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Financial inclusion and disparity: a case of India

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FINANCIAL INCLUSION AND DISPARITY: A CASE OF INDIA

Meenakshi Rajeev

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ABSTRACT

This paper highlights the inequality in financial penetration and usage in India, based on macro level data, and shows how certain regions, such as the Northeastern or Eastern of the country need special attention by the policy makers. Credit schemes need to be formalized so that the weaker regions and socially disadvantaged sections, especially in the lower income categories, receive better access to formal credit. Based on the analysis of unit record (household level) data from the National Sample Survey Organisation (NSSO), the gender-wise inequality is also considered persistent, particularly regarding access to credit. This paper argues that some of these selected groups need special attention by the formal credit institutions. The mere opening of a bank account in the name of financial inclusion for these sections is not sufficient. One needs to facilitate them in such a manner that their relation with banks becomes a sustainable one.

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1. INTRODUCTION

One of the common characteristics of most developing nations is that a large percentage of the poor are self-employed either in agriculture or in small business –whether it be in manufacturing or service sector. As a result they usually require a steady stream of financial resources to meet their working capital needs. These resources, in a country like India, originate both in a formal and informal manner. The formal sector for these resources includes three major types of banks: commercial, cooperative, and regional rural banks; while the informal sector comprises private money lenders, pawn brokers, friends, and relatives. Many self-employed individuals also operate in an interlinked market where they take a loan from the input supplier and subsequently output is sold to the same person. When a resource poor individual accesses the informal credit market, they often face inauspicious conditions such as high interest rate, short period of repayment etc. Our analysis of the data presented in the following sections shows that the relevant interest rate is usually higher than 36% and sometimes even above 100%. Also, village money lenders often take advantage of the poor borrowers and force those borrowers to sign off their land as a collateral, in cases of unrecovered loans. Therefore, it is essential that the poor have easier access to a formal financial sector. This is particularly important in order to ensure both inclusive growth and a reduction in inequality, the latter which has increased in the post reform period in India.

Even today, 50% of the poor do not have access to the formal financial sector in India (see Bhattacharjee, M. (2012)). The collateral (security) based lending policies of the formal agencies keep the formal sector out of the reach of the poor. The formal agencies justify their position in terms of the high transaction costs incurred by dealing with a large number of smaller accounts. The new asymmetry information school (Hoff and Stiglitz, 1990) attributes the problem of dealing with the poor by the formal agencies to asymmetries of information about the borrowers in the credit markets.

In this context, it is also notable that a poor person not only needs credit for income generating purposes but some of the credit requirements are used in non-income generating activities such as health and education as well, which are also essential. It is often difficult for the poor to access the formal sector for such consumption purpose loans. In addition to loans, two other major services that formal sector should provide to the poor are the safe savings and remittance facilities.

Observing the fact that large proportion of citizens still do not have access to the formal banking sector, the Honorable Finance Minister in his budget speech in 2007, emphasized the need for financial inclusion fostered by the Reserve Bank of India[1] (RBI) through the formal financial institutions. This drive aims at bringing all

[1] RBI is India's Central Bank.

citizens under the bank network and one of the major instruments used to do so is via the opening of the *no frill accounts*. While such endeavors have been able to extend the reach of the formal banks, dependence of the poor on informal lenders continues to persist. Rajeev and Vani (2012), via a survey in Karnataka, reveal that even after massive financial inclusion drive in the state, around 50% of farmers continue to depend on the informal lenders. One of the major problems to access formal sector loans in Karnataka arises from lack of land records. Informal lenders on the other hand provide loan with other forms of security such as future labour services promised by the borrowers or sometime even without any collateral.

From the perspective of the formal banking sector, India has a comparatively better network than other emerging nations such as Brazil. The banking sector was nationalised in India in 1969 and subsequently, there was a massive drive to spread banking networks to the rural areas as a large percentage of the population lived in rural regions. This led to the opening of a large number of bank branches of the nation. It was also customary to lend 40% of the total credit to priority sectors, which include agriculture and small businesses. However, despite such endeavors, the formal banking sector is still unable to meet the demands of the growing population. I argue in this paper that this is not merely caused by the lack of bank branches but also owing to the inaccessibility problem that the poor face due to lack of education and relevant knowledge, thus making financial literacy as important as access.

Access to financial services has become all the more important given the fact that government is now contemplating providing relief to the poor by direct cash transfers to their bank accounts. This is to reduce leakage of funds due to corruption.

In this back drop the current paper uses both secondary level data and field survey based information to shed light on the problem of financial exclusion that persists in India. Also, both secondary micro and macro level data are used for the study. An analysis of the macro level data presented in the next section reveals the unequal supply of banking services across the nation. A micro level analysis of financial exclusion in terms of accessibility to credit is provided in section 3, based on the National Sample Survey Organisation's (NSSO) household survey data. Afterwards, different dimensions of the problem of exclusion are also taken up based on our field survey experiences in the penultimate section. A concluding section follows at the end.

2. INEQUALITY IN FORMAL FINANCIAL SERVICES: A MACRO PERSPECTIVE

Rakesh Mohan, former deputy governor of the RBI, defined financial exclusion as "the lack of access by certain segments of the society to appropriate, low cost, fair and safe financial products and services from mainstream providers" (Mohan, 2006).

Large scale financial exclusion is not only an aspect of India's banking sector alone, it has global presence. It is estimated that more than half of the world's adult population is not involved in any kind of financial services to either borrow or save (Chakrabarty, 2011). Amongst the excluded, 2.2 billion people are concentrated in Africa, Asia, Latin America, and the Middle East. As an emerging nation India is of concern as given her large population base, India has a greater number of financially deprived households than US, Latin America, Middle East and Europe combined together (Chakrabarty, 2011).

