International Advance Journal of Engineering, Science and Management (IAJESM)
ISSN -2393-8048, January-June 2022, Submitted in March 2022, iajesm2014@gmail.com

Financial Inclusion and Its Role in Economic Development of India

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Abstract

Financial inclusion is a process enabling individuals and enterprises, irrespective of their financial condition, to access fundamental financial products and services. Financial inclusion has been a major catalyst for economic progress in India, particularly in rural and disadvantaged regions. In the current study, the historical development of the financial inclusion policies is thus tracked, and their overall impact on the economy is recorded. A secondary data and empirical review of the collected data provided by the official government reports, financial sector institutions, and international organisations to the financial mechanism shows that the mechanisms of financial inclusion have widened access to credit, encouraged entrepreneurship, decreased the poverty level, and opened the gates of economic participation. The findings emphasise the pivotal role of initiatives such as Pradhan Mantri Jan Dhan Yojana, MUDRA Yojana, and various financial literacy programs in fostering inclusive growth. Despite observable impediments, such as insufficient financial literacy among lower socioeconomic strata and inadequate infrastructure in rural regions, this study underscores financial inclusion as a pivotal catalyst for India's economic transformation and a fundamental basis for future growth.

Keywords: **Financial Inclusion, Economic Development, Pradhan Mantri Jan Dhan Yojana (PMJDY), MUDRA Yojana, Financial Literacy**

Introduction:

Financial inclusion is fundamental to sustained economic development as it offers vital financial services—such as savings accounts, credit, insurance, and pensions—to disadvantaged and frequently marginalised individuals. The financial inclusion road to 2019 was characterised as having an element of progress as well as enduring challenges. In spite of the growth in the bank sector and the subsequent efforts of the government, a significant percentage of Indians were still outside the formal systems.

A 2011 survey of the entire country recorded that less than one-third of adult Indians (34.6%, or around 35%) owned a bank account, with those who were actively using formal financial institutions most commonly as a way of saving or taking out a loan consisting of even smaller groups: only 12% were involved in keeping, and no more than 8% reported borrowing. According to the CRISIL Inclusix index, the upward trend is minor, as it increased to the range of 40.1 in 2011 compared to the 35.4 in 2009. This was the path, which indicated a slow increase in the growth level, in which the overall financial-inclusion score of India took a moderate scale. In the mid-2010s – the 2015 to 2017 period – initial indications showed that the percentage of those holding the account had passed the 50% threshold.

To a considerable extent, that has been the tremendous increase in response to programmes like Aadhaar-linked Jan Dhan Yojana, as more accounts were issued in the name of the total growth of bank accounts. Despite this increase in the number of account holders, there was a low rate of frequent transactions and continued usage, particularly among rural and low-income groups. Most of the newly registered accounts, especially in underdeveloped areas, were passive account holders, and as such, emerged with low or rare interactions on the accounts. There were some stark differences, as seen in the state-wise analysis between 2005 and 2018. Goa recorded a high Financial Inclusion Index (FII) of 1.0 in 2016, but Kerala and Maharashtra also showed a strong level of progress; thus, states like Bihar, Madhya Pradesh, and Uttar Pradesh lagged significantly, revealing gaps. The analytic findings of the evidence up to 2019 demonstrated that only a small section of the states, namely Goa, Maharashtra, and Kerala, were placed in the high-inclusion bracket consistently, with the rest being in the low-to medium-inclusion band, with the states located in Central, Eastern, and Northeastern India falling mainly in the low-inclusion category. This resulted in 23 states being characterised as high inclusion each year, with 27-29 of 32 states under monitoring actively living in the low classification during the year 2018. In sum, these studies confirm that despite measurable progress before 2019, regional disparities were rampant in the Indian financial-inclusion background, where actual accessibility and utilisation were struggling in various parts of the country.

The government pursued robust measures, the 2014 launch of the Pradhan Mantri Jan-Dhan Yojana (PMJDY), which expanded account ownership dramatically, and the Aadhaar identity program, which streamlined Know-Your-Customer compliance and accelerated account access. Between 2011 and 2017, over 90% of the population was enrolled in the Aadhaar identity, and half of these identity holders were linked to bank accounts. However, meaningful inclusion must also involve frequent and widespread usage of the financial products, a challenge that remains to this day, especially with the low-income and rural residents.

