Chapter – 2

Nature and Extent of Exclusion

Background

2.01 Access to finance, especially by the poor and vulnerable groups is a pre-requisite for employment, economic growth, poverty reduction and social cohesion. Further, access to finance will empower the vulnerable groups by giving them an opportunity to have a bank account, to save and invest, to insure their homes or to partake of credit, thereby facilitating them to break the chain of poverty.

2.02 The banking industry in India has recognized this imperative and has undergone certain fundamental changes over the last two decades. Reforms since the early nineties in the banking sector have facilitated increasing competition, the development of new generation private sector banks as well as technological breakthrough in diverse financial products, services and delivery channels. With the recent developments in technology, both delivery channels and access to financial services have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines (ATM), credit / debit cards, internet banking, online money transfer, etc.

2.03 The moot point, however, is that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology – allowing, for example, more accurate targeting of sections of the market – have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed "financial exclusion". These people, particularly, those living on low incomes, cannot access mainstream financial products such as bank accounts, low cost credit, remittances and payment services, financial advisory services, insurance facilities, etc.

2.04 In its landmark research work titled "Building Inclusive Financial Sectors for Development"[1] (2006), more popularly known as the Blue Book, the United Nations (UN) had raised the basic question : "why are so many bankable people unbanked?" An inclusive financial sector, the Blue Book says, would provide access to credit for all "bankable" people and firms, to insurance for all insurable people and firms and to savings and payments services for everyone.

2.05 "Financial inclusion, thus, has become an issue of worldwide concern, relevant equally in economies of the under-developed, developing and developed nations. Building an inclusive financial sector has gained growing global recognition bringing to the fore the need for development strategies that touch all lives, instead of a select few."[2]

[1 & 2] The book is a result of a project undertaken by the UN Department of Economic and Social Affairs (DESA) and the UN Capital Development Fund (UNCDF) to analyse the obstacles to financial inclusion and to report on efforts to overcome those obstacles in various countries.

2.06 Experience has shown that in the initial phase of real and financial sector reforms, there is a need to build in adequate provisions ensuring that the economically weak segment of population have increased participation in the process of economic growth and social development. Reforms in financial systems, therefore, need to be complemented by measures that encourage the institutions, instruments, relationships and financing arrangements to be properly geared for providing sound, responsive financial services to the majority of the people who do not have such access.

Who Needs to be Included?

2.07 The essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, etc.

2.08 "However, inclusive finance does not require that everyone who is eligible uses each of these services, but they should be able to choose to use them, if they so desired. To this end, strategies for building inclusive financial sectors have to be creative, flexible, appropriate to the national situation and if necessary, nationally owned."[3]

2.09 For promoting financial inclusion, we have to address the issue of exclusion – of people who desire the use of financial services, but are denied access to the same. In countries with a large rural population like India, financial exclusion has a geographic dimension as well. Inaccessibility, distances and lack of proper infrastructure hinder financial inclusion. Vast majorities of population living in rural areas of the country have serious issues in accessing formal financial services.

