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Modi Government Makes Great Stride in FINANCIAL DEEPENING

SKOCH Research

By Sameer Kochhar

I have been analysing and writing on the issues related to financial inclusion for more than two decades. The National Sample Survey of 2005 drew the media and the policymakers' attention to the issue of financial exclusion. As per the survey report, just around 27 per cent of farm households had access to formal sources of finance.

The objective of Financial Inclusion is poverty alleviation. Data in India needs to be more comprehensive, accessible and reliable. Every report starts a raging debate on the number of poor, the number of jobs, the state of inequality, etc. Most of my work over the past decades relates to out-of-the-box macro research and co-relating the same with actual primary field research and case studies. I find not-so-obvious evidence that shows what is working and what is not.

In February 2011, the Swabhimaan scheme was launched to ensure basic banking services to unbanked villages with a population of 2,000 and above by March 2012. I have noted the reasons for the sub-optimal performance of the Swabhimaan scheme in my book 'Defeating Poverty: Jan Dhan and Beyond'.

Some of these problems were addressed in Pradhan Mantri Jan Dhan Yojana, launched in August 2014. The Jan Dhan scheme proved immensely successful in providing access to banking services to the unbanked section of society. As per my study, the credit outreach gap was reduced by 14.64% under Modi Government (Rangarajan methodology).

But did it have any outcomes that can be measured?

Financial Deepening

Financial deepening captures the financial development relative to the economy. It has three broad parameters – depth, access and efficiency. Depth takes into account the size and liquidity of markets. Access refers to the ability of individuals or firms to access financial services. Efficiency denotes the ability of institutions to provide financial services at low cost and with sustainable revenues and the level of activity of capital markets.

Financial deepening may be defined as increasing the size, scope, and access to a country's financial system. It entails the growth and diversification of a country's financial markets and instruments. Financial deepening is observed through increased financial intermediation, expanded financial markets, and improved financial infrastructure.

In 2012, the World Bank sought to benchmark the financial systems around the world; in the process, they developed an index to measure the Financial Depth of an economy. Financial depth is divided into two areas: Financial Institutions and Financial Markets.

Academic evidence has shown that the development of financial institutions and financial markets significantly impacts economic growth, poverty reduction and economic stability. The combination of multiple factors assessing the progress of Financial Institutions and Markets leads to the Financial Deepening Score, a metric that measures the financial depth of an economy.

Indicators

There are several aspects and instruments of financial development. It includes depth and development of stock markets, mutual funds, insurance and bank credit. The following are key indicators of financial deepening:

- Mutual Funds AUM to GDP (%)
- Pension Funds AUM to GDP (%)
- Insurance Premium (Life and Non-Life) Volume to GDP (%)
- Private Sector Credit to GDP (%)
- Stock Market Capitalization to GDP (%)
- Stocks Traded to GDP (%)
- International Debt Securities Government to GDP (%)
- Total Debt Securities of Non-Financial Corporations to GDP (%)
- Total Debt Securities of Financial Corporations to GDP (%)

Measurement

The progress in financial deepening can be measured through a score. I call it the 'Financial Deepening Score'. This score is based on our over two decades of research in this sector and is also in line with the global standards and formula used by the World Bank.

I have broadly divided it into two areas: (1) Financial Institutions and (2) Financial Markets.

Financial institutions include progress in the areas of Mutual Funds, Pension Funds, Insurance Premium and Private Sector Credit. In comparison, financial markets include the progress in the areas of Stock Market Capitalisation, Stocks Traded, International Debt Securities Government, Total Debt Securities of Non-Financial Corporations and Total Debt Securities of Financial Corporations.

Both financial institutions and markets are key components of the financial system and play a crucial role in the country's economic development. Financial Institutions and Markets scores are taken at an equal weightage to determine the Financial Deepening Score.

Financial Institutions act as intermediaries between lenders and borrowers, they also provide a wide range of financial services, such as banking, insurance, pensions, and investment opportunities. The indicators taken under Financial Institutions form the Financial Institutions Score. The indicators and the respective weights are:

- Mutual Fund Assets Under Management (% of GDP) – 0.25
- Pension Fund Assets Under Management (% of GDP) – 0.23
- Total Insurance Premium (Life and Non-Life) (% of GDP) – 0.25
- Private Sector Credit (% of GDP) – 0.27

Financial Markets are platforms where individuals, organisations, and governments buy and sell financial instruments such as stocks, bonds, currencies, derivatives, and other securities. Financial Markets assist the economy through liquidity provision and capital formation. The indicators taken under Financial Markets form the Financial Markets Score. The indicators and the respective weights taken are:

- Stock Market Capitalization (% of GDP) – 0.25
- Stocks Traded (% of GDP) – 0.23
- International Debt Securities Government (% of GDP) – 0.04
- Total Debt Securities of Non-Financial Corporations (% of GDP) – 0.23
- Total Debt Securities of Financial Corporations (% of GDP) – 0.25

Progress under Modi

Since 2013-14, India has experienced considerable financial deepening, leading to increased access to financial services, enhanced capital formation, poverty reduction, and overall long-term economic development. The above graph shows India's progress in the realm of financial deepening. In 2013-14, the Financial Deepening Score of India was at 19.71, followed by minor fluctuations and slight improvements till 2018-19, when the Financial Deepening Score stood at 23.85. The pandemic caused the Financial Deepening Score to reduce to 21.07; however, since then, India has seen a significant improvement in the Financial Deepening Score, moving from 21.07 in 2019-20 to 32.2 in 2020-21. In 2021-22, the Financial Deepening Score stood at 31.85. From 2013-14 to 2021-22, the Financial Deepening Score increased by 61.6%.