The experience of India proves that economic development cannot be considered independent of the problem of financial inclusion. What empirical studies have found is that the connection is positive and statistically significant between enhanced access to financial services and the increase of economic performance indicators, such as higher GDP growth, lower income poverty levels, and higher entrepreneurship. This relationship is even more important in emerging economies, as it is inclusive financial systems that enable individuals and small businesses to invest, mitigate risk, and promote economic growth throughout the business environment nationally.

In spite of a significant expansion in the scale of India's financial system, the current challenges in the aspects of usage, depth, and regional differences persist. It is in this context that the future of inclusive finance in the country can be appraised in terms of its role in supporting the future economic growth of India and social equity in the many years to come.

Objectives of the Research

1) To analyse the development of financial inclusion policies in India.
2) To evaluate the influence of financial inclusion on many sectors of the Indian economy.
3) To examine the obstacles and impediments to financial inclusion.
4) To investigate the correlation between financial inclusion and economic indicators.

Research Methodology

This study utilises a secondary data analysis methodology, drawing on data from diverse sources, including books, journals, government organisations, research institutions, and academic publications. This research seeks to elucidate the correlation between financial inclusion and economic progress in India.

Financial Inclusion and Its Role in Economic Development of India:

Financial inclusion, which entails giving affordable savings, credit, insurance, and pension facilities to people, businesses, and communities, is important in the development of India due to high economic inequality, a high unbanked population, and high rural-urban disparity. Policies contributing to financial inclusion can reduce poverty and encourage the development of entrepreneurs, and therefore promote macroeconomic growth. And by allowing families to invest in education, health, and productive assets, households can also simultaneously realise a reduction of inequality, the injection of new ideas, and job creation.

Financial inclusion is one of the pillars of poverty reduction that is brought out in the literature since it needs to provide income-producing activities to residents in underserved regions through access to credit. This improves the standard of living. New firms and small businesses are thus able to increase activities, generate jobs, and add to GDP.

Key efforts, such the Pradhan Mantri Jan Dhan Yojana (PMJDY), initiated in 2014, and the MUDRA Yojana, established in 2015, exemplify the government's dedication to ensuring universal access to banking services. PMJDY opened basic bank accounts to all households, and MUDRA Yojana helped extend finance to microenterprises, hence stimulating entrepreneurship and employment.

The origin and speedy growth of digital banking (UPI and mobile banking apps) have caused even more improvement in terms of inclusive finance, more so in the regions where the infrastructure is low.

Historical Context of Financial Inclusion in India

India initiated financial-inclusion aims before to independence; however, the issue did not get sustained policy focus until the attainment of statehood. Initial endeavours concentrated on the proliferation of the banking network and the provision of credit to the disadvantaged rural populace, a process that accelerated subsequent to the economic deregulation in 1991.

One of the milestones was the nationalisation of 14 big commercial banks in 1969. It was found that before nationalisation, only about 22% of the banking system was spread out across the countryside; however, by 1990, this figure had risen to 58%, with approximately 35000 branches being opened. This is an indication of the success of the plan. At the same time, the introduction of the Lead Bank Scheme in 1969 distinguished one bank (in each district) with the task of leading the development of the bank and providing specific credit growth; the basis of the place-determined strategy of financial inclusion appeared.

In coordination with various other state-led interventions, Regional Rural Banks (RRBs) came into being in the year 1975, which was to meet the unique credit requirements of the rural areas of India. By March 2018, the number of RRBs increased to 56, covering 644 districts and having 20,024 branches – only 17 branches in 1975 and 3,279 branches in 1980. As of March 2019, the deposits of these institutions were 458,000 crore, and advances were 275,000 crore, with a concentration on agriculture and micro, small, and medium enterprises. Since the 1990s, the microfinance institutions (MFIs) and self-help groups (SHGs) have taken central places in the Indian financial market. As per the end-June 2019 data, there were 152 institutions where MFIs were operating, and the gross loan portfolio was 189,000 crore. Their development has highlighted the importance of women, most of whom form the vast majority of customers. The SHG-Bank Linkage Programme, established in 1992, achieved a significant scale of coverage: As of March 2018, 8.7 million SHGs have become a part of banks, mobilising cumulative savings of over 19.5 thousand crore Rs. During the year 2017–18, a total of 47,185 crore was given out as bank loans to SHGs, of which women constituted almost 86% of SHG membership. There is an impressive improvement, as quantitative indicators prove. Between 1975 and 1990, the number of RRB branches swelled by tripling to 3,279 in 1980 and 14,443 in 1990. By 2010, over 40 per cent of rural adults had a bank account, and aggregate lending to SHGs had crossed 80,000 crores as compared to less than 20,000 crores in 2005.