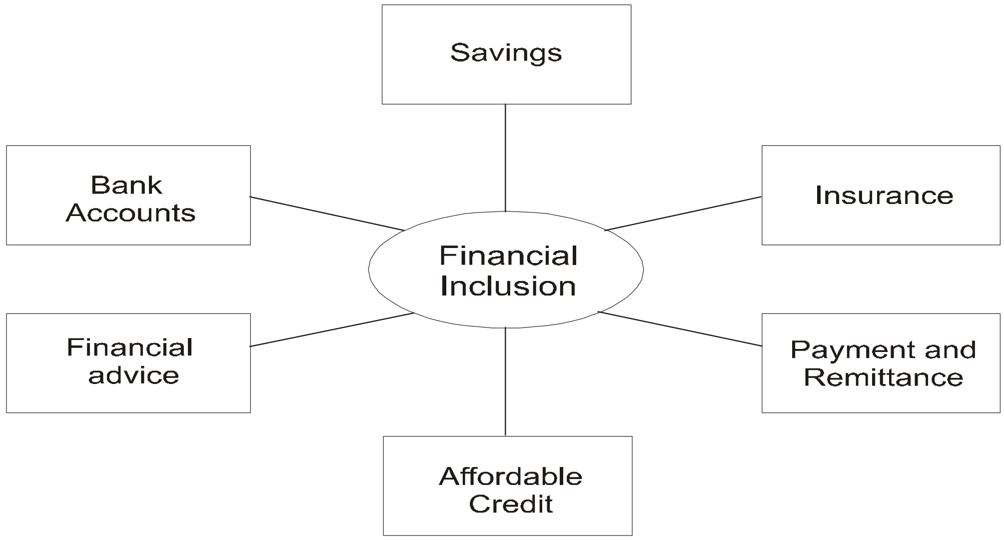
2.10 Another facet of exclusion which needs to be addressed is "Social Exclusion" – which is an extreme consequence of what happens when people do not get a fair deal throughout their lives, often because of disadvantages they face at birth, and this can be transmitted from one generation to the next. Social exclusion is about more than income poverty. It is a short-hand term for what can happen when people or areas have a combination of problems such as unemployment, discrimination, poor skills, low incomes and poor housing. These problems are linked and mutually reinforcing.

Financial Inclusion - Defined

2.11 By financial inclusion, we mean delivery of banking services and credit at an affordable cost to the vast sections of disadvantaged and low income groups. The various financial services include savings, loans, insurance, payments, remittance facilities and financial counseling / advisory services by the formal financial system. An open and efficient society is always characterized by the unrestrained access to public goods and services. As banking services are in the nature of public goods, financial inclusion should therefore be viewed as availability of banking and payment services to the entire population without discrimination of any type.

[3] The Blue Book – Chapter 1 : Setting the stage for building inclusive financial sectors, pp3.

FINANCIAL INCLUSION



2.12 However, the term financial inclusion is perceived in different ways under different contexts. There is a view that only access to credit is treated as financial inclusion whereas the other view includes all the services extended by the financial institutions. That apart, financial inclusion by banks and other institutions must target, apart from personal / private investment requirements of individuals and groups, the universal public investment requirements necessary for development of infrastructure, social sector services, public utilities and productive forces / capacity building efforts, etc. Thus, financial inclusion may well be all about money and finance, but with the ultimate objective of directly abolishing the state of social exclusion in the economy.

2.13 The Committee, on several occasions, deliberated at length the need for arriving at a working definition of the term "Financial Inclusion". In these deliberations, a consensus emerged that merely having a bank account may not be a good indicator of financial inclusion. Further, indebtedness as quantified in the NSSO, may also not be a fully reflective indicator. Hence, the ideal definition should look at people who want credit, but are denied the same. However, the Committee also appreciated the fact that bankers cannot be advised to extend credit to everyone who approached them. If genuine claimants for credit are denied, then there is a case of exclusion. Therefore, it naturally means that all cases of denial of credit may not be exclusion. Further, the fact of denial of credit should be probed further. As this aspect raises the issue of creditworthiness or bankability, the Committee also deliberated on what could be done to make the "institutionally excluded", bankable or creditworthy. The Committee was also concerned with the issue regarding the denial of credit by formal sources for no fault of the credit applicant and what is needed to address such a situation? This may require re-engineering of existing financial products or delivery systems and making them more in line with the expectations of the intended clientele.

2.14 The segregation between institutional and non-institutional sources of credit was recognised, as indebtedness to the moneylender cannot be a sign of financial inclusion. Rather it has to be seen as a sign of exclusion as a major part of this segment would have been denied access to institutional credit.

2.15 The Committee felt the need for a normative definition – one, which would look into the issues, related to people desiring access to credit, but denied the same. Other issues may be a spin-off from this basic premise. A broader definition could also be considered; one, which would take care of issues not only, related to savings and credit, but also insurance and financial advisory services.

2.16 Viewed from the angle of indebtedness, nearly 49% of the farmer households in the country were indebted – of which, 27% to formal sources and 22% to informal sources. Can this be interpreted to mean that this 22% were in need of bank credit, but denied? Of the remaining 51% of farm households who are not indebted at all, 78% were small and marginal farmers who would, definitely, welcome access to credit on reasonable terms. Only the remaining segment may not require any form of external support.

