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Financial Services and Financial Inclusion for Sustainable Development*

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Financial services and financial inclusion for sustainable development

Financial inclusion, central to poverty reduction and to inclusive and sustainable development, is a driver for the post-2015 development agenda. The use of new technologies and innovative business models exhibited a large potential in overcoming access barriers. Governments have an important role in setting up sound regulatory frameworks and conditions to extend supply and affordability of services, to ensure that financial services remain supportive of the real economy, and creating an expanded demand for financial services, such as through financial education and empowerment. Actions towards financial inclusion could contribute to facilitated, speedier, safer and less costly transfer of remittances, the importance of which is also recognised on sustainable development goals.

The importance of financial services is manifold. As infrastructure services, they provide valuable inputs to the economy at large. Through banking, securities and insurance services, financial services facilitate domestic and international transactions, mobilise and channel domestic savings and broaden the availability of credit for firms, including small and medium enterprises (SMEs), and households. As an economic sector in its own right, financial services contribute to output and employment, with several activities having high value added and requiring qualified jobs.

Financial inclusion, defined as the effective access and use by individuals and firms of *affordable and sustainable* financial services from formal providers, can contribute to poverty reduction and economic and social development. This importance has been recognised by the Open Working Group proposal for the Sustainable Development Goals (SDGs) which made access to financial services a component in several targets (see box). The General Assembly has already decided that this proposal is the main basis for the post-2015 intergovernmental process. Furthermore, the synthesis report from the United Nations Secretary-General on the post-2015 sustainable development agenda states the relevance of ensuring that all people across income and geography, including women, persons with disabilities, youth, the aged, migrants and other groupings have access to financial services, underlining the importance of equal access for women and girls. Access to financial services is therefore expected to be acknowledged as a driver for development in the post-2015 development agenda.

Key points:

- Effective use and access of affordable and sustainable financial services contributes to poverty reduction and economic and social development;
- Financial inclusion contributes to facilitated, speedier, faster and less costly remittances;
- Innovative business models and new technologies have large potential in overcoming access barriers;
- Governments have a central role in the policy mix and regulatory framework to extend supply and affordability of services, and to expand demand for financial services, towards financial inclusion.

<u>Sustainable Development Goals and Access to Financial Services</u>

Access to financial services is mentioned throughout the Open Working Group proposal as an element to achieve several goals. To end poverty in all its forms everywhere (goal 1), it is necessary that, by 2030, all men and women, in particular the poor and the vulnerable, have among other things access to financial services (1.4). This access is also included in the target to double agriculture productivity and incomes of small-scale food producers, in particular women, indigenous peoples, family farmers, pastoralists and fishers (2.3), towards ending hunger, achieving food security and improved nutrition and promoting sustainable agriculture (goal 2). To achieve gender equality and empower all women and girls (goal 5), it is proposed to undertake reforms to give women equal rights to, *inter alia*, access to financial services (5.a).

To promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all (goal 8), access to financial services is included in development-oriented policies that should be promoted to support productive activities, decent job creation, entrepreneurship, creativity and innovation, and to encourage the formalization and growth of micro-, small- and medium-sized enterprises (8.3). The capacity of domestic financial institutions should be strengthened to encourage and expand access to banking, insurance and financial services for all (8.10). Increase access of small-scale industrial and other enterprises, in particular in developing countries, to financial services, including affordable credit (9.3), is also proposed to build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation (goal 9).

Lack of access to financial services can represent a major impediment to income opportunities and economic welfare of individuals, particularly for the poor, women and youth, rural populations, migrants and those engaged in the informal economy, as well as for firms, particularly SMEs and microenterprises. In 2014, 61 per cent of people over 15 years old held an account with a formal financial institution. Women, with 57 per cent, and youth, with 45 per cent, are worse off. Although this represents a great improvement with respect to 2011 (51 per cent of people over 15 held an account, with 47 per cent for women and 37 per cent for youth), it is necessary to go much further. Financial services are more available to the 8.4 per cent of the world population that concentrate 83.3 per cent of total wealth, even if the remaining 91.6 per cent, although with modest average wealth holding, represent more than $40 trillion. The share of adults in developed countries with an account with a formal financial institution is more than twice that of developing countries. In developing economies, only 34 per cent of firms take out bank loans, compared to 51 per cent in developed economies.

