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# THE IMPACT OF ACCESS TO FINANCIAL SERVICES, INCLUDING BY HIGHLIGHTING THE IMPACT ON REMITTANCES ON DEVELOPMENT: ECONOMIC EMPOWERMENT OF WOMEN AND YOUTH

*12-14 November 2014*

## PRESENTATION OF THE BACKGROUND NOTE

*by*


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## Single-Year Expert Meeting

# Impact of access to financial services, including by highlighting remittances on development: Economic empowerment of women and youth

Background note by the secretariat (TD/B/C.I/EM.6/2)
12-14 November 2014

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# Main topics

**Road map to this analysis on financial inclusion policies / options**

- Trends and issues in financial inclusion
  - Developments in financial services, in remittances, state of play of financial inclusion, obstacles for financial inclusion
- Options to improve access to financial services
  - New technology and mobile money
  - Innovative business models
- Remittances and financial inclusion
  - Development role, costs, maximizing the development impact of remittances
- Policies and regulations
  - Supply side and demand side
- Financial inclusion, trade agreements and regulatory reform
  - Trade policy and regulatory concerns, shift in regulatory focus

# Context

**Financial inclusion and the post-2015 development framework**

Financial inclusion

- Defined as “effective access and use by individuals and firms of financial services from formal providers”
- Is an important element of the post-2015 SDGs & contribute to poverty reduction, and economic and social development
- Increasingly recognised by international fora such as the G20
- In the post-crisis financial regulatory reform, financial inclusion has gathered policy attention along with financial stability and prudential regulation
- Is also important in maximizing the developmental impact of remittances by formalizing their flows, reducing their transfer costs and facilitating their investment into productive activities.