2.17 The Committee also considered the segment of the population "once included", but has since gone out of the system either due to default or other reasons. The Committee held the view that this aspect formed a part of the sub-set of those who got credit at some time in the past, but were denied the same, later on. The number of defaulted loan accounts could be taken as a proxy to translate this aspect into a quantifiable indicator.

Financial Inclusion - Working Definition

2.18 Based on the above discussions, the following working definition of "Financial Inclusion" was considered by the Committee :

> *Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.*

Holding a bank account itself confers a sense of identity, status and empowernment and provides access to the national payment system. Therefore, having a bank account becomes a very important aspect of financial inclusion. Further, financial inclusion, apart from opening and providing easy access to a No Frills account, should also provide access to credit, perhaps in the form of a General Credit Card (GCC) or limited OD against the no frills account. It should encompass access to affordable insurance and remittance facilities. It should also include credit counseling and financial education / literacy. While financial inclusion, in the narrow sense, may be achieved to some extent by offering any one of these services, the objective of "comprehensive financial inclusion" would be to provide a holistic set of services encompassing all of the above.

NSSO Survey Results

2.19 The Committee debated the various dimensions of inclusion and concluded that while aspects such as savings, remittance facilities, insurance, etc. were important, nevertheless exclusion was particularly germane from the standpoint of access to credit by vulnerable groups. The Committee accordingly scanned the data put out by the NSSO in the situation assessment survey on "Indebtedness of Farmer Households" (2003). The Committee noted that the definition of indebtedness as adopted in the survey referred to farmer households having outstanding loans from institutional or non-institutional sources[4] in cash or kind having a value of Rs.300 or more at the time of transaction.

2.20 As per NSSO data, 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). In other words, 73% of farm households do not have access to formal credit sources. For purposes of this analysis, "financially excluded" households will be defined as those not having any debt to formal credit sources. The various aspects of such exclusion among specific regions and population groups are indicated below.

Level of Non-indebtedness : Across Regions

2.21 The farm households not accessing credit from formal sources as a proportion to total farm households is especially high at 95.91%, 81.26% and 77.59% in the North Eastern, Eastern and Central Regions respectively. In terms of absolute numbers these regions taken together account for 64% of farm households not accessing credit from formal sources as detailed below :

No. of Farmer Households (HH) in Lakh

Region	Total HHs	Indeb-ted HHs	% to total HHs	Non indeb-ted HHs	% to total HHs	Indeb-ted to formal sources	% to total HHs	Exclu-ded by formal sources	% to total HHs
Northern	109.46	56.26	51.40	53.2	48.60	27.423	25.05	82.04	74.95
North Eastern	**35.40**	**7.04**	**19.90**	**28.36**	**80.10**	**1.448**	**4.09**	**33.95**	**95.91**
Eastern	**210.61**	**84.22**	**40.00**	**126.39**	**60.00**	**39.467**	**18.74**	**171.14**	**81.26**
Central	**271.33**	**113.04**	**41.60**	**158.29**	**58.40**	**60.814**	**22.41**	**210.52**	**77.59**
Western	103.66	55.74	53.70	47.92	46.30	45.586	43.98	58.07	56.02
Southern	161.56	117.45	72.70	44.11	27.30	69.072	42.75	92.49	57.25
Group of UTs	1.48	0.49	33.10	0.99	66.90	0.15	10.14	1.33	89.86
All India	**893.50**	**434.24**	**48.60**	**459.26**	**51.40**	**243.96**	**27.30**	**649.54**	**72.70**
NE, C & E Regions *	**517.34**	**204.30**	**39.49**	**313.04**	**60.51**	**101.73**	**19.66**	**415.61**	**80.34**
Share to All-India (%)	**57.90**	**47.05**		**68.16**		**41.70**		**63.99**	

* NE = North-Eastern Region, C = Central Region, E = Eastern Region.

2.22 The Southern Region, on the other end, exhibits relatively better levels of access to formal / non-formal sources (72.7%) mainly on account of spread of banking habits and a more robust infrastructure.

