EXECUTIVE BOARD MEETING

SM/15/26
Correction 2

March 9, 2015

To: Members of the Executive Board

From: The Secretary

Subject: **India—Selected Issues**

Board Action: The attached correction to SM/15/26 (1/30/15) has been provided by the staff:

Evident Ambiguity **Page 57**

Questions: Mr. Cashin, APD (ext. 36104)
Ms. Jain-Chandra, APD (ext. 35881)
Mr. Tulin, APD (ext. 34938)

FINANCIAL INCLUSION AND ACCESS IN INDIA: ANALYSIS USING A STRUCTURAL MODEL[1]

Greater financial inclusion and enhanced access to credit have been longstanding policy objectives in India. Concerted policy efforts have been made towards these objectives, such as increasing access to the formal financial system by the agricultural sector and small and medium-size enterprises. This chapter examines India's efforts at financial inclusion and related outcomes, and then analyzes the effect of greater financial access on macroeconomic indicators, such as GDP growth, as well as inequality and financial stability using a micro-founded general equilibrium model.

1. **While India scores well on creating an enabling environment for financial inclusion, outcomes lag peer countries**. On the household side, survey data indicate that ~~only 35 percent of adults have bank accounts (compared with 60 percent average for BRICs)~~about 59 percent of households had bank accounts at the time of the 2011 Census of India. Furthermore, there is considerable variation across the population, as people in rural areas, women and low-income individuals are even less likely to be part of the formal financial system. Furthermore, despite increasing financial deepening (measured by the credit-to-GDP ratio), access to credit has improved mostly for relatively large firms, indicating that smaller firms face constraints in accessing finance. As a result, potential entrepreneurs do not have access to working capital and investment funding at reasonable rates, dragging down growth. Despite having the Priority Sector Lending program in place to channel resources to SMEs (as well as agriculture), ninety percent of small firms do not have access to bank services (Mor Committee, 2014). Tackling financial exclusion, as well as addressing inequality more broadly, has been an important policy priority in India for many years (Box 1). This chapter focuses on firms' access to finance, given the absence of detailed financial data at the household level, and models different constraints and the impact of removing them on growth and inequality.

Model Description and Data

2. **Obstacles to financial inclusion in emerging market and developing countries vary and can be grouped into three broad categories:**

- **Access barriers**. These typically reflect high documentation requirements by banks for opening, maintaining, and closing accounts, and for loan applications. Also they reflect various forms of immeasurable rationing, including red tape and the need for informal guarantors as connections to access finance. These obstacles increase the cost of participation in the financial system.

[1] Prepared by Era Dabla-Norris, Sonali Jain-Chandra, D. Filiz Unsal and Eva Van Leemput.