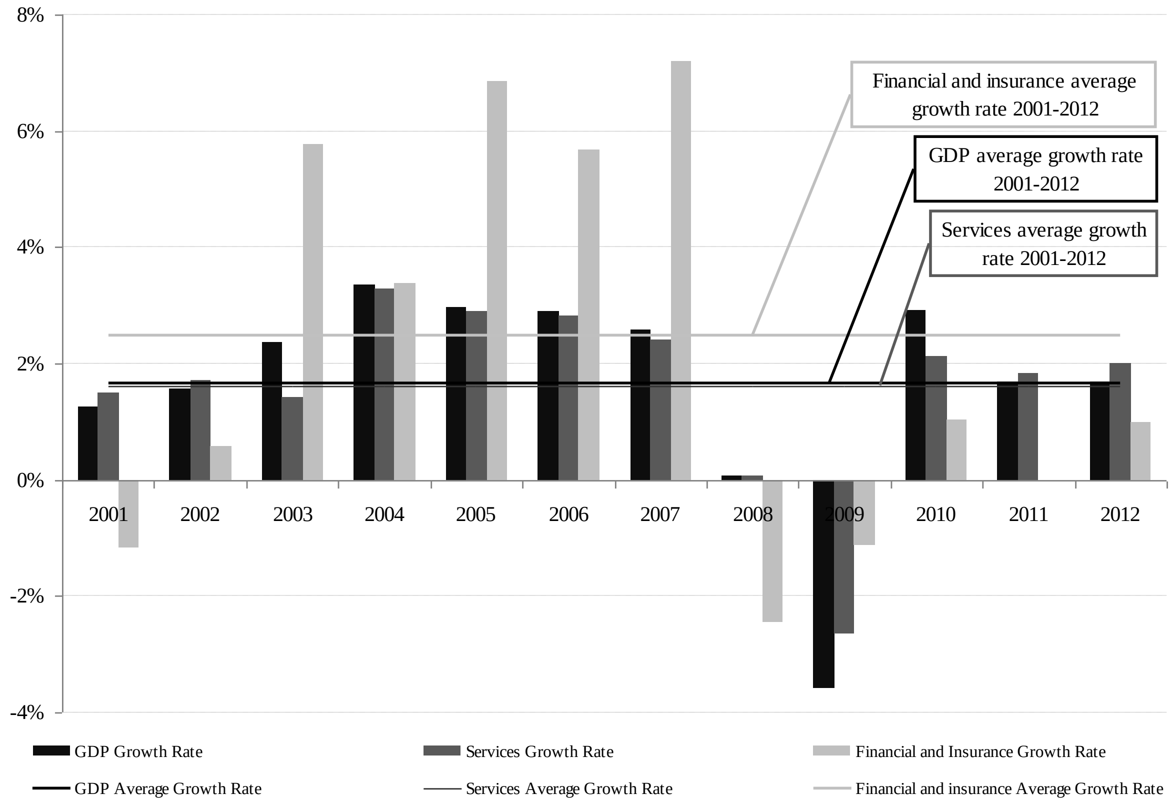
# Developments in financial services

**Financial services can contribute to output and employment**

- Encompass activities with high value added and qualified jobs
- In OECD countries, grew faster than GDP and the overall services sector in the pre-crisis, decelerating afterwards growing less than GDP and the overall services sector after the crisis

OECD countries: annual change in GDP, services and financial services, 2001-2012 (%)

*Source*: UNCTAD based on OECD



# Developments in financial services

**Financial services play an important multidimensional role:**

- Provide inputs for activities in the primary, industrial and tertiary sectors & individuals (as infrastructure services)
- Through banking, securities and insurance services, facilitate domestic and international transactions, mobilize domestic savings and broaden the credit availability
- Facilitate trade (e.g., letters of credit, insurances)

**International flows become important:**

- Cross-border exports in financial services reached around $445 billion in 2013 with an annual growth rate of 10% for 2000-2013
- Developed countries account for 80% of global exports but developing countries exports grew faster (12%). Dcs are still net importers of financial services;
- Asia accounts for 80% of developing countries' exports ($68b 2013);
- The consideration of financial inclusion needs to factor in the increasing trade in financial services