Table 2.1 Selected indicators of Financial Inclusion - Cross Country Analysis, 2011

S.NO.	Country	Number of bank Branches	Number of ATMs	Number of bank Branches	Number of ATMs	Bank Deposit	Bank Credit
		Per 1000 sq. km		Per 0.1 Million		as % to GDP	
1	**India**	**30.43**	**25.43**	**10.64**	**8.9**	**68.43**	**51.75**
2	China	1428.98	2975.05	23.81	49.56	433.96	287.89
3	Brazil	7.93	20.55	46.15	119.63	53.26	40.28
4	Indonesia	8.23	15.91	8.52	16.47	43.36	34.25
5	Korea	79.07	...	18.8	...	80.82	90.65
6	Mauritius	104.93	210.84	21.29	42.78	170.7	77.82
7	Mexico	6.15	18.94	14.86	45.77	22.65	18.81
8	Philippines	16.29	35.75	8.07	17.7	41.93	21.39
9	South Africa	3.08	17.26	10.71	60.01	45.86	74.45
10	Sri Lanka	41.81	35.72	16.73	14.29	45.72	42.64
11	Thailand	12.14	83.8	11.29	77.95	78.79	95.37
12	Malaysia	6.32	33.98	10.49	56.43	130.82	104.23
13	UK	52.87	260.97	24.87	122.77	406.54	445.86
14	USA	9.58	...	35.43	...	57.78	46.83
15	Switzerland	84.53	166.48	50.97	100.39	151.82	173.26
16	France	40.22	106.22	41.58	109.8	34.77	42.85

Source: Financial Access Survey, IMF; UK data from 2010

From the above table, it is clear that the problem of financial exclusion in terms of the indicators noted in Table 2.1 is higher in India when compared with a multitude of developed and emerging economies. The widespread financial exclusion in India is visible both in the form of high population per bank branch and low proportion of the population having access to basic financial services like savings accounts, credit facilities, and access to credit and debit cards.

In developed economies, financial inclusion focuses more on fair and transparent financial products and financial literacy. In developing economies however, access itself to financial products and knowledge about their operational details is a critical concern (Chakrabarty, 2011). In India, while emphasis on both of these aspects are necessary, certain regions of the country need special treatment vis-à-vis the rest; as there is stark inequality in financial inclusion among them, a symptom that is thought to be closely associated with the level of development of the regions, measured by various development indicators.

Selected Macro Indicators for India: Region wise Inequality

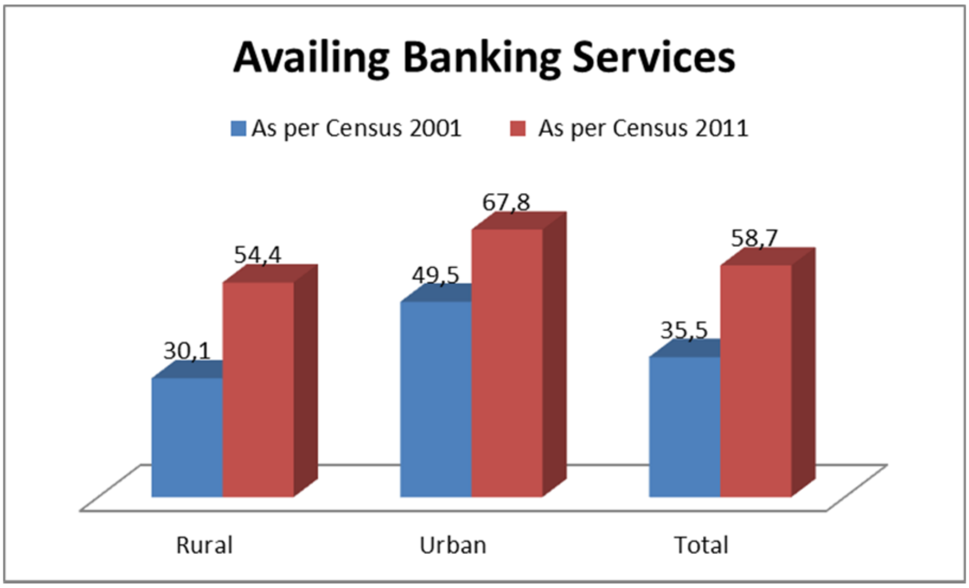
The first measure I present can be thought as penetration indicators (Table 2.2) which shows the number of bank accounts per 1000 individuals. From that same table, regional inequality is readily apparent; while the eastern and north eastern regions have very low penetration, southern and western regions have relatively higher penetration. If we look at the percentage of population availing bank services, difference between rural and urban can be clearly seen even though there is some amount of improvement over the last decade (Fig. 2.1).

Table 2.2 Region-wise penetration of banking in India, 2005 - 2011

Region-wise Average Penetration per 1000 (penetration is calculated as the ratio of no. of bank accounts*1000 and population)							
REGIONS	2005	2006	2007	2008	2009	2010	2011
North Eastern region	0.26	0.30	0.32	0.35	154.30	0.45	0.50
Southern region	0.76	0.78	0.84	0.90	0.98	1.08	1.14
Eastern region	0.35	0.36	0.37	0.41	0.32	0.49	0.55
Northern region	0.60	0.62	0.63	0.71	1.07	0.82	0.89
Western region	1.06	1.09	1.15	1.25	1.34	1.36	1.46
Central region	0.40	0.41	0.43	0.47	0.53	0.58	0.64

Source: Computed using data from RBI

Fig. 2.1 Percentage of households availing Banking Services for Census 2001 & 2011



In the next table (2.3), the usage of banking services in terms of mobilization of deposits and credit disbursement can be seen. In terms of these two indicators too regional differences are prominent: eastern and north eastern regions lag much behind the others.

Table 2.3 State and region wise number of credit and deposit accounts per lakh population -2013