Level of Non-indebtedness : Across States

2.23 The proportion of non-indebted farmer households was most pronounced in Jammu & Kashmir (68.2%) and Himachal Pradesh (66.6%) in the Northern Region,

[4] Institutional sources include Government, cooperative societies and banks, while non-institutional sources include agricultural / professional money lenders, traders, relatives and friends, doctors, lawyers and other professionals etc.

all States in the North-Eastern Region (61.2% to 95.9%) except Tripura, in Bihar (67%) and Jharkhand (79.1%) in Eastern Region, and Chhatisgarh (59.8%), Uttar Pradesh (59.7%) and Uttaranchal (92.8%) in the Central Region, as per details given below :

State / Region	Non-indebted farmer HHs @		State / Region	Non-indebted farmer HHs @	
	Lakh	%		Lakh	%
Northern	**53.21**	**48.7**	West Bengal	34.53	49.9
Haryana	9.11	46.9	**Central**	**158.29**	**58.4**
Himachal Pradesh	6.03	66.6	Chhatisgarh	16.50	59.8
Jammu & Kashmir	6.43	68.2	Madhya Pradesh	31.09	49.2
Punjab	6.38	34.6	Uttar Pradesh	102.38	59.7
Rajasthan	25.26	47.6	Uttaranchal	8.32	92.8
North Eastern	**28.36**	**80.4**	**Western**	**47.92**	**46.3**
Arunachal Pradesh	1.15	94.1	Gujarat	18.20	48.1
Assam	20.51	81.9	Maharashtra	29.72	45.2
Manipur	1.61	75.2	**Southern**	**44.11**	**27.3**
Meghalaya	2.44	95.9	Andhra Pradesh	10.84	18.0
Mizoram	0.60	76.4	Karnataka	15.52	38.4
Nagaland	0.51	63.5	Kerala	7.82	35.6
Tripura	1.19	50.8	Tamil Nadu	9.93	25.5
Sikkim	0.36	61.2			
Eastern	**126.39**	**60.0**	**Group of UTs**	**0.99**	**66.9**
Bihar	47.42	67.0			
Jharkhand	22.34	79.1	**All India**	**459.26**	**51.4**
Orissa	22.09	52.2	@ refers to non-indebtedness to both formal / non-formal sources		

Level of Indebtedness to Institutional Sources

2.24 Derived data indicate that only 27.3% of the total farm households were indebted to institutional sources as detailed below :

Region	Total no. of HHs (lakh)	Incidence of indebtedness to both formal and non formal sources		Indebtedness to institutional sources	
		Lakh HHs	(% to total HHs)	Lakh HHs	(% to total HHs)
Northern	109.46	56.26	51.39	27.42	25.05
North Eastern	35.40	7.04	19.88	1.45	4.09
Eastern	210.61	84.22	40.01	39.47	18.74
Central	271.33	113.04	41.66	60.81	22.41
Western	103.66	55.74	53.77	45.59	43.98
Southern	161.56	117.45	72.70	69.07	42.75
Group of UTs	1.48	0.49	33.10	0.150	10.14
All India	**893.50**	**434.24**	**48.60**	**243.96**	**27.30**

2.25 Data disaggregated by States indicate that indebtedness among the more "inclusive states" also exhibit high recourse to non-institutional sources of finance. In the States of the Southern Region this is particularly the case in Andhra Pradesh and Tamil Nadu. The State-wise levels of exclusion from formal sources are provided later in the Report.

Level of Non-indebtedness : Across Marginal / Small Farmer Households

2.26 It can be seen from the table below that 87% of all non-indebted farm households belong to the marginal (70.6%) and small (17.1%) farmer categories. The NSSO estimates of the year 2003 show that only around 45% of marginal famer households (viz., up to 1 ha.) had access to both institutional and non-institutional credit. There are no data to show the position of finance extended exclusively to marginal farmers by institutional sources. A major portion of the credit from financial institutions for weaker sections has supported small farmers. However, marginal farmers who account for 66% of all farm holdings remain by and large excluded from the formal financial system and by rough approximation, only around 20% of these households access credit from formal banking sources.