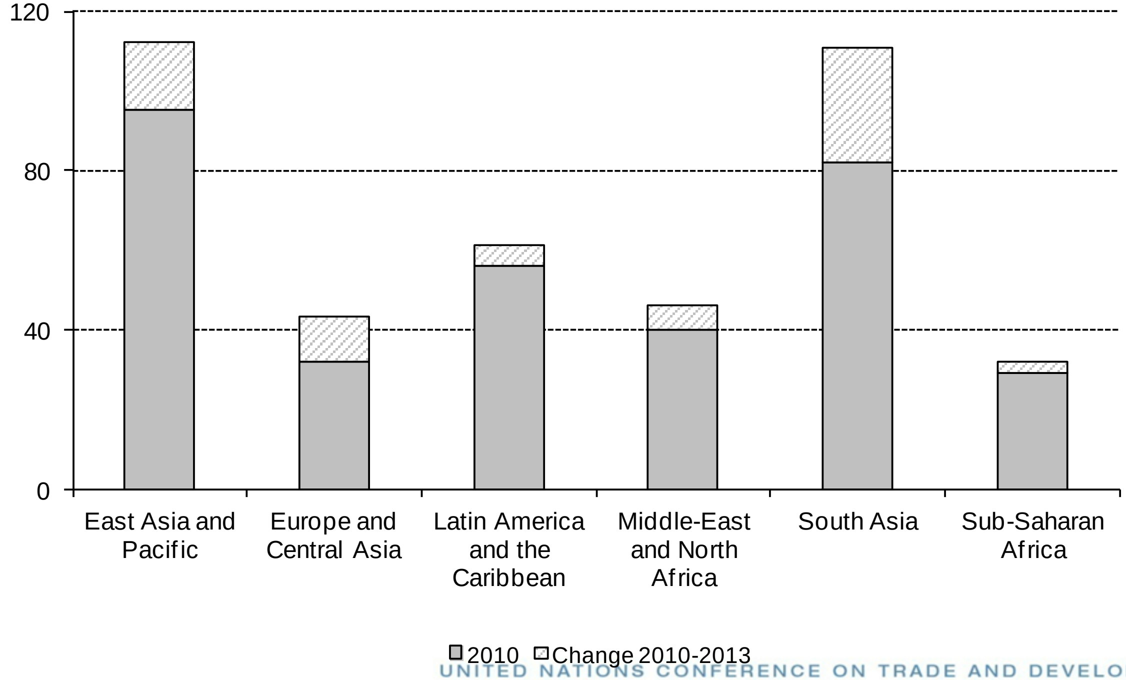
# Developments in remittances

**International remittance flows have been significant:**

- Reached $542 billion in 2013, of which $404 billion to developing countries where they represent a major source of external finance
- Reflect higher number of international migrants - 232 million in 2013 (3.2% of world population), 48% of which are women
- Grew between 2010-2013 in all developing regions and, in LDCs, grew faster than FDI and ODA between 2003 and 2012

Changes in remittance inflows by developing region, 2010 and 2013 ($billion)

*Source*: The World Bank

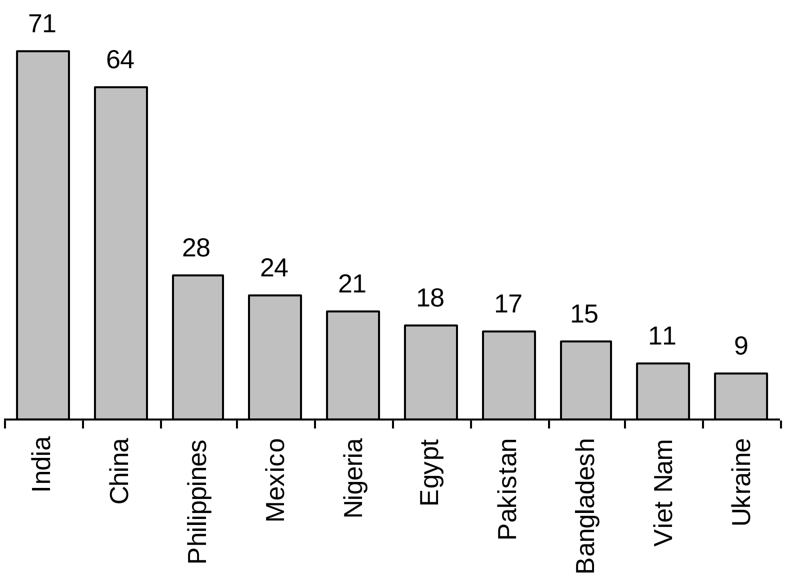


# Developments in remittances

## Remittances flows are important for several countries:

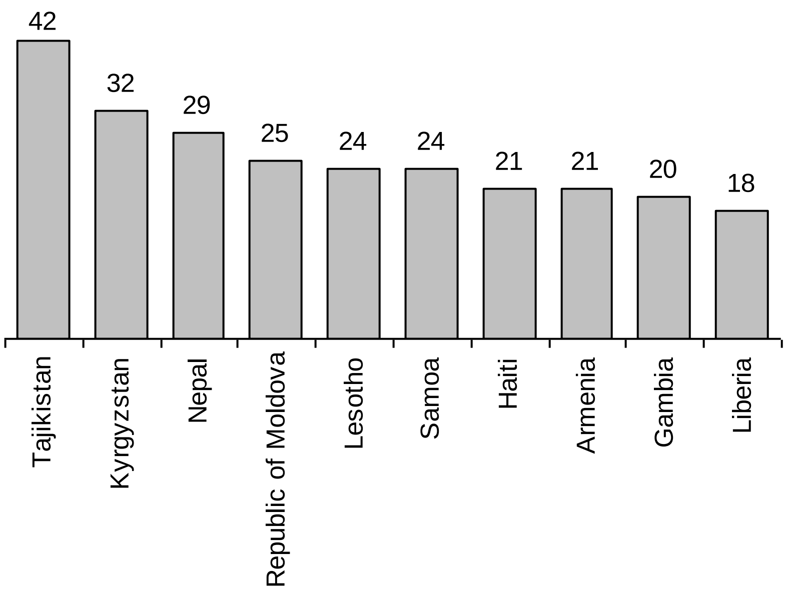
Forecast for top 10 receivers of remittance flows, 2014 ($billion)