Region wise deposit and credit accounts per lakh population of scheduled commercial banks : 2013					
Region/State/ UT	No. of Deposit accounts	No. of Credit accounts	Population (in lakhs)	Number of deposit accounts per lakh population	Number of credit accounts per lakh population
NORTHERN REGION	**160492204**	**13256865**	**1588.93**	**101006.76**	**8343.29**
Haryana	26,779,927	1994675	253.51	105634.65	7868.09
Himachal Pradesh	8,267,127	601779	68.65	120431.26	8766.41
Jammu & Kashmir	11,420,478	962427	125.41	91062.94	7674.06
Punjab	36,501,910	2445504	277.43	131570.00	8814.74
Rajasthan	40,881,863	4452558	685.48	59639.38	6495.49
Chandigarh	2,899,723	233239	10.55	274738.07	22098.54
Delhi	33,741,176	2566683	167.88	200984.60	15288.85
NORTH-EASTERN REGION	**26018798**	**2830186**	**448.76**	**57979.05**	**6306.65**
Arunachal Pradesh	747,307	74687	13.84	54006.82	5397.52
Assam	18,521,012	1908626	312.06	59351.61	6116.30
Manipur	1,016,037	100031	25.70	39528.52	3891.67
Meghalaya	1,567,491	150981	29.67	52832.82	5088.87
Mizoram	608,197	78428	10.97	55431.43	7147.97
Nagaland	795,608	112650	19.79	40212.65	5693.70
Tripura	2,763,146	404783	36.74	75209.81	11017.75
EASTERN REGION	**173520895**	**15170638**	**2713.29**	**63952.19**	**5591.23**
Bihar	46,564,874	4847171	1040.99	44731.14	4656.29
Jharkhand	20,791,591	1927797	329.88	63027.48	5843.91
Odisha	33,485,397	3573265	419.74	79776.11	8513.00
Sikkim	542,289	38658	6.11	88815.83	6331.39
West Bengal	71,732,038	4747982	912.76	78587.96	5201.78
Andaman & Nicobar Islands	404,706	35765	3.81	106338.99	9397.47
CENTRAL REGION	**217037302**	**17562245**	**3080.71**	**70450.50**	**5700.72**
Chhattisgarh	14,590,111	1101016	255.45	57114.89	4310.07
Madhya Pradesh	45,547,600	4250484	726.27	62714.58	5852.50
Uttar Pradesh	146,135,807	11371927	1998.12	73136.53	5691.30
Uttarakhand	10,763,784	838818	100.86	106716.96	8316.42
WESTERN REGION	**176255762**	**22344033**	**1748.60**	**100798.49**	**12778.28**
Goa	4,398,904	251029	14.59	301595.36	17210.92
Gujarat	53,773,689	3944590	604.40	88970.82	6526.49
Maharashtra	117,330,082	18132385	1123.74	104410.04	16135.70
Dadra & Nagar Haveli	405,497	9810	3.44	117976.84	2854.16
Daman & Diu	347,590	6219	2.43	142895.90	2556.66
SOUTHERN REGION	**291779634**	**57122324**	**2525.42**	**115537.26**	**22618.98**
Andhra Pradesh	95,339,373	16563737	845.81	112719.91	19583.34
Karnataka	70,020,126	8196017	610.95	114608.05	13415.14
Kerala	43,348,781	7603467	334.06	129763.22	22760.74
Tamil Nadu	81,262,945	24390116	721.47	112635.19	33806.13
Lakshadweep	73,286	6596	0.64	113669.29	10230.64
Puducherry	1,735,123	362391	12.48	139037.53	29038.83
ALL-INDIA	**1045104595**	**128286291**	**12105.70**	**86331.64**	**10597.18**

Source: Author's analysis based on data from RBI Branch banking statistics and Census of India 2011

3. ACCESS TO FINANCIAL SERVICES: ANALYSIS OF NSSO DATA[2]

Financial inclusion ensures access to various facilities including savings, credit, remittances and insurance. In developing economies like India, where a large percentage of the population is self-employed, hovering around 50 to 60 percent just in agriculture, the role of credit facility is critical. The present paper analyses the data provided by the NSSO on access to credit by (especially the poor) households. Though data is not recent, this was the most recent macro level data set on indebtedness available at unit records for public at the time of preparation of the paper. This exercise helps in the understanding of various problems of access to credit by households where the income is generated via self-employment.

The present analysis utilizes unit level NSSO data (59th round, All India Debt and Investment Survey, 2003)[3]. This data set provides substantial information regarding household debt and investment for 1, 43,285 households in India, covering both rural and urban areas. While this source provides rich micro level information through a representative sample as mentioned above, there has been a limited number of studies that used this data rigorously (see Rajeev, M., & Vani, B. P. (2011), Rajeev, M., Bhattacharjee, M., & Vani, B. P. (2013)., Bhattacharjee (2012), Rajeev, M., & Bhattacharjee, M. (2012), Rajeev, M., & Bhattacharya, M. (2011)).

The next round of this survey has been recently completed by the NSSO (Debt and Investment in India: NSS 70th round, January-December 2013) and a few highlights of the survey were published very recently, and some of those will be discussed subsequently.

To understand the nature of indebtedness faced by households of different economic status, this paper subdivides the households into different classes according to their monthly per capita consumption expenditures (MPCEs, used as a proxy for income). This helps to provide a picture in terms of level of income of the households.

3.1 Accessibility to Credit

Using the large set of NSSO data categorized into class intervals based on Monthly Per-capita Consumption Expenditure (MPCE), I first show the percentage of households that have outstanding loan as in 2002 (Table 3.1). This indicator is termed as the *Incidence of Indebtedness* (IOI) and includes access to credit both from the formal as well as informal sources.

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[2] This section has been written utilizing information from Rajeev and Vani (2011): Emerging out of shadow, VDM, Verlag.

[3] NSSO collects data on debt and investment related variables on a decennial basis. The 59th round data has been collected through stratified random sampling procedure, where rural villages and urban blocks form the first stage units and the households are the second stage units.

A careful examination of the data reveals that IOI is higher for the higher income groups. Similarly, IOI for male headed households is higher than female headed households. Schedule tribes (ST) households have lower IOI than the general or other backward classes (OBC) category households. With these characteristics, it seems justified to interpret incidence of indebtedness as access to credit rather than a distressed debt ridden situation as interpreted by many authors. An overall low figure of IOI then raises the doubt about the adequate access to credit (Table 3.1a).

Table 3.1a Incidence of Indebtedness, India, 2002 (NSSO 59th Round)

Rural		Urban	
MPCE (Rs.)	India (%)	MPCE (Rs.)	India (%)
0-254	23.15	0-384	18.36
254-338	25.04	384-511	18.23
338-425	26.29	511-600	19.13
425-510	27.48	600-700	18.22
510-600	27.11	700-800	16.61
600-700	29.20	800-950	17.95
700-950	28.80	950-1500	16.57
950-1500	26.28	1500-2500	19.32
1500-3000	29.53	2500-3500	20.14
Above 3000	16.85	Above 3500	15.36
Total	26.54	Total	17.79

Source: Author's analysis of NSSO 59th round data

The table 3.1 shows that access to credit is rather low for the households, however, income and access seem to move in the same direction. Access in rural regions seems to increase slightly as we move upward in expenditure, suggesting that comparatively richer amongst the poorer households have somewhat higher access. For the highest expenditure category, incidence of indebtedness is low, which may be related to a lesser need for credit. In other words, this phenomenon may be correlated to demand considerations rather than supply side. This particular trend is seen in urban areas as well. However, in urban areas, access remains lower throughout.