There was a very sharp jump in the Financial Deepening Score during 2020-21. The score increased from 21.07 in 2019-20 to 32.20 in 2020-21. This is an unprecedented surge. This figure particularly intrigued me. The financial year 2020-21 was the worst hit due to COVID-19 pandemic and the lockdowns. It was not a normal year. It was the year when human beings faced one of the worst crises. Almost all major economies contracted during the year.

India's gross domestic product (GDP) at constant (2011-12) prices witnessed a contraction of 6.6 per cent during the year. At the same time, the nominal GDP or GDP at current prices witnessed a contraction of 1.4 per cent during the year. I have based my calculations on the current prices. A question can be raised, does the Financial Deepening Score for 2020-21 look impressive because of the contraction in GDP?

The above graph presents a comparative analysis of the Financial Deepening Score. The original score is based on the actual GDP data at current prices. The GDP in 2020-21 was lower than 2019-20 as there was a contraction in the economy due to the COVID-19 pandemic. For the sake of analysis, let's assume that 2020-21 is a normal year with around 14 per cent of GDP growth at current prices, and similar growth continues in 2021-22.

The line in white is based on assuming 14 per cent GDP growth for both 2020-21 and 2021-22 at current prices. While for 2020-21, the Financial Deepening Score comes down to 28.31 when we take the assumptive GDP with 14 per cent growth from the original score of 32.20 for the financial year 2021-22. The figure looks slightly better for 2021-22. It rises to 29.53 per cent in 2021-22 based on nominal GDP growth of 14 per cent during the year. Even if the GDP growth were normal at around 6 to 7 per cent at constant prices or around 14 per cent at the current prices during 2020-21 and 2021-22, the Financial Deepening Score would look impressive. The score in 2021-22 is 49.82 per cent higher compared to the score of 2013-14.

What led to Impressive Improvement in Financial Deepening Score?

The Financial Deepening Score is the result of several factors. As I have mentioned above in this paper, financial deepening results from two broad factors – financial institutions and financial markets. There has been progress in both these segments. However, the surge in the Financial Markets Score is sharper.

Financial Institutions

The development of Financial Institutions has been assessed through indicators such as the progress of Mutual Funds, Pension Funds, Insurance Premiums, and Private Sector Credit, all relative to the GDP. The combination of Mutual Funds, Pension Funds, Insurance Premiums, and Private Sector Credit forms the Financial Institutions Score. The Financial Institutions Score has slightly improved, going from 15.34 in 2013-14 to 17.42 in 2021-22. The sudden jump seen in 2020-21 is due to the contraction of the economy due to the pandemic that inflated certain values. The major contributors to the progress are Pension and Mutual Funds, with Non-Life Insurance and Household Sector credit also slightly contributing.

Financial Markets

The development of Financial Markets has been assessed through indicators such as Stock Market Capitalization, Stocks Traded, International Debt Securities Government, and Total Debt Securities of Financial and Non-Financial Corporations. The Financial Market Score improved slightly from 2013-14 to 2018-19, going from 24.08 to 31.42. However, the pandemic saw the Financial Markets score reduce to 25.99. However, the Financial Markets Score significantly increased from 25.99 to 46.07 from 2019-20 to 2020-21. The significant increase in the Financial Markets is mainly due to the increased Stock Market Capitalisation and Stocks Traded. Since 2013-14, there is evidence that financial markets have broadened over time.

Conclusion & Way Forward

India has made considerable progress in financial development and deepening since Prime Minister Modi assumed office in 2014. The biggest contributor to the financial deepening in the past nine years is the broadening of financial markets and increased awareness and participation in mutual funds and pension funds.

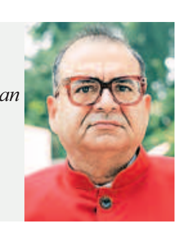
Other major contributors to financial deepening in the nine years between 2013-14 to 2021-22 are the surge in non-life insurance premiums and household sector credit. The external debt taken on by the government has been stable, with the debt securities issued by financial and non-financial corporations moderately fluctuating over time.

However, several areas need attention. Notable among them are private sector credit, especially the credit to micro, small and medium enterprises (MSMEs).

The next part of this study will illuminate how spatially dispersed this deepening is. We are also doing field research and case studies on how various schemes of the Center and States impact equity and quality of growth. Given that jobless growth is a perennial problem, including during the highest growth years under the UPA government, most data leads to a 'he said, she said' kind of argument.

This effort is likely to show the honest and unbiased truth ■

***Sameer Kochhar** is Chairman, **SKOCH Group**, Reforms Historian and an Acclaimed Author of* ModiNomics *and* Defeating Poverty *amongst others.*



INDIA'S HONEST INDEPENDENT ASSESSMENT

SKOCH Summit | 30th September 2023, New Delhi

9 Year Report Card

STATE OF BFSI

The last nine years have been remarkable for Financial Inclusion. The top-level data tells us so. Data that is based on unconventional analysis or global best practices – both point in the same direction.

We find credit outreach gap has reduced by 14.64% since 2014 (Rangarajan methodology), and the Financial Deepening Score (World Bank Methodology) has increased by 61.6% in the same period.

It is time to correlate that with ground-level performance and case studies to present the quality of this growth in perspective.

Ours was the first research that showed the job-generative impact of Pradhan Mantri Mudra Yojana in September 2017. There were no statistics available at the time. We were able to do the study based on our ongoing assessment of the BFSI sector, data gathered directly and our field research.

The findings were tweeted by the Hon'ble Prime Minister and even used in Parliamentary replies. Subsequent reports that appeared years later confirmed our findings.

We have started a similar exercise to see the ground covered by BFSI in the past nine years and look forward to active participation in this Honest and Independent Assessment of the sector.

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