*Source*: The World Bank




Top 10 receivers of remittance flows, 2013 (% of GDP)

*Source*: The World Bank



# State of play of financial inclusion

**Financial inclusion is key for income and welfare opportunities:**

- Basic payment, savings and insurance services benefit the poor
- For firms, lack of access to financing is a major obstacle, affecting SMEs, microenterprises and new firms in developing countries
  - In DCs, only 34% of firms have a bank loan (51% in developed countries). Informal firms (80% of microenterprises and SMEs) face major challenges in financial access;
- In 2011, only 50% of people over 15 years had an account with a formal financial institution (2.5 billion adults do not have it), with women and youth (15-24 years) lagging behind (only 47% of women and 37% of youth have a formal account);
- The share of adults in developed countries that have a formal bank account is more than twice that of developing countries;
- Research work is on-going for better measurement of inclusion (density – or account with formal financial institution – is often used) and availability of meaningful data is central to this effort and to support evidence based policy options.

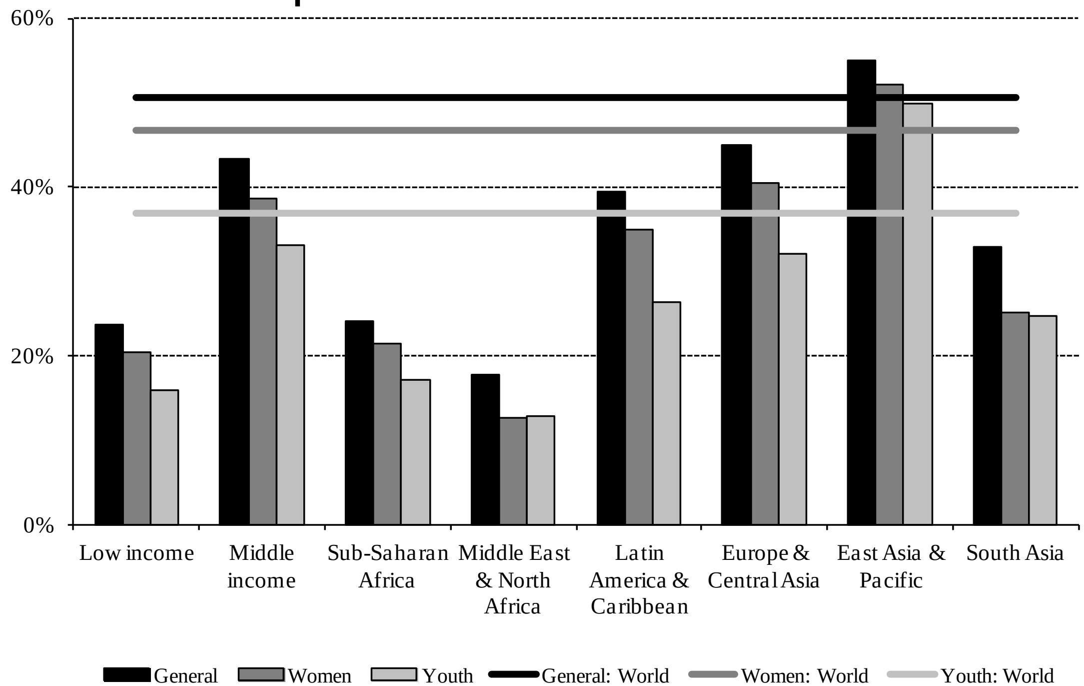
# State of play of financial inclusion

**Heterogeneity in financial inclusion among developing countries:**

- Middle income countries have an account penetration rate that doubles the one of low income countries
- Asia and the Pacific exceed the global average of account penetration (including for women and youth) while Middle East and North Africa and Sub-Saharan Africa lag behind. Women lag behind more in LAC and youth in Europe and Central Asia