More recent consolidated tables published by NSSO (see Table 3.1b) also show that even after a decade things have not improved considerably. Firstly, even though there is some improvement in IOI, it has remained low. Secondly, urban IOI figures have remained lower than the rural showing disparity, which is also pronounced across various economic categories shown through asset classes.

Table 3.1b Incidence of indebtedness (IOI) and average debt per household (AOD) by asset holding class: all-India, 2013, NSSO 70th Round

Decile class of hh asset holding	Rural			Urban		
1)	2) IOI (%)	3) AOD per hh (Rs.)	4) AOD per indebted hh (Rs.)	5) IOI (%)	6) AOD per hh (Rs.)	7) AOD per indebted hh (Rs.)
1	19.62	9705	49478	9.34	5587	59808
2	22.30	8819	39554	14.63	11934	81587
3	27.05	13811	51053	20.16	20075	99572
4	27.46	15673	57077	24.16	28430	117662
5	30.95	18800	60746	21.67	29915	138076
6	32.99	23441	71047	23.44	36751	156807
7	32.69	28770	88006	23.77	55519	233609
8	37.33	37662	100877	25.42	91069	358212
9	42.64	29.41	56658	132867	168470	572822
10	41.32	111884	270747	31.74	398457	1255405
all	31.44	32522	103457	22.37	84625	378238

Source: Source: NSS 70th round, Key Indicators of Debt and Investment in India

The data for the 59th round (where individual household statistics is available) is further analysed by disaggregating the households belonging to various different social groups in order to show inequality in access in terms of relevant indicators. This analysis reveals certain interesting features (see Table 3.2).

In India, caste based categories are placed under Scheduled Casts (SC), Scheduled Tribes (ST) and Other Backward Classes (OBC). These casts, tribes and classes (to keep the nomenclature), have access to a number of benefits provided by the government. By examining the access to credit by these sectors of the population, it is readily apparent that ST households have much less access than others.

Table 3.2 Incidence of Indebtedness by social groups, Rural India, 2002

Rural MPCE (Rs.)	Scheduled Tribes (%)	Scheduled Casts (%)	Other Backward Classes (%)	General (%)	All (%)
0-254	15.58	26.45	24.61	24.32	23.16
254-338	17.27	25.86	28.10	22.89	25.04
338-425	17.35	27.07	28.05	26.35	26.30
425-510	20.83	29.04	29.31	25.43	27.48
510-600	21.81	25.94	30.77	23.95	27.11
600-700	22.14	30.66	30.62	27.95	29.20
700-950	15.76	23.82	32.37	28.74	28.80
950-1500	14.15	26.78	29.30	24.97	26.28
1500-3000	12.89	30.67	32.53	28.20	29.53
Above 3000	17.63	75.65	30.15	9.57	16.85
Total	17.98	27.03	28.98	25.66	26.51

Source: Author's analysis of NSSO 59th round data

In order to understand whether the differences across the different segments are statistically significant we have conducted a Chi-square test,, whose results are available in table 3.3.

For the Chi-square test, we denote:

p_1= SC category, p_2= ST category, p_3 = OBC category, p_4 = general or others category; where p_i's are proportion of indebted households in the respective categories.

The statistical test conducted tests the equality of the proportion of indebted households in the respective categories. Thus, the Null hypothesis is given by: Ho: $p_1 = p_2 = p_3 = p_4$. The null hypothesis is tested against the Alternative hypothesis of H_a: $p_1 \neq p_2 \neq . p_3 \neq p_4$.

Table 3.3 Testing for differences in Incidence of Indebtedness Across different social groups, 2002

	Scheduled Tribes	Scheduled Caste	Other Backward Class	Others
Share of non-indebted households	82.6	74.5	73.0	78.5
Share of indebted households (IOI)	17.4	25.5	27.0	21.5
	100	100	100	100
Pearson Chi-Square	1078223	Significance level	0.000	

Source: Author's analysis of NSSO 59th round data

This test shows a statistically significant difference in access across groups. More precisely, on the basis of the chi-square test, I reject the null hypothesis in favor of the alternative hypothesis, and conclude that the given data do not support the view that the incidence of indebtedness is the same across different social groups. In other words, there is a statistically significant difference across social groups in terms of access to credit. The nature of these differences was discussed above.

Next, we try to examine whether within these social groups there exists an unequal access to credit. Table 3.4 shows the Gini coefficient across the different social groups in both rural and urban areas. This table suggests that an unequal access to credit within a group is, in general, higher in urban regions. Earlier I showed that access to credit is lower in the urban areas.

Table 3.4 Inequality across social group in access to credit: Rural and Urban India, 2002

Gini coefficient Across Social Group			
Rural		**Urban**	
Scheduled Tribes	0.2451	Scheduled Tribes	0.3307
Scheduled Castes	0.2274	Scheduled Castes	0.2635
Other Backward Classes	0.2489	Other Backward Classes	0.2893
Others	0.2831	Others	0.3170
Total	0.2634	Total	0.3208

Source: Author's analysis of NSSO 59th round data

The different dimensions of indebtedness shown from this disaggregated analysis of a larger data set, suggest an existence of a number of challenges to the formal credit sector, as well as messages to be taken into consideration. The tribal households are usually poorer and less educated and therefore they find it extremely difficult to approach formal banks. They do not have access to credit even from the informal sources. Thus amongst the backward classes, it is necessary to prioritize and provide credit assistance, especially those below the poverty line. Fostering a culture of self-help groups from these members should also be another priority.

In addition to a multitude of social groups, another household division based on gender is of utmost importance. Table 3.5 examines the access of credit by the gender of the head of the household. In India and some other emerging economies, female-headed households are considered comparatively weaker to the opposite. This data set of about 150,000 households is again disaggregated in terms of male and female-headed households, with their incidence of indebtedness. The data suggests compliance with the customary beliefs expressed above and in result, male headed households have a greater accessibility to credit.

