Collection

Quantitative Data

Panel Data: The main methodology to be adopted for data collection will be through the use of panel data and select government publications and reports of selected financial institutions in India.

This data will include:

Financial Inclusion Indicators: Indicator like the proportion of adult population with access to bank, access to credit, use of electronic money and use of formal saving instruments.

Sources may include:

- The Reserve Bank of India (RBI) Reports
- Statistical data of National Bank for Agriculture and Rural Development (NABARD).
- The Global Findex Database which offers financial access information throughout the world.

Poverty Levels: The poverty levels, income and socio-economic characteristics of the respondents are obtained from official publications including those of Ministry of Finance and Planning Commission. This data will facilitate time series analysis and determine the level of association between the level of financial inclusion and poverty reduction.

DATA ANALYSIS AND INTERPRETATION

1. FI Index

Objective: Analyse the FI-Index progression to measure changes in financial inclusion over time.

FI-Index Comparison (2023 vs. 2024)

Year	FI-Index Value
March 2023	60.1
March 2024	64.2

Source: RBI (Reserve Bank of India) Report, July 2024

Interpretation: The increase in the value of the FI-Index from 60.1 in March 2023, to 64.2 in March 2024, (+4.1 percent), a clear indication of significant achievements made towards the enhancement of access of financial services. This could be due to a continuous implementation of government policies and strategies such as National strategy for financial inclusion that looks at enhancing the population’s ability to access banking, credit and digital payment products.

Implication: The new positive trend of the FI-Index indicates the actual progress towards achieving the government’s initiative of deepening financial inclusion for the excluded and rural sectors in the country. Higher index is usually found with decreased poverty levels, better economic wellbeing and increased economic prospects of the low income earners.

2. Bank Account Ownership and Digital Payment Adoption

Objective:

- Examine the impact of Pradhan Mantri Jan Dhan Yojana (PMJDY) on bank account ownership.
- Explore the shift from cash to digital payments in India.

Aspect	**Details**
Total Bank Accounts	1.5 billion bank accounts linked to mobile apps
Jan Dhan Accounts	432 million accounts promoting financial inclusion
UPI Transactions	Over 22.7 billion transactions worth $768 billion in 2023; expected to grow to 15-20 billion/month by 2024
Mobile Wallet Growth	Payments increased at a CAGR of 72.1%, reaching $2.5 trillion (₹202.8 lakh crore) from 2019 to 2023
Central Bank Digital Currency	Pilot of Digital Rupee by RBI providing a government-backed digital payment alternative
Contactless Payment Trend	Increased popularity post-pandemic, reflecting a move towards hygiene and convenience
Pay Later Services	Expected to serve over 50 million users by 2024
Regional Disparities	High transaction volumes in Telangana, Karnataka, Andhra Pradesh, and Maharashtra; challenges in other regions
Future Projections	Digital payments expected to reach $100 trillion by 2027, driven by innovations and tech-savvy population

Source: NPCI Digital Financial Inclusion

3. Credit Accessibility

Objective: Assess the disparity in credit accessibility across regions in India.

Indian credit accessibility by states

Southern States: Region wise, Tamil Nadu, Andhra Pradesh and Karnataka has revealed better credit access. For example, Tamil Nadu has been dubbed as having strong credit facilities especially to the industry and agriculture sectors35. These social institution aspects of the states create a foundation for higher lending rate and enhanced access to formal credit.

North-eastern States: On the other hand, north-eastern region has a considerably poor credit accessibility with figures said to be approximately 10%. They blamed this on factors such as; limited banking facilities, relatively low level of economic activities, and ignorance.

National Trends: Globally, a steady 148% of India's GDP is contributed by the domestic credit to the private sector, although it is quite low as compared to the global figure. This means there is a systematic problem in which a significant chunk of the population cannot access, or has limited access to banking services.

Comparative Analysis: Southern vs. Northern States

Southern States:

- Better credit availability (as percentage say, Tamil Nadu at 30%).
- Improved banking sector and development of the programmes that enhance financial education.
- The microfinance institutions in countries that have more developed microfinance sectors lending to higher balances.

Northern States:

- Overall the firms have limited access to credit relative to their counterparts in the south.
- This is evident because there are states such as Uttar Pradesh where the problem is so huge due to poor economic status and few places to access banking facility.

4. Insurance Coverage

- **Objective**: Measure the reach of low-cost insurance programs

  Insurance Coverage through PMSBY

Scheme	Number of Policies(Crores)
Pradhan Mantri Suraksha Bima Yojana (PMSBY)	21.24

Interpretation: Out of these programs PM[SBY] has offered over 21.24 crore economically cheap insurance policies for economically weaker sections of society. This outreach guarantees the low income earners get financial protection services.

Implication: Insurance basically provides for protection against moments of vulnerability that may be occasioned by health or accident or any other form of disaster. Policies like PMSBY make economically weaker sections secure financially thus do not have to depend formal high priced channels in case of emergencies. What is more, it helps protect one's well-being and sustain community's economy, as people who count on insurance are less likely to be deprived of proper means of income in the case of an emergency.

5. Rural Employment Guarantee and Livelihood Support.

- **Objective:** To highlight the employment impact and labour contribution of MGNREGA in rural areas.