Proportion of people with a formal bank account by income and region, 2011 (%)

*Source*: UNCTAD based on the World Bank

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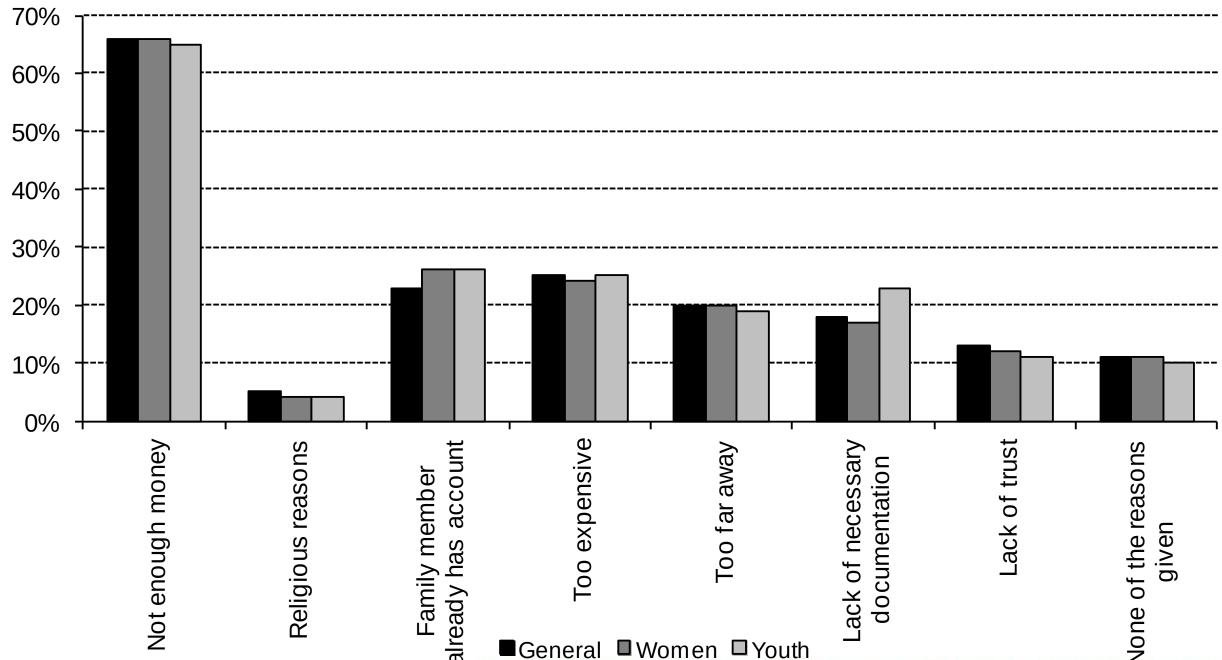
# State of play of financial inclusion

**There is a variety of reported obstacles for financial inclusion:**

- No demand for bank accounts from people across gender, age groups and geography, and firms
  - Lack of disposable money is a main reason for having no account
  - Exclusion for physical, economic, administrative and psychological barriers such as cost, travel distance, paperwork and lack of trust in banking system
  - These barriers mainly affect the poor, women, youth, rural population, informal workers and migrants

Self-reported barriers to use of formal accounts, 2011 (%)

*Source*: Demirguc-Kunt et al (2012)