Government Initiatives and Schemes for Financial Inclusion

The Government of India has implemented a portfolio of radicalisation interventions that are aimed at promoting inclusive financial inclusion, albeit in rural and poor communities. In the next paragraphs, the major schemes are outlined, and the new numerical information is provided:

Pradhan Mantri Jan Dhan Yojana (PMJDY): Introduced in August 2014, PMJDY expeditiously expanded financial inclusion. By March 2019, 34.4 crore (344 million) bank accounts had been opened, and the cumulative deposits reached approximately ₹88,500 crore. Rural and semi-urban accounts were around 63.6 per cent of the total number, with women being 55.2 per cent of such accounts, which indicates the social justice nature of the scheme. As of mid-2019, there were more than 27 crore RuPay debit cards issued, and as per estimates, over 99 per cent of Indian households had access to a bank account within a 5 km radius. Financial Literacy and Digital Inclusion: Acknowledging that account access alone is insufficient, the government inaugurated over 1,500 Financial Literacy Centres (FLCs) by 2019, mainly in rural and semi-urban regions, to instruct citizens in banking, digital payments, and related subjects.

The National Centre for Financial Education (NCFE) reported that, as of 2019, only 27% of Indian adults qualified as financially literate, though this represented measurable progress over previous years. NCFE has recorded an increment of 17 per cent in the financial literacy of youth between 2016 and 2019. Concurrently, digital payment platforms—especially the Unified Payments Interface (UPI)—scaled quickly after 2016; however, the most pronounced growth trends emerged after 2019.

The Pradhan Mantri MUDRA Yojana (PMMY), introduced in April 2015, supplies unsecured, collateral-free loans to micro and small enterprises. By March 2019, 18.3 crore (183 million) loans valued at approximately ₹8.93 lakh crore had been sanctioned. Most of the beneficiaries were women, and states that had less financial inclusion, such as Uttar Pradesh and Bihar, registered significant participation. Credit growth under MUDRA loans between

2015 and 2019 has increased access to credit for the excluded groups and helped in income generation and entrepreneurship development.

Impact of Financial Inclusion on Economic Development

Financial inclusion is a qualifying economic growth factor in India that has brought observable declines in the poverty level and growth in entrepreneurship as well as social protection, especially for rural and underprivileged groups.

The provision of formal financial services, including the major ones, viz., savings, credit, and insurance, has played a critical role in reducing poverty. It has been depicted that poverty decreased in the rural areas from 45% in 1993 to about 25% in the year 2011, and financial inclusion was pivotal in this development. Second, empirical data support the above assertion by showing that areas with high financial inclusion indices recorded growth rates up to 1.5 percentage points higher as compared to those in the low inclusion areas.

With the help of microfinance and credit facilities, families are empowered to invest in health and education, which enhances human capital and opens up prospects of earning more income. The World Bank report states that families owning bank accounts have a 20–25% probability of exiting the poverty trappings rather than the non-banking families.

Financial inclusion, in the form of schemes like Pradhan Mantri MUDRA Yojana, has expanded access to credit, among other things, and enabled entrepreneurial functions, creating the micro-enterprises that are essential to economic growth in India. As of March 2019, the MUDRA scheme had sanctioned around 18.3 crore loans to the tune of 8.93 lakh crore to micro-enterprises, constituting about 31 percent of the Indian GDP and employing well over 111 million people as per estimates of the government before March 2019. Earlier empirical analyses have revealed that the MUDRA loan recipients displayed average growth of business and larger numbers of entrepreneurs, mainly female, among all the recipients, with a 40 percent growth rate reported in all the loans and 35 percent in the female loans. Likewise, the massive availability of credit has promoted new jobs and diversification in the rural zone, beyond conventional farming. The influence of a wider spectrum of financial inclusion has also elevated the social security of vulnerable groups. Atal Pension Yojana, introduced in 2015 to boost retirement savings in the unorganized sector, had 14.95 million subscribers by 2019. This plan provides a minimum monthly pension worth 1,000 to 5,000 rupees after retirement, which makes the plan financially stable for millions of elderly members. Concurrently, the linkage of bank accounts to welfare schemes enabled Direct Benefit Transfers (DBT). By March 2019, the aggregate transfer of DBT was 7 lakh crores of rupees, the overall leakages had decreased significantly, and the money was also transferred to the beneficiaries faster. To conclude, financial inclusion has led to the expansion of banking services and has delivered quantifiable achievements in economic development and reduction of poverty alleviation, the creation of employment, and the proliferation of social security in India by 2019.