Category of farmer HH	**Size class of land owned (Ha)**	**Total farmer HHs (no. lakh)**	**Non-indebted farmer HHs (no. lakh)**	**Incidence of exclusion by both formal and non formal sources (%)**	**Proportion of non-indebted HHs. (%)**
Marginal	<1.00	589.06	324.04	55.0	70.6
Small	1.01 – 2.00	160.60	78.68	49.0	17.1
Semi-medium	2.01 – 4.00	93.50	39.10	41.8	8.5
Medium	4.01 – 10.00	42.58	14.84	34.9	3.2
Large	10.00 +	7.76	2.60	33.6	0.6
All sizes		**893.50**	**459.26**	**51.4**	**100.0**

2.27 It is discernible that the proportion and level of inability to access credit increases with the decline in size of farm holdings.

Level of Non-indebtedness : Across Social Groups

2.28 The highest levels of non-indebtedness to both formal and non-formal sources is observed among Scheduled Tribes (ST) with 63.7%, followed by Scheduled Castes (SC) with 49.8% as detailed below :

Households	**Sche-duled Tribes**	**Sche-duled Castes**	**Other Backward Classes**	**Others**	**All**
Total no. of farmer HHs (lakh)	119.24	155.93	370.43	247.90	893.50
Non-indebted farmer HHs (lakh)	75.94	77.60	179.96	125.76	459.26
Proportion of non-indebted farmer HHs (%)	63.69	49.77	48.58	50.73	51.40

2.29 Incidence of financial exclusion among all non-cultivator households was estimated at 78.2% which comprises of 78.8% of agricultural labourer households, 71.4% of artisans and 79.7% of other rural households. Out of 5.96 crore non-cultivator households about 4.66 crore were estimated to be financially excluded. The number of non-cultivator households affected by financial exclusion was the highest for 'others' category (2.44 crore), followed by agricultural labourer households (1.67 crore) and artisans (0.55 crore) as detailed below :

Households	Agricul-tural labourers	Artisans	Others	Total non-cultivators*
Number of households (crore)	2.12	0.77	3.06	5.96
Number of households facing financial exclusion (crore)	1.67	0.55	2.44	4.66
Incidence of financial exclusion(%)	78.80	71.40	79.70	78.20

* Agricultural labourers, artisans, others (as per National Classification of Occupations, 1968)

Data based on AIDIS Report on Household Indebtedness in India (59th round), NSSO.

Scheduled Commercial Banks 2005 – Credit Gap – District Level Estimate

2.30 According to Basic Statistical Returns of Scheduled Commercial Banks 2005 (including RRBs), there were 77 million credit accounts and 467 million deposit accounts. Of the credit accounts, 98% were extended to individuals (including partnership, proprietary concerns and joint families). Of the deposit accounts, 28% were term deposits while 72% were current or savings deposits.

2.31 The RBI had also attempted an analysis of the district-wise gaps in financial inclusion by Scheduled Commercial Banks disaggregated by population group features (viz., rural, semi-urban, urban and metropolitan). As the preponderance of financially excluded population occurs in rural and semi-urban areas, the analysis lays primary focus on this group. To arrive at the gaps in financial inclusion, the district-wise population and the number of credit accounts held by the scheduled commercial banks, separately for the rural and semi-urban branch offices were taken. Taking the difference of per branch population and per branch credit accounts, the gaps in financial inclusion, are estimated.

2.32 The Committee has perused the analysis made by RBI. It agrees with the view that the inter-district variations are much sharper vis-à-vis the inter-State variations, which is only to be expected, taking into account the huge regional disparities in development indices.