Table 3.5 Incidence of Indebtedness by head of the households, Rural India, 2002

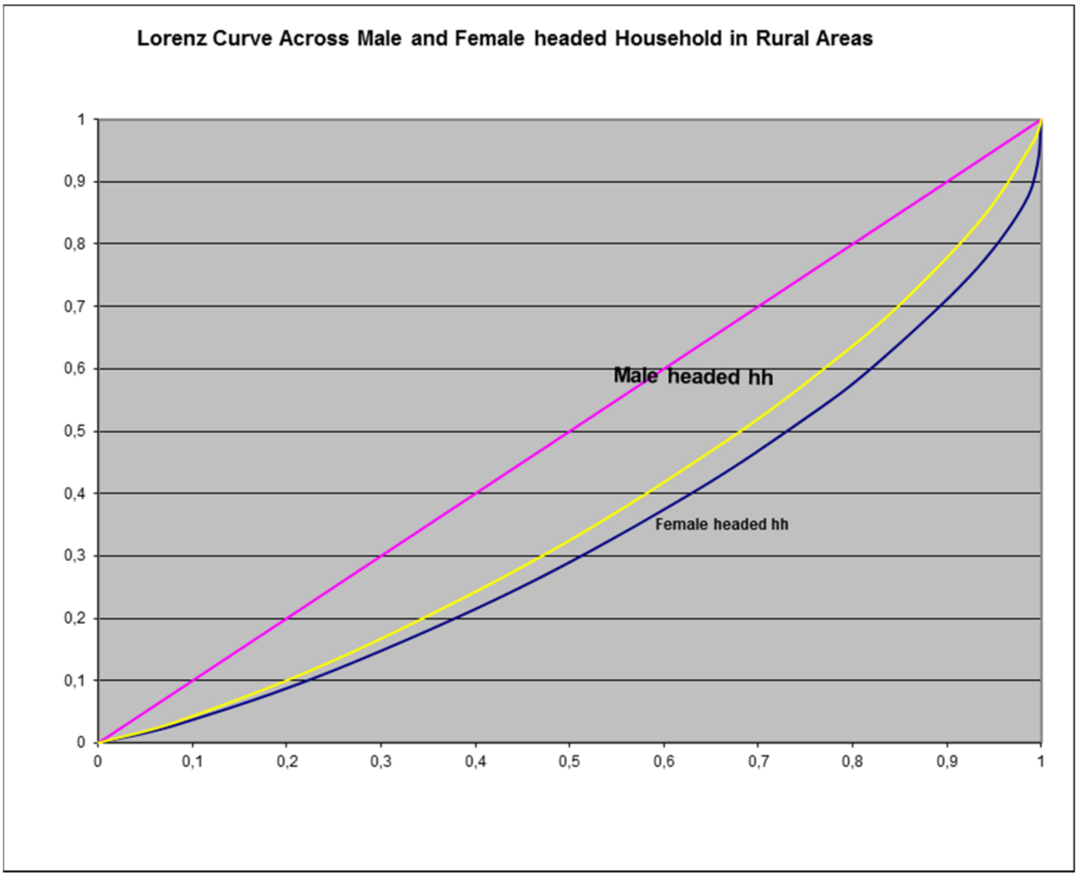
Rural MPCE (Rs.)	Male headed (%)	Female headed (%)	All (%)
0-254	23.90	16.63	23.14
254-338	26.13	15.36	25.04
338-425	27.13	18.97	26.30
425-510	28.51	18.83	27.48
510-600	28.65	15.03	27.11
600-700	30.38	19.45	29.20
700-950	30.19	19.71	28.80
950-1500	27.72	15.32	26.28
1500-3000	33.88	13.14	29.53
Above 3000	27.16	8.09	16.85
Total	27.59	17.44	26.51

Source: Author's analysis of NSSO 59th round data

Figure 3.1 shows inequality as measured via the Lorenz ratios for access to credit in case of male and female headed households. It is observed that inequality in access is more pronounced for the female headed house. Thus females are not only discriminated against males, but poor females are much more discriminated compared to the comparatively richer ones. This observation calls for serious attention[4].

[4] For more details see Rajeev, Vani and Bhattacharjee (2011).

Fig 3.1 Lorenz Curve across male and female headed households in rural areas



Source: Computed by the authors by using NSSO 59th round data

Next, table 3.6 shows the incidence of indebtedness across different occupational classes. As per NSSO's classification, we show occupation categories as agricultural labour, households engaged in agriculture, households self-employed in non-agriculture work etc. It is interesting to note that amongst the poorest category of household's incidence of indebtedness values do not differ much across different occupation classes. For example, access to credit for other labour category is higher than for farmers engaged in agriculture for the lowest per capita expenditure category (see table 3.6). However, moving up along the expenditure categories suggests that farmers appear to have higher access to credit. This reiterates the earlier assertion that for the poorest category, access to credit continues to be a major problem.

Table 3.6 Incidence of Indebtedness according to occupation class, 2002

Monthly Per Capita Expenditure Class (Rs.)	Self-employed in Non-agriculture activities (%)	Agricultural labour (%)	Other labour (%)	Self-employed in agriculture (%)	Others (%)	All (%)
0-254	24.50	22.50	27.20	25.90	12.50	23.20
254-338	26.80	24.10	24.60	27.70	13.60	24.90
338-425	27.10	25.80	29.30	27.30	16.10	26.20
425-510	28.00	28.30	27.60	28.90	18.70	27.50
510-600	26.10	29.20	28.10	29.50	14.80	27.10
600-700	29.20	25.70	35.00	32.70	17.70	29.30
700-950	28.90	25.10	24.00	35.30	19.80	28.90
950-1500	29.00	20.10	17.20	33.90	19.70	26.30
1500-3000	33.70	26.70	21.50	39.50	24.10	29.50
Above 3000	27.70	88.40	0.00	34.70	5.90	16.90
Total	27.40	25.50	27.20	29.50	17.30	26.50

Source: Author's analysis of NSSO 59th round data

3.2 Terms and Conditions of Credit

Sources of Loan

The above analysis attempts to capture the access to credit from different sources. However, it is known that the terms of the informal credits, especially from money lenders are often unfavorable, as they come with a larger rate of interest. If the rate of return from investment is lower than the rate of interest, the poor often fall into a debt trap. Taking this into consideration, priority sector lending norms and more recent financial inclusion drives have been introduced through the Indian formal banking sector. In this backdrop the following question arises: What is the record then of the formal lending agencies in delivering credit to the poor? I next attempt to analyze the database at a disaggregated level to bring forth the sources of credit for households of different economic status.

