

Financial Inclusion and Social Inclusion in India: A Theoretical Exploration of their Interrelationship

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ABSTRACT

Inclusive development has become an important issue in today's development discussions, especially in developing countries like India. While financial inclusion and social inclusion are widely acknowledged as key to promoting fair growth, they are often studied separately in academic literature and policy discussions. This separation risks ignoring the complex relationship between access to financial services and broader social participation. This paper explores the connection between financial inclusion and social inclusion, focusing on India. Using the Capability Approach, Social Exclusion Theory, and Institutional Theory, the study views financial and social inclusion as connected processes instead of separate policy goals. A framework is created to show the two-way relationship between financial and social inclusion and to highlight important factors that influence this connection. By redefining inclusion as a relational and institutional process, this paper adds to the literature on inclusive development and suggests directions for future research and integrated policy development.

Keywords: Financial Inclusion, Social Inclusion, Inclusive Development, Capability Approach, Institutional Theory, India

1. INTRODUCTION

Inclusive development has become a key focus for public policy and academic research, especially in countries experiencing rapid economic growth along with ongoing inequality. Even though economic growth has helped reduce poverty, it hasn't ensured that everyone has fair access to opportunities, resources, and participation in institutions. Ongoing gaps based on income, gender, caste, education, and location continue to create exclusion, highlighting the limitations of growth-focused development models (Atkinson & Marlier, 2010; Sen, 1999). In this context, financial inclusion and social inclusion are essential components of inclusive development.

Financial inclusion involves ensuring that individuals and businesses, especially those usually excluded from the formal financial system, can access affordable and appropriate financial services (World Bank, 2018). These services generally include savings, credit, insurance, and payment options. Recent research shows that financial inclusion goes beyond just having an account. It includes ongoing use, affordability, service quality, and consumer protection (Demirgüç-Kunt et al., 2015). As a result, financial inclusion is

increasingly seen as a way to boost economic participation, lower vulnerability, and enhance household well-being.

On the other hand, social inclusion is a broad concept that focuses on individuals' and groups' ability to fully participate in social, economic, and political life with dignity and equality (Silver, 2015). Social exclusion stems from systematic disadvantages rooted in historical inequalities, institutional discrimination, and established social hierarchies. In India, social exclusion occurs through caste-based marginalization, gender inequality, differences between rural and urban areas, and regional disparities, despite constitutional protections and targeted welfare efforts (Thorat & Newman, 2010).

Despite being significant topics in development discussions, financial inclusion and social inclusion are often treated as separate objectives. Financial inclusion efforts usually concentrate on increasing access to formal financial systems, while social inclusion frameworks focus on empowerment, participation, and equal opportunities. This separation obscures the interconnected nature of these processes. Financial exclusion can worsen social exclusion by limiting economic agency and participation, while social exclusion can hinder access to and effective use of financial services due to low education, weak social networks, and institutional bias (Leyshon & Thrift, 1995; Sen, 2000).

India provides a compelling case study for examining this relationship. In the last decade, the country has rolled out large-scale financial inclusion initiatives, including the Pradhan Mantri Jan Dhan Yojana (PMJDY), Aadhaar-based identification, and direct benefit transfers. While these efforts have significantly improved access to formal financial services, patterns of usage and outcomes still vary across different social groups (Reserve Bank of India, 2022). This raises questions about whether financial inclusion alone is enough to create real social inclusion.

To address this gap, this paper takes a theoretical approach to explore the relationship between financial inclusion and social inclusion in India. The study develops a framework that illustrates the two-way relationship between financial and social inclusion and identifies key institutional and digital factors that influence this connection.

1.1 Theoretical Contribution of the Study

Although previous literature has thoroughly examined financial inclusion and social inclusion as separate goals, there has been little focus on their conceptual interconnection. Many studies on financial inclusion assume that improved access to financial services will automatically lead to greater social inclusion outcomes. On the flip side, research on social inclusion often highlights empowerment and participation without clearly considering the role of financial systems as tools for inclusion.

This study adds to the literature in three main ways. First, it redefines financial inclusion and social inclusion as mutually reinforcing processes instead of separate or sequential outcomes. Second, it presents a framework that explicitly identifies how financial and social inclusion are connected and emphasizes the influence of social and institutional factors on inclusion results. Third, by using India as a case study, which has wide financial access but persistent social inequality, the paper provides insights applicable to other emerging economies seeking inclusive strategies. In doing so, the study supports theory-building on inclusive development and lays the groundwork for future empirical research.

2. THEORETICAL FOUNDATIONS OF FINANCIAL AND SOCIAL INCLUSION

To understand the link between financial and social inclusion, one needs a theoretical approach that considers both individual choice and systemic limitations. This study applies the Capability Approach, Social Exclusion Theory, and Institutional Theory to define inclusion as a multi-faceted and relational

journey.