# State of play of financial inclusion

**Structural and regulatory issues for financial inclusion:**

- When not adequately regulated, information asymmetry may lead to undersupply of credit to particular groups, and moral hazard may lead to excess supply and indebtedness
  - Imperfect competition could lead to market concentration, undersupply in rural areas and to the poor
  - Undiversified sector could be vulnerable to external shocks and to disruption of stable supply
- Policies should seek efficient markets but also equitable and affordable access to financial services
- Universal access is hampered by low bank penetration in rural areas, heavy documentation requirements that may exclude workers in rural areas, informal sector or migrants lacking official wage slips, tax payments or residential proof
- Excessive regulation may deter access to financial services
  - Anti money laundering regulation with stringent requirements may create bias against low value added customers

# Options to improve financial inclusion

**Possible avenues to improve financial inclusion:**

- New technology and innovative business models to improve supply and outreach of financial services
- Improved financial literacy and capacity by users
- Extension and better affordability of traditional financial services, including greater access to bank branches and lending, given the continued importance of traditional banking services

**Technology reduces physical and economic barriers:**

- The provision of financial services was improved by technology in the past – credit and debit cards, prepaid cards, ATMs
- Exponential ICT progress opens the way for new services as mobile payments and mobile banking, with the potential for financial inclusion – in particular in rural and remote areas, benefiting from the rapid uptake of mobile telephony in developing countries.

# Mobile money

**Financial inclusion benefits from mobile money schemes:**

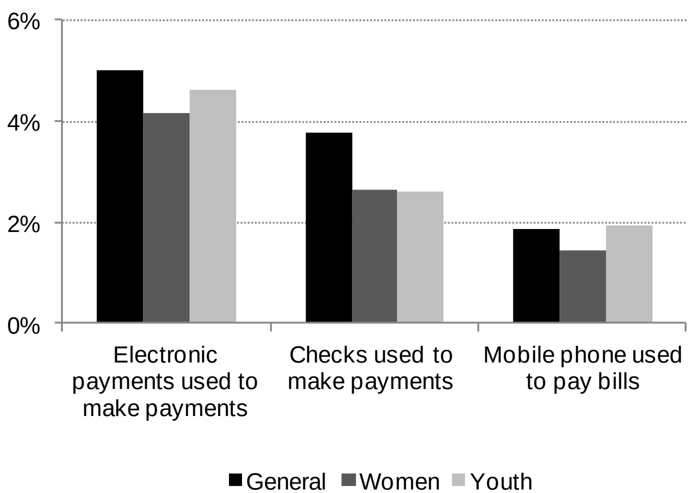
- Mobile network operators offer financial services through wireless applications, including the possibility to use the mobile phone to store money, make transfers (facilitating remittances) or payments.
  - In July 2014 there were almost 250 mobile money schemes in developing countries (130 in March 2012)
  - M-PESA in Kenya had, in March 2012, 15 million active customers, and processes more transactions domestically within Kenya than Western Union globally
  - Mobile money may be linked to bank account to provide access to other services such as savings, credits and insurances
- Mobile money is however not a panacea for financial inclusion, as it still accounts for a smaller value of transactions than traditional instruments.
  - In Kenya, the daily value of transactions between banks is almost 700 times larger than between M-PESA accounts.

# Mobile money

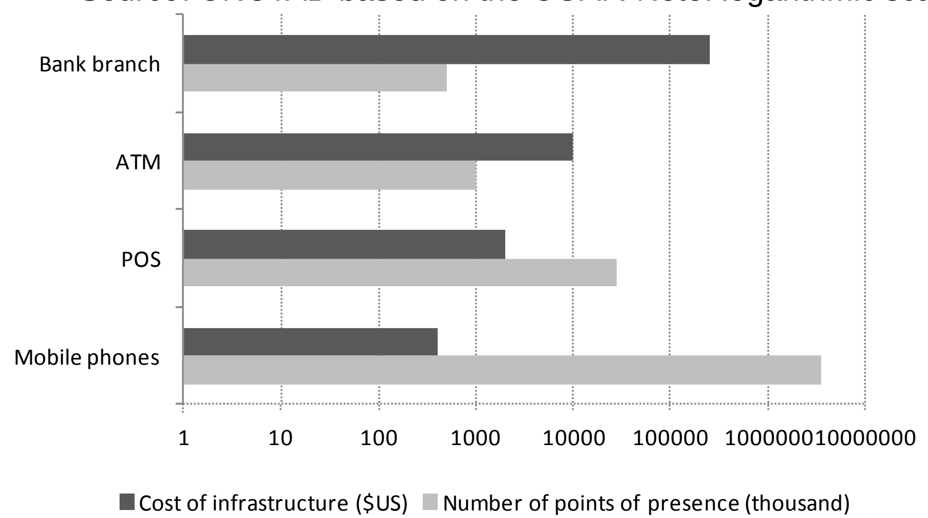
**Important advantages of mobile money schemes:**