Table 3.7 Loans by types of credit agency: Rural India, 2002

Rural MPCE (Rs.)	Formal agencies (%)	Relatives and friends (%)	Informal moneylenders (%)	Total (%)
0-254	38.54	13.21	48.24	100
254-338	38.2	12.93	48.87	100
338-425	36.75	13.57	49.67	100
425-510	41.05	13.2	45.75	100
510-600	43.42	11.58	45.01	100
600-700	42.72	10.11	47.18	100
700-950	53.6	10.1	36.31	100
950-1500	57.74	9.96	32.31	100
1500-3000	70.72	10.64	18.64	100
Above 3000	69.48	3.56	26.97	100
Total	42.47	12.25	45.28	100

Source: Author's analysis of NSSO 59th round data

One feature from this analysis becomes strikingly noticeable: in rural regions of India, as we move up the expenditure class, access to formal credit increases substantially, this same behavior happens as well for the urban sector (see Rajeev and Vani, 2011). For the poorest categories, this is slightly better in rural than urban areas, possibly due to the existence of various scheme-based loans. In other words, conditions of the urban poor are seen to be much worse (Ibid.). The poorest category that needs loan in better terms and conditions more than others is the one that has been deprived of such access. The challenges to the credit institutions in this context become clearer from the analysis of the data from the farmer- households.

This particular feature of the Indian credit market has been highlighted by a number of authors (Nair, 1991). These studies however, are based on limited samples from particular villages or other equally small subdivisions. A study that shows the same behavior with a representative sample of the totality of India for different expenditure categories, as well as an urban-rural divide is not commonly observed.

Secondly, access of loans by the general category is higher in the case of formal sector loans compared to the Schedule Caste (SC) and Other Backward Class (OBC) households (see Rajeev and Vani, 2011).

Another analysis done in this context considers a division of households as provided by NSSO in terms of male and female-headed households (Table 3.8), and examines the sources of credit. Our analysis further shows that the female headed households are usually headed by widows with small children. It suggests that female-headed households have much lower access to formal sources of credit both in rural and urban areas. This behavior is true for almost all income categories. This gender dimension calls for certain special measures.

Table 3.8 Share of formal lending agencies of total number of loan outstanding by head of households, India, 2002

Rural MPCE (Rs.)	Male headed (%)	Female headed (%)	Urban MPCE (Rs.)	Male headed (%)	Female headed (%)
0-254	39.5	27.2	0-384	21.6	20.3
254-338	39.1	24.9	384-511	26.2	22.5
338-425	37.9	23.4	500-600	29.0	32.6
425-510	41.8	31.8	600-700	35.1	26.7
510-600	43.9	35.5	700-800	42.5	32.1
600-700	42.7	42.5	800-950	47.7	46.4
700-950	54.2	47.2	950-1500	60.7	62.9
950-1500	57.7	57.6	1500-2500	80.7	64.8
1500-3000	72.4	45.1	2500-3500	90.1	85.9
Above 3000	89.3	0.0	Above 3500	91.3	97.6
Total	43.2	32.9	Total	46.1	38.6

Source: Author's analysis of NSSO 59th round data

For the lowest expenditure category, one observes that, of total number of loans outstanding to male-headed households, 39.5 percent of loan is outstanding from formal lending agency (to households below MPCE of Rs 254 in rural area) and only 27% to the female-headed households.

Rate of Interest

Sources of credit in turn impact the rate of interest to be paid on a loan. The scenario revealed through sources of credit is to some extent corroborated by the picture shown through the rate of interest. A slightly larger proportion of households receive loan at a lower interest rate due to the fact that the friends, relatives, shopkeepers and other traders do not charge a very high interest rate. However, poorer households still take the burden of a higher interest rate. Also there are households that pay rate of interest higher than 60%. Such usurious rate may lead to debt trap and misery (Table 3.9).

Table 3.9 Share of loans by rate of interest, Rural India, 2002

Rural Households	Rate of Interest			
MPCE (Rs.)	Below 15 (%)	15-60 (%)	Above 60 (%)	Total (%)
0-254	51.29	44.50	4.21	100.00
254-338	47.45	50.49	2.06	100.00
338-425	45.87	52.31	1.82	100.00
425-510	47.32	50.91	1.77	100.00
510-600	44.87	54.18	0.95	100.00
600-700	43.00	56.20	0.80	100.00
700-950	50.86	48.49	0.65	100.00
950-1500	53.87	44.81	1.32	100.00
1500-3000	66.24	33.73	0.03	100.00
Above 3000	66.69	33.31	0.00	100.00
Total	47.59	50.75	1.66	100.00

Source: Author's analysis of NSSO 59th round data

Amongst different social groups usually the general category has been able to get the benefit of the lower interest rate and it is the male headed households that gets better share of low cost loan both in the rural and urban areas (see Rajeev and Vani, 2011).

Purpose of Loan

Unfavorable terms and conditions may worse an already unfavorable starting situation if the loan is used for non-income generating purposes. It is often argued in the literature that one of the main hurdles that the poorer sections need to overcome is the usage of those particular loans for ceremonies, or activities of the sort (see Krishna, 2004). In order to formally examine this through the representative sample at hand, we compute the percentage of indebtedness across different expenditure classes classified according to the purpose of loan. Use of loan for non-income generating purposes is seen to be prevalent across all income (expenditure) categories and also across rural and urban India (see Table 3.10).

Table 3.10 Loans by purpose and household class, Rural India, 2002

Rural		India		
MPCE (Rs.)	Capital expenses in business (%)	Current expenses in business (%)	Household and other expenses (%)	Total (%)
0-254	25.52	16.40	58.08	100
254-338	23.24	17.92	58.84	100
338-425	24.57	16.40	59.03	100
425-510	24.37	19.84	55.79	100
510-600	24.46	21.31	54.23	100
600-700	21.54	19.79	58.67	100
700-950	24.14	23.12	52.74	100
950-1500	25.11	24.19	50.71	100
1500-3000	13.69	20.38	65.93	100
Above 3000	18.83	5.52	75.65	100
Total	23.97	19.30	56.73	100

Source: Author's analysis of NSSO 59th round data

Amongst the households headed by females, a very small percentage has used a loan for income generating purposes. Previous analysis shows that these households have lower access to credit from formal sector and hence face higher interest rates. If the loan is used for non-income generating purposes, it can further add to their distress and perpetual indebtedness.

In this context the study highlights a dearth of access to formal credit even for essential consumption purposes such as health or education. This can lead to an unfavorable situation as some of these expenditures may be unavoidable.