2.33 For the purpose of addressing the issue of critical exclusion, the Committee identified those districts where the exclusion is most severe. For the same, it identified two parameters – districts with :

- Per branch rural and semi-urban population above 19,272 (AI average) ***and***
- Credit Gap +95%

2.34 This analysis revealed that out of 583 districts, as many as 256 districts (spread over 17 States and 1 UT) fall in the above category. Almost all the major

States in the North-Eastern, Eastern and Central Regions are affected as well as a few districts in States like Gujarat, Rajasthan and Maharashtra. The district-wise, State-wise particulars are indicated in Annexure I. A summary of the analysis is provided in the following table :

Sr. No.	State	No. of districts	Range of credit gap (%)
1	Arunachal Pradesh	5	99.3 – 98.3
2	Assam	19	98.5 – 96.1
3	Bihar	37	98.6 – 95.0
4	Chhattisgarh	15	98.0 – 96.5
5	Dadra & Nagar Haveli	1	97.6
6	Gujarat	7	98.1 – 95.7
7	Haryana	5	96.9 – 95.4
8	Jharkhand	12	97.8 – 95.6
9	Madhya Pradesh	30	98.3 – 95.3
10	Maharashtra	20	98.0 – 95.1
11	Manipur	9	99.2 – 97.9
12	Meghalaya	1	99.0
13	Mizoram	1	98.3
14	Nagaland	6	99.3 – 98.2
15	Orissa	2	95.3 – 95.2
16	Rajasthan	14	97.8 – 95.2
17	Uttar Pradesh	58	98.6 – 95.1
18	West Bengal	14	97.1 – 95.2
	Total	**256**	

Note : The above analysis considers only commercial banks (including RRBs). Co-operatives (which have a strong presence in Gujarat, Maharashtra and Rajasthan) are not covered.

Source: Analysis by DESACS, RBI, New Delhi

Summing up

2.35 *Extent of Exclusion – NSSO Survey 59th Round*

(a) General :

- 51.4% of farmer households are financially excluded from both formal / informal sources (459 lakh out of 893 lakh).
- Of the total farmer households, only 27% access formal sources of credit; one third of this group also borrow from non-formal sources.
- Overall, 73% of farmer households have no access to formal sources of credit.

(b) Region-wise :

- Exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64% of all financially excluded farmer households (from formal sources) in the country (415.61 lakh households out of 649.54 lakh households).Overall indebtedness to formal sources of finance alone is only 19.66% in these three regions (4.09% for North-Eastern Region, 18.74% for Eastern Region and 22.41% for Central Region).

(c) Occupational Groups :

- Marginal farmer households constitute 66% of total farm households. Only 45% of these households are indebted to either formal or non formal sources of finance (small farmers – 51%, medium farmers – 65.1% and large farmers – 66.4%).
- About 20% of indebted marginal farmer households have access to formal sources of credit (medium farmers – 57.6% and large farmers – around 65%).
- Among non-cultivator households nearly 80% do not access credit from any source.

(d) Social Groups :

- Only 36% of ST farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.

2.36 Analysis of the data provided by the Basic Statistical Returns of Scheduled Commercial Banks reveal that critical exclusion (in terms of credit) is manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95% and above. This is in respect of commercial banks and RRBs. Credit coverage by cooperatives is also on a relatively low level, as nearly 62% of its members are non-borrowing members.

2.37 While NSSO and BSR data (as indicated above) show critical exclusion as manifest in certain regions and social / economic groups, there are other sets of data which show a different picture. As per CMIE (March 2006), there are 11.56 crore land holdings. 5.91 crore KCCs have been issued as at the end of March 2006, which translated into a credit coverage of more than 51% of land holdings by formal sources. Further data with NABARD on the doubling of agricultural credit indicates that agricultural loan disbursements during 2006-07 covered 3.97 crore accounts.

2.38 Thus, there are different estimates of the extent of inclusion thru' formal sources. Further, the reference period of the data is also not uniform – the BSR statistics take 2004 as the base, CMIE 1995 (published March 2006), while NSSO covers position during 2003. Consequently, this has had an impact on quantifying the extent of levels of exclusion. RBI / NABARD should look into this aspect and study the reasons for such large differences arising in the estimate of levels of exclusion.

2.39 However, notwithstanding such differences in the data available, what can be stated with certainty is that exclusion exists – to a large extent among specific occupational groups, specific social groups and in specific regions, either in isolation or in conjunction. It is, therefore, imperative to roll out an action plan to cover the highly excluded areas / regions in a very definite, time-bound manner. Towards realizing this objective, the Committee recommends formulation of a National-level Action Plan, which is discussed in the next Chapter.