Financial inclusion and remittances

Actions towards financial inclusion could contribute to facilitated, speedier, safer and less costly transfer of remittances. Such reduction in costs can in fact be promoted for instance by regulation promoting interoperability, shared infrastructure, the combined use of banking, postal and telecommunication networks, competition policies, financial infrastructure as payment systems, and transparency on transfer costs. This is important from a development perspective as a 10 per cent rise in remittances may contribute to 3.5 per cent reduction in the share of people living in poverty, and it is estimated that a 5 per cent reduction on remittances transfer costs could yield $15 billion in savings. This is recognised by the SDGs proposal, through target 10.c to reduce costs to less than 3 per cent of remittances and eliminate corridors with costs higher than 5 per cent by 2030, and also underlined in the synthesis report from the United Nations Secretary-General on the post-2015 sustainable development agenda. Financial services such as savings, loans and insurances, are also important to maximise the development role of remittances by facilitating options to invest these private funds in productive activities, social services and infrastructure. These investment options may comprise diaspora funds and this channelling may be enhanced through financial education and tax and credit incentives. As indicated in Table 1, remittances represent a relatively stable source of revenue for recipient countries and support their development. On the other hand, remittances represent a promising source of demand for financial services and may thus contribute to financial inclusion.

Table 1: Personal remittances receipts as percentage of GDP by type of economy, 2008-2013

	2008	2009	2010	2011	2012	2013
Developed	0.3	0.3	0.3	0.3	0.3	0.3
Transition	1.4	1.7	1.4	1.4	1.4	1.4
Developing	1.8	1.7	1.6	1.5	1.5	1.5
Africa	3.4	3.3	3.3	3.2	3.3	3.2
America	1.5	1.4	1.2	1.1	1.1	1.1
Asia	1.7	1.6	1.5	1.5	1.4	1.4

Source: UNCTADStat

Barriers and strategies for financial inclusion

Several barriers of access to financial services were identified, encompassing lack of money, irregular income, unemployment, costs, ownership of an account by a family member, distance and low connectivity, documentation constraints, lack of trust, lower education or financial literacy, and low availability of financial providers. Efforts towards the identification of barriers and determinants of financial inclusion are important to design policy responses.

Innovative business models emerged, addressing barriers to access to financial services and creating new business opportunities. State-owned, cooperative, development and community banks proved to be particularly amenable in extending access to finance to a broader range of untapped population and income groups. These banks, including as examples cited the Brazilian Development Bank (BNDES) and cooperative models in China, northern Italy, Germany and Switzerland, support productive investment, promote competition, and have contributed to proven resilience in compensating credit crunch. New payment technologies and the use of banking correspondents enable the combined use of banking, postal and retail networks to expand coverage and reduce costs in the provision of financial services. The banking correspondent models range from cash-merchants to full-fledged banks, with associated proportional adjustments in regulation. The postal bank in Brazil opened 10 million accounts in 10 years and it is estimated that 1 billion people in over 50 countries are banked through postal systems.

New technologies may reduce physical and economic barriers to access financial services improving enabling infrastructure readiness such as interconnection platforms, and identification and authentication systems. Technology also allows for new payment systems and networks, including mobile money schemes that capitalize on mobile telephony uptake to offer a variety of financial services with lower infrastructural costs, increase coverage and that tend to be more gender neutral and youth friendly. An often cited example is M-PESA in Kenya that had, at the end of March 2012, 15 million active customers. These services can contribute to remittances by making viable the transfer of small amounts, provide information enabling the assessment of credit risk, and increase willingness to save by making available data analytics on customer's financial lives. Depending on a critical mass of users and on the specific regulatory environment, mobile money schemes are not a panacea for financial inclusion. Operations are limited by low levels of liquidity in agents, and some are less suitable for the elderly and some people with disabilities.