4. PROBLEM OF FINANCIAL EXCLUSION IN RURAL AND URBAN REGIONS: EXPERIENCES FROM FIELD SURVEY

To understand the recent scenario a survey was carried out during 2011 in the state of Karnataka. As this is a state with comparatively better financial system, an assessment of such a state may show the kind of interventions needed for the rest of India. I discuss here the experiences both from rural and urban sectors of the state.

4.1 Sampling Methodology

Three districts with a high level of indebtedness have been selected to examine various aspects of financial inclusion of the rural households, especially the farmer. These districts are: Mandya, Chamarajanagar and Haveri. The first two are amongst the five districts with highest indebtedness located in South Karnataka. Chamarajanagar has the highest indebtedness amongst all districts of Karnataka. Amongst the districts of North Karnataka, Haveri has the highest level of indebtedness.

Dr D. M. Nanjundappa's committee report (2002) on regional imbalances provides a detailed assessment of the Talukas. That is, the district subdivisions[5] of Karnataka in terms of their agriculture productivity and infrastructure. A study of this analysis reveals that the district of Mandya falls under the set of districts having a relatively good agriculture infrastructure and performance. Using the same analysis, Haveri is a middle performing district and Chamarajanagar is a low performing district. Using the agriculture infrastructure and performance indices constructed in Dr Nanjundappa's committee report, we select one worse and one better performing Talukas from each district. This sampling techniques serves the purpose of broadening the scope and obtaining a balanced view on the farmers' indebtedness situation in Karnataka.

As mentioned above, from each district 50 households per Taluka, with two Talukas from each district were selected. The selection of sampling observations per selected Taluka is as follows: First, a visit is made to all the 'farmers coordination centres' (Raita Samparka Kendras ,RSKs in short). For example, in the district of Mandya, the Talukas of Maddur and Mallavalli were selected. The former records a better performance than the latter. With four RSKs in the Maddur Taluka and from the purview of each RSK, two villages are then selected. Next, about six households are chosen randomly from a list of households provided by the respective RSK The total sample selected from Maddur and Mallavalli talukas are 50 each. Similarly, two Talukas from Chamarajanagar districts viz., Kollegal (having 5 RSKs) and Elandur (2 RSKs) were selected. Five households were randomly selected from each village of Kollegal and; in case of Elandur, to arrive at a sample size of 50 respondents, 4 villages from each RSKs and 6 households from each village were randomly chosen. Following the same procedure we have selected 50 samples from Kollegal (a backwards taluka) and Yelandur (better performing Taluka) each. In Haveri, two Talukas Viz., Haveri (backward), and Ranibennur (better performing), with 50 households per Taluka were chosen following the same methodology.

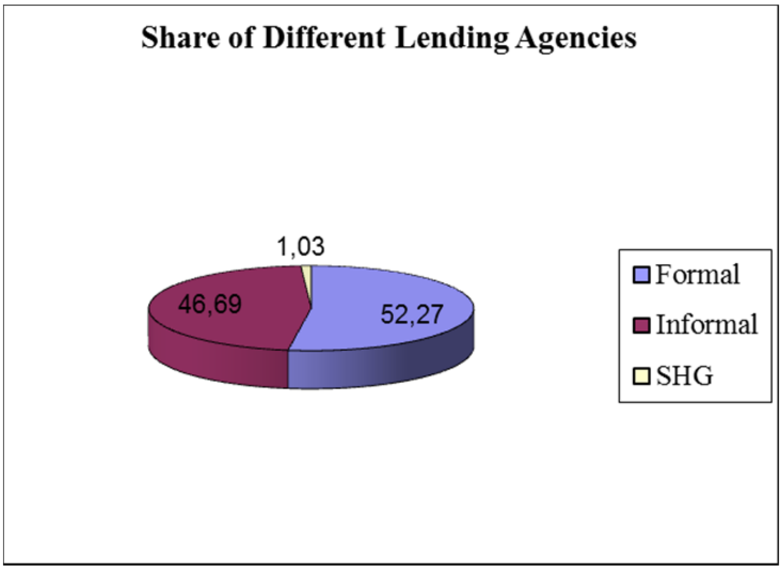
[5] Several Talukas make a district.

4.2 Findings

Rural Region

Our findings from the state of Karnataka where financial inclusion drive is considered to be in good progress is no better than what we observed from secondary data some years back. Thus the situation appears to remain more or less the same (see Fig. 4.1). The informal sector still constitutes around 46 percent of loan to the farmers. A small percentage of loan for farm activities also come from the Self-Help Groups (SHGs) which are primarily female groups. The survey shows that they borrow from the group in order to meet agricultural production related needs.

Fig. 4.1 Share of Different Lending Agencies (Three Districts Combined)



Source: Field Survey

Legend: SHG = Self-Help Groups

Within the formal sector, commercial banks constitute the major source of formal credit, however they appear to be biased more towards large farmers. In the district of Mandya the sample shows disbursement of loans by the cooperative banks. It is worth noting that cooperative banks are active in certain regions only. However, wherever they are active they tend to reach out to the small and marginal farmers. The same behavior occurs in Mandya. This is an important issue that should be taken into account by the relevant policy makers.

Since in Mandya district farmers avail loan from cooperatives they pay a rather low interest rate as state government subsidizes cooperative loans to a great extent. However, interest on informal sector loan remains rather high sometimes goes beyond 100 percent with modal value at 36 percent (see Table 4.1).