- Incentivises use of banking services by establishing linkages
- Allows for sectoral development (e.g. credit and insurance mobile financial products for farmers promote agricultural development)
- Information on mobile money usage may help credit scoring
- It is more gender neutral and youth friendly and it has lower infrastructure costs and broader coverage.

Developing countries: methods of payment, 2011 (percentage)
*Source*: UNCTAD based on the World Bank




Cost of infrastructure ($US) and number of points of presence (thousands) by channel of delivery
*Source*: UNCTAD based on the CGAP. Note: logarithmic scale.



# Innovative business models

**Innovative business models address traditional access barriers:**

- Product design that meets market failures, consumer needs, and behavioural obstacles can foster use of financial services
  - For instance, weather-related agricultural risks may be addressed by innovative insurance products
- The interaction between different networks is facilitated by new mobile banking and payment technologies

**Banking services may be provided with developmental objectives:**

- State-owned, cooperative, development and community banks, and Islamic finance may complement some private banking services
  - These banks allow productive investment (80% of total assets in South Asia), compensate credit crunch, and promote competition in oligopolistic markets;
- Credit financial inclusion is pursued by an integrated action of Islamic commercial banks, rural banks and cooperatives

# Innovative business models

**Microfinance help the underserved households and SMEs:**

- Is provided by microfinance institutions, commercial banks and banks with a developmental role
- Targets lower-income segments of population, unbanked and under-banked, often ignored or not fully covered by traditional commercial banks
  - Criticism on microfinance suggests that it is used more for consumption smoothing and risk management rather than investment and entrepreneurship among the poor;
  - Further criticism relates to moral hazard of relaxed credit screening and underwriting standards leading to oversupply of lending to non-creditworthy clients and therefore to over-indebtedness

# Innovative business models

**Correspondent banking contributes to financial inclusion:**

- The use of banking correspondent (representative operating on behalf of banks) leverage on existing networks of agents and institutions (e..g, post offices, retail agents)
- Financial inclusion strategies in Brazil include a gradual reduction of regulation and the enlargement of correspondent networks to include lottery agencies and riverboat banks in the Amazon
- Posts have long been serving as correspondents that may offer a full range of legally independent and regulated financial services
  - Posts have the world's largest physical network, with twice as many post offices (500 thousand) as commercial bank branches (275 thousand) in developing countries, and operate in remote areas (80% of post offices in Sub-Saharan Africa are in small and medium-sized towns and rural areas with 83% of the population)
  - UPU estimates that 1 billion people in over 50 countries are banked through postal systems

# Remittances and financial inclusion

**Strong relationship between remittances, financial inclusion and poverty reduction:**

- Remittances represent important and usually steady flows that increase household income and spent in social services (e.g., health and education)
  - Increased international attention - The UN Conference on Sustainable Development and the High-Level Dialogue on Migration and Development
- Remittances contribute to increasing demand of financial services by making recipients more inclined to join the formal financial sector
  - Providers have recognised this potential and started to offer additional services along with remittance accounts
- Remittances as financial inflows and the expansion in financial services will contribute to economic and human development. A 10% rise in remittances may lead to 3.5% reduction in the share of people living in poverty.