The regulatory focus for digital financial services should be in promoting network interoperability, enabling innovation without prescribing a specific bank or telecom centric model, licensing for a level playing field, and address information security risks. The coordination between different regulators is important and applies to the interaction between financial and telecom regulators and also to the interaction between regulators of different countries. Standardization of systems used in digital financial services businesses is important as the fragmentation of standards entails risks to the proliferation of technology that requires economies of scale. Decisions on technology convergence or coexistence should ensure that standards do not become barriers for developing-country operators to participate and serve their populations.

The central role of public policy mix and regulatory frameworks

Furthermore, financial services have market failures. When not adequately regulated, information asymmetry or poor consumers' protection laws could result in undersupply of credit to particular population groups and cause excess supply and indebtedness to others. Imperfect competition could lead to market concentration, raising costs and market segmentation, with resultant undersupply in rural areas, for the poor, and for the economy in general. Undiversified financial sectors could be vulnerable to external shocks and disrupt stable supply. These market failures point to the importance of sound regulations to promote effective financial inclusion, universal access, and competition. For instance, microfinance is credited with providing financial services to underserved segments, although with risks of microcredit oversupply and over indebtedness.

Governments can play an important role in financial inclusion by developing a sound regulatory and institutional framework that envisages efficient markets and equitable and affordable access to financial services, and moving from principles to specific actions. A tailored and comprehensive policy mix towards financial inclusion should include building a robust institutional environment and ensuring adequate infrastructure, including communications and energy. It should promote technological innovation and the collection and analysis of data towards evidence-based policies. Furthermore, it must promote competition and consumer protection. Governments can also consider direct measures, such as subsidies and mandatory requirements, particularly towards universal access. These may encompass the obligation to offer basic or low-fee accounts such as the no-frills accounts in India, exemptions from some onerous documentation requirements and other universal services obligations. Applying regulation in a proportionate manner by defining differentiated requirements to attend different needs, whenever feasible, is central to support many of these financial inclusion initiatives. In the Philippines, requirements on risk management, capital, liquidity and others were applied in a proportionate way to non-bank providers, with the application of transaction limits and of ring fencing of e-money operations. Policies should also aim at promoting demand through financial literacy and availability of information, including the use of standards for disclosure and transparency; and, when adequate, increasing the use of financial services by the Government. The Reserve Bank of India promotes payment of direct benefit transfers, such as pensions, through electronic transfer.

The regulatory framework should pursue financial inclusion simultaneously with financial integrity and stability. Further research is needed to identify possible synergies or compromises between these regulatory objectives. Trade liberalization also impacts the financial inclusion regulatory framework, specifically in measures related to universal access. In particular, the effective regulation of foreign firms become a salient issue with their substantial presence in domestic financial markets and with the risk of "cherry picking". Therefore, trade liberalization efforts need to be carefully coordinated and synchronized with adequate domestic regulations to promote financial inclusion and stability. A coherent approach that ensures the right to regulate is necessary between multilateral efforts under the Doha Round and parallel liberalization processes such as the Trade in Services Agreement and regional trade agreements (RTAs), including mega-RTAs, which go deeper in influencing domestic regulation.

Regarding credit services, global efforts regarding financial inclusion need to focus on channelling financial resources to the real economy in a sustainable way in both developing and developed countries. The importance of this focus is supported by recent examples, such as the new strong relationship between corporate borrowing and shareholders' pay-outs in the United States, and inter-financial credits much higher than financing used by the real economy in the Euro area. Financial inclusion efforts need to give particular attention to the poor, women, and youth. Although it is necessary to continue supporting all economic activities, policy and regulatory frameworks should aim in particular towards higher value added economic activities. In this context, the adoption of financial inclusion policies by decision makers, together with an enabling mix of macroeconomic, trade, industrial and other policies, needs to ensure that financial services, including savings, credit, insurance and other services, remain in support of the real economy and of the SDGs in the post-2015 world.

References

For more on this topic and references, refer to the following documents, available at http://unctad.org/en/pages/MeetingDetails.aspx?meetingid=495:

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