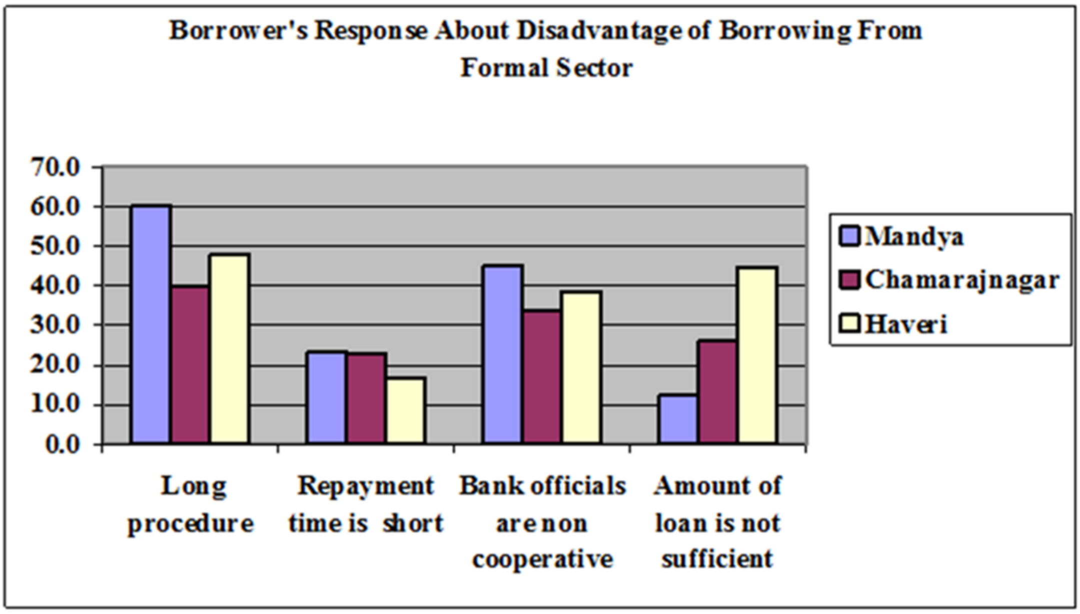
Table 4.1 Modal Value of Rate of Interest for Loans from Formal and Informal Sectors

Districts ⇒	Mandya	Chamarajanagar	Haveri
Formal	3	7	7
Informal	36	36	36

Source: Field survey

Even after a sustained high growth period by the economy, the situation does not seem to have changed substantially. One important question that arises is what difficulties are found by the farmers while accessing formal sector. As most of these farmers are not quite educated they find the procedures complicated and poor cooperation from the bank officials.

Table 4.2 Major Problems of Accessing Credit from Formal Lending Agencies



Source: Field Survey

Secondly, there are also certain beneficial schemes for the farmers such as Kissan Credit card. Our survey shows that even though the farmers hold this card they are not aware of it, let alone knowing its special benefits

Urban Region

When in the rural region the analysis focused on the farmers, in the urban region of the state of Karnataka the informal services sector is the main focus, as that is the occupational group where a larger number of either poor or less educated self-employed people are engaged. The three major markets in the city of Bangalore in Karnataka: the K R market, Jaynagar market, and K R Puram market are considered for this section. Respondents of the survey are small traders in these markets who either sit on the pavement and do business or have a small shop. The commodities exchanged are produce, flowers, consumer goods of daily use (clothing, foot ware etc.) and consumer durables of local made variety like mobile phone, TV etc.

Firstly, a striking aspect to note here is most if not all, of the banks have branches in these markets. Indeed a few banks have their head office near to the city market. Therefore availability of banking infrastructure is not an issue.

Secondly, from the estimates of income, it seems that most of the pavement based traders earn a large sum of income (comparable to a formally educated school teacher). This implies that they have enough financial resources to demand the services of a bank. These traders also deal with informal financial intermediaries on a regular basis for business credit and make saving in the informal sector, which carries its own risk. However, almost none of them avail any formal banking services. On the one hand, there is a severe hesitance to avail banking services not related to the physical distance but rather to psychological factors (a 'mental distance'). In urban areas, since the other customers are educated, these unsophisticated customers get crowded out. On the other hand, the informal lender, whose regular and close contact inside the market place makes them more comfortable even though interest rate charged is quite high. This is a problem in the urban regions as a whole, not only just in Bangalore. A point which needs serious attention by the policy makers if they are concerned about inclusive growth.

5. CONCLUDING REMARKS

This paper highlights the inequality in financial penetration and usage in India, based on macro level data, and shows how certain regions, such as the Northeast or East of the country need special attention by the policy makers.. Credit schemes need to be formalized so that the weaker regions and socially disadvantaged sections, especially in the lower income categories, receive better access to formal credit. One of the ways in which the problems of access to formal credit may be addressed is via self-help groups (SHGs). In India, these are mainly the groups comprised of women. They operate on joint liability basis and hence reduce the risk of non repayment of loan for the lender where a loan is given without collateral. If such groups can be formed for the farmers (male members) they could help poor agricultural workers to access formal credit institutions without having to provide any security. Thus the problem of non accessibility due to not having land records can be addressed (Rajeev, Vani and Veerashekharappa, 2012). Based on a large representative sample provided by NSSO this study not only estimated the extent of financial exclusion in rural and urban regions of India but also reveals the inequality in access in terms of income, social classes and gender. These findings raised important challenges to the credit institutions.

This exercise highlights that the poorest category self-employed households needs special attention from the formal financial institutions if inclusive growth and better distribution of income is to be fostered. *The poor even find it difficult to access credit from the informal sector and rates of interest are rather high which dent their financial position further and lead to a debt ridden situation (*see Bhattacharjee, M., Rajeev, M., & Vani, B. P. (2009), Bhattacharjee, M., & Rajeev, M. (2010).)*.*

The analysis of households according to purpose of loan across various social groups reveals that Schedule Tribe groups have been utilizing a large percentage of loans for income generating purposes. We have also shown that this group gets loans from the formal sector, possibly under different schemes. The pressing need is to extend the reach of such schemes to a larger number of households under the same or similar circumstances, as the analysis reveals that only a small percentage of such households get credit from any source.

It has also been shown, from the detailed analysis presented above that amongst the households headed by a woman, a very small percentage has been using these loans for income generating purposes. Earlier analyses show that these households also have lower access to credit from formal sector and hence face higher interest rates. If the loan is used for non-income generating purposes, it can further add to their unfavorable situation and perpetual indebtedness.

Therefore, some of these selected groups need special attention of the formal credit institutions. Opening a bank account for these people will not be sufficient. Facilitating them in such a manner that their relation with banks becomes sustainable.

The data analysed above though based on a large sample, are dated. To paint a more recent picture a survey has been conducted in both rural and urban regions of India. They do not show an encouraging picture. Firstly, though access to credit by the rural poor is better due to priority sector lending norms small and marginal farmers do not get proper access to credit for want for land records. Secondly, while there are some useful schemes such Kissan credit cards for the farmers, they are not aware of the potential benefits. Therefore financial literacy is a major problem and the challenging tasks in front of the policy makers are to ensure land records and appropriate information.

In urban regions it is observed that though physical distance to the banks is minimal, ‘mental distance’ is the major hindrance. A business correspondent model where a bank official or and agent appointed by bank go near to the customers is seen as a possible solution. Formation of self-help group of farmers (joint liability groups) or urban customers (such as traders in a market place) can also be experimented as an alternative.

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