Challenges to Financial Inclusion in India:

In spite of the significant growth in financial access in India, several challenges continued to thwart full financial inclusion for the poor and remote rural areas before 2019. These constraints are examined using empirical data as outlined below.

The main obstacle was poor financial literacy, especially in low-income rural and semi-urban areas. Studies and surveys in this period indicated that the financial literacy rate in rural India remained low—one national survey in 2018–19 suggested only about 24–30% of rural adults were knowledgeable about basic financial concepts. Research from states like Kerala and Uttar Pradesh indicated that rural financial literacy lagged behind urban areas, adversely affecting formal saving, credit, and the use of financial services. For example, a scholarly study in Aligarh reported that low rural awareness was a key factor limiting the use of formal financial institutions. Surveys by the National Centre for Financial Education and the Reserve Bank of India up to 2019 revealed that while there was progress in basic digital banking awareness, significant deficiencies in practical knowledge persisted, impeding effective utilization.

Despite programs like the Pradhan Mantri Jan Dhan Yojana (PMJDY), the accessibility of physical banking infrastructure remained a major hurdle. Approximately 66% of rural households had access to banking services by the late 2010s. Yet, the number of ATMs and branches in remote regions was limited, often leading to prolonged wait times and access issues. The average distance to the nearest bank branch for unbanked villages improved dramatically—from 43.5 km in 1951 to 4.2 km by 2019—but some spatial and social inequalities persisted, leaving many poor, underprivileged areas underserved.

The advance of digital financial services posed further challenges. By 2018–19, internet usage and digital service access were far lower in rural compared to urban areas. Pre-2019 data show that only about one-fourth to one-third of rural households used or had access to the internet, versus more than half of urban households. Gender and socio-economic gaps were notable: women and disadvantaged groups faced even more limited digital literacy and device access, inhibiting equal participation in digital finance.

Additionally, many accounts opened through government inclusion schemes remained dormant due to low or no balances, sporadic income, lack of incentive, or limited awareness. The limited number of bank employees, high transaction costs in remote regions, cumbersome documentation requirements, and persistent reliance on informal finance channels further hampered inclusion.

These considerations reveal that, despite millions being newly linked to the formal financial system before 2019, critical questions about meaningful usage, closing the digital divide, and securing true inclusion—especially for India's poor and remote communities—remained unresolved.

Conclusion:

Its development was observed as one of the primary motives for the goals of promoting socially equitable and inclusive economic growth. Policy initiatives—most notably the Pradhan Mantri Jan Dhan Yojana (PMJDY)—extended formal financial services, enabling the opening of more than 34 crore (340 million) bank accounts by March 2019. Till that time, 55.2% of such accounts were owned by women, particularly in rural places. The MUDRA Yojana, at the same time, had availed loans of nearly 18.3 crore and about 8.93 lakh crores to enterprises through micro and small enterprises, nourishing entrepreneurship and generating employment. The national action plan also combined the endeavors to increase financial literacy alongside the growth of digital financial services. Notwithstanding these achievements, notable deficiencies remained. Towards the end of the 2010s, physical access to banking facilities was maintained by about 66% of all rural households, leaving 34% unserved. Adult financial literacy was also rather low in the rural areas: approximately only 24-30% of people understood the basic financial concepts, and almost one-third of them did not have bank accounts and did not use digital means of payment. There was a sharp digital divide; rural households had internet access of 24%, urban areas had 48%, and people were slow to use digital financial services because there was limited confidence and education. In the meantime, the Indian Financial Inclusion Index was progressing steadily, increasing during the period March 2017 to March 2019 from 43.4 to 49.9, indicating gains in access and use and the quality of services to people. The poverty levels among the rural population dropped significantly between 1993 (45%) and 2011 (22%) as financial inclusion reforms took place. Analytical research findings reveal that countries that attract wider financial inclusion enjoyed GDP growth rate improvements of as much as 1.5 percent. To support the encompassing development, a continuous digitalization of financial inclusion, the strengths of the banking network, and specialized financial literacy education courses among unserved groups are needed.

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