Scheme	Key Data
Mahatma Gandhi National Rural Employment Guarantee Scheme	60 million households employed, 309.01 crore persondays generated

Interpretation: 60 million households were employed and 309.01 crore persondays were generated under MGNREGA, reflecting its significant role in providing rural employment and supporting livelihoods.

6. Education Expenditure in India

India's Education Expenditure: India's education expenditure stands at 4.6% of its GDP.

Global Average: The global average for education expenditure is 4.77% of GDP.

Interpretation: India's education expenditure is 4.6% of GDP, slightly lower than the global average of 4.77%. This suggests that while India is investing significantly in education, there's room to increase spending to match global standards and improve educational outcomes, especially in underserved areas.

7. Healthcare Expenditure in India

India's Healthcare Expenditure: India's healthcare expenditure stands at 1.0% of GDP.

Global Average: The global average for healthcare expenditure is 9.8% of GDP.

Interpretation: India's healthcare spending is **8.8% lower** than the global average, indicating that India is underinvesting in healthcare compared to other countries. This gap suggests that the healthcare system may lack sufficient resources to address the needs of its population effectively.

FINDINGS, SUGGESTIONS

FINDINGS

- A 4.1-point increase in the FI-Index, reflecting progress in financial inclusion.
- Over 1.5 billion bank accounts, with 432 million under PMJDY, and UPI transactions hit $768 billion in 2023.
- Southern states have better credit access, while the North-East lags due to limited banking infrastructure.
- PMSBY provided 21.24 crore low-cost insurance policies.
- MGNREGA employed 60 million households, supporting rural livelihoods.
- Education spending (4.6% of GDP) is below the global average, and healthcare spending (1.0%) is significantly lower than the global average (9.8%).

Impact of Financial Inclusion on Poverty Reduction

Based on the findings, there is a positive impact of financial inclusion on poverty reduction:

- This improves the FI-Index and the usage of digital payments to improve financial access to contribute to economic participation and financial stability of the excluded groups.

- The increase in credit availability in areas endowed with infrastructure enhances economic operations and the generation of wealth.
- Insurance policy ensures that those with little means do not fall deeper into misery due to upcoming circumstances that cost a lot of money.
- MGNREGA's employment of 60 million households supports rural livelihoods.
- Increased investment in these areas could further reduce poverty by improving job opportunities and health outcomes.

Thus, the evidence points to directions on the impact of financial inclusion and poverty eradication in India.

SUGGESTIONS

1. Strengthen Financial Literacy Programs
    - Partner with relevant local institutions, and educational institutions and social media marketing to enhance the knowledge of every person on the banking, credit, insurance and digital payment.
2. Enhance Digital Payment Infrastructure
    - Extend the existing internet connectivity and Mobile network coverage in the rural areas to enable people access different forms of digital payment.
3. Address Regional Credit Disparities
    - Far more microfinance organizations must be retained in regions that need them and popularize affordable credit since they help small business owners and low-income families.
4. Promote Low-Cost Insurance Awareness
    - Providing information through community activities, local newspapers, mobile marketing to avail various cheap insurance schemes like PMSBY etc. for the low income groups.
5. Encourage Regional Financial Inclusion Hubs
    - Establish regional hubs that serve as access points for banking, credit, and digital payment services, particularly in underserved areas.
6. Increase Financial Technology Possession and Application among the Elderly and Low Technological Aptitude Individuals
    - Provide hands-on workshops and simplified digital training for older adults and those unfamiliar with technology.
7. Introduce More Flexible Pay Later and Micro-Credit Options
    - Pioneer low-interest micro credits and pay-later options tailored to the financial capacity of low-income households.

CONCLUSION

This research highlights the importance of the role of and use of access to financial services to reduce poverty in India where many are locked out from basic banking services. However, there are new improvements observed by raising the Financial Inclusion Index from 60.1 in March, 2023 to 64.2 in March, 2024, gaps in factors including; Account Ownership and Use, Financial Literacy and Understanding and affordable service charge for using mobile money services are still evident; especially to vulnerable groups in Bottom of the Pyramid Consumers and Consumers in the Informal Economy segments.

Schemes such as the Pradhan Mantri Jan Dhan Yojana which began in August 2014 and the Pradhan Mantri Suraksha Bima Yojana launched in April 2015 have increased both banking and micro insurance affordability.

However, the credit accessibility is still considerably uneven across the regions, especially, between the southern and the northeastern states.

The data imply that though the APT has been declining, individuals are still susceptible to spending volatility, even due to COVID. These shocks are key challenges why financial inclusion plays crucial role of giving people proper tools to handle and improve their finance.

Based on these findings, the study suggests that for financial inclusion to address poverty most effectively, policy makers should enhance financial literacy, enhance the utilization of electronic means of payment, and enhance popularization of the inexpensive insurance products. Non-bank micro-credit and increasing accessibility of the population to the financial services by creation of regional financial inclusion centres are additional measures.

Therefore, the availability of financial services and improving communities' level of knowledge on financial matters are among the important steps towards economic growth of India and poverty eradication beneficial to millions of people.

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