2.1 Capability Approach

The Capability Approach, developed by Sen (1999), views development as the growth of individuals' freedoms—their capability to lead fulfilling lives. In this view, just having access to resources isn't enough; what matters is people's ability to transform resources into meaningful results. Financial inclusion boosts capabilities by allowing individuals to manage risks, invest in education and healthcare, and engage in productive economic activities. Access to savings, credit, and insurance enhances financial security and personal independence, thus expanding individual choice.

Social inclusion is a key part of the capability framework since participation, dignity, and freedom from discrimination are essential for well-being. Groups that experience social exclusion often face obstacles that limit their ability to turn financial access into tangible benefits. The capability approach highlights the interlinked nature of financial and social inclusion and stresses the need for supportive social and institutional measures.

2.2 Social Exclusion Theory

Social exclusion theory looks at how certain individuals or groups are systematically pushed out of economic, social, and political systems (Silver, 2015). Financial exclusion is a key part of social exclusion, as not having access to formal financial services limits involvement in the broader economy. Meanwhile, social exclusion—evident in low educational levels, weak social networks, and discrimination—restricts individuals' ability to access and make effective use of financial services (Leyshon & Thrift, 1995).

2.3 Institutional Theory

Institutional theory highlights the impact of formal and informal institutions on inclusion results. Regulatory frameworks, governance quality, and consumer protections affect access to financial services, while informal institutions like trust and social norms influence interactions with these systems. The quality of institutions plays a significant role in shaping the relationship between financial and social inclusion, especially in contexts with uneven governance capacity.

Together, these theoretical perspectives challenge access-oriented views of inclusion, emphasizing the relational and institutional aspects of inclusive development.

3. CONCEPTUALIZING FINANCIAL INCLUSION

Financial inclusion involves both access to and effective use of formal financial services. In India, it has been promoted as a way to reduce poverty, empower individuals, and improve welfare. However, ongoing issues like inactive accounts, low financial literacy, and a lack of trust in institutions show that just having access doesn't guarantee meaningful inclusion. These challenges underline the need to view financial inclusion within broader social and institutional settings.

4. UNDERSTANDING SOCIAL INCLUSION

Social inclusion is the process through which individuals and groups access the resources, opportunities, and institutions needed for full participation in society. In India, social exclusion results from caste hierarchies, gender roles, educational gaps, and geographic isolation. Education, social networks, and trust in institutions significantly influence how individuals engage with formal systems, including financial institutions.

5. FINANCIAL AND SOCIAL INCLUSION IN THE INDIAN CONTEXT

India serves as an important example for understanding the link between financial and social inclusion. The country has nearly universal financial access but still faces ongoing social exclusion. Initiatives like PMJDY and digital public infrastructure have changed the nature of exclusion. They have shifted the barriers from physical access to issues like ability, trust, and the role of institutions. This situation makes India a valuable context for examining why financial inclusion efforts might lead to uneven social outcomes.

6. CONCEPTUAL FRAMEWORK AND PROPOSITIONS

This study views financial inclusion and social inclusion as processes that support each other.

Financial Inclusion -> Social Inclusion:

Access to financial services boosts economic participation, risk management, and individual agency, which in turn promotes social inclusion.

Social Inclusion -> Financial Inclusion:

Education, social connections, and trust in institutions linked to social inclusion help people access and effectively use financial services.

Propositions

P1: Financial inclusion positively affects social inclusion by increasing economic participation and individual agency.

P2: Social inclusion positively affects financial inclusion by lowering structural and institutional barriers.

P3: The quality of institutions and digital abilities influence how financial inclusion and social inclusion relate to each other.

7. POLICY IMPLICATIONS

The analysis suggests that treating financial inclusion as a goal in itself may lead to only symbolic or incomplete inclusion. Expanding access without tackling social and institutional issues may improve formal metrics but leave exclusion patterns mostly unchanged. Effective strategies for inclusion need to connect financial sector policies with wider social development efforts, especially those that focus on education, digital skills, and trust in institutions.

8. CONCLUSION AND FUTURE RESEARCH DIRECTIONS

By rethinking financial inclusion and social inclusion as connected and mutually supportive processes, this paper critiques isolated approaches to inclusive development. The framework highlights that just having access is not enough; real inclusion relies on people's abilities and the institutional environments where financial systems function. Future research should test the propositions from this study and explore how digital and institutional factors shape inclusion outcomes in various socio-economic contexts. For policymakers, this study highlights the importance of moving beyond strategies focused only on access and developing integrated frameworks that address both the financial and social aspects of exclusion.

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