# Remittances and financial inclusion

**Transfer costs are major impediments to remittance flows:**

- Importance of making transfer systems less costly and more efficient
- A 5% reduction on remittance costs is estimated to yield $15 billion in savings
- South-South remittances are costly due to factors including lack of information and lack of competition (e.g., exclusivity contracts)
- One of the targets proposed for the SDGs is to reduce the transaction costs to less than 3% of migrant remittances by 2030 and eliminate remittance corridors with costs higher than 5%
- G-8 and G-20 agreed on the target of reducing the global average transfer costs to 5% of remittances in 5 years (it was 8.1% in the second quarter of 2014)

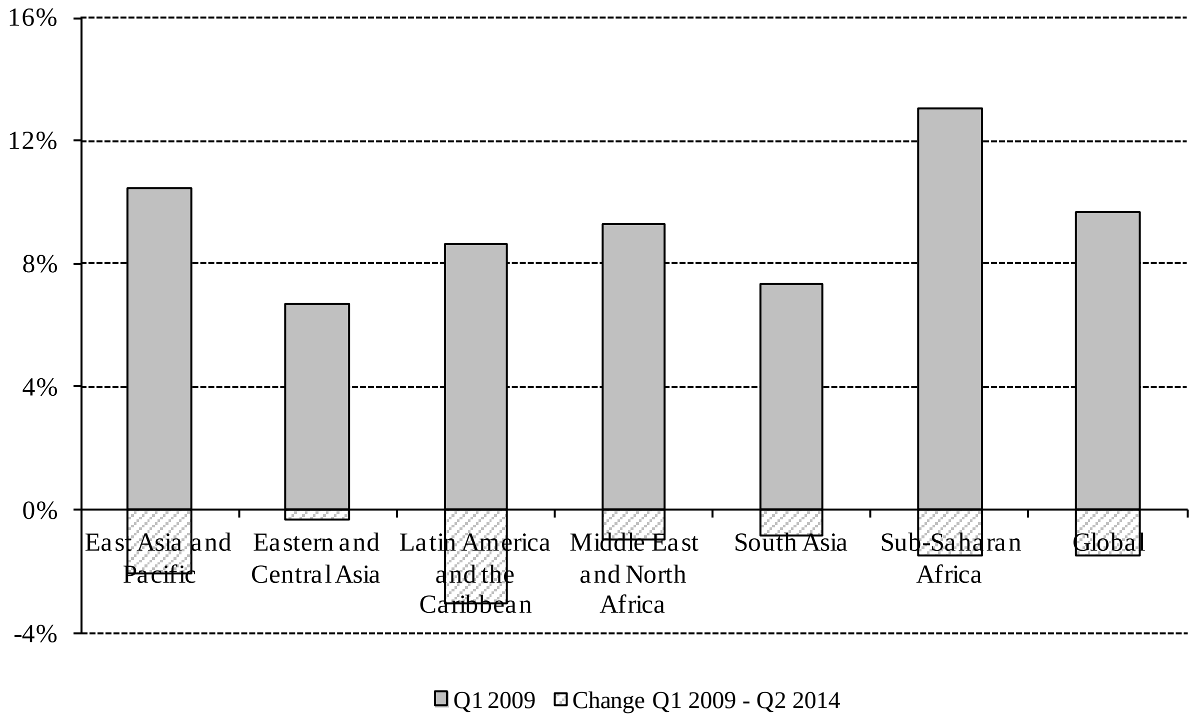
# Remittances and financial inclusion

**Remittances costs have decreased but not enough:**

- The cost of sending remittances decreased for all developing regions but, in many LDCs, costs still range from 14-20%
- Latin America and the Caribbean is the region with the lowest average cost of remittance transfer (5.6%) while Sub-Saharan Africa remains the region with the highest cost (11.6%)

Change in the cost of remittances between 2009-2014, by developing economies

*Source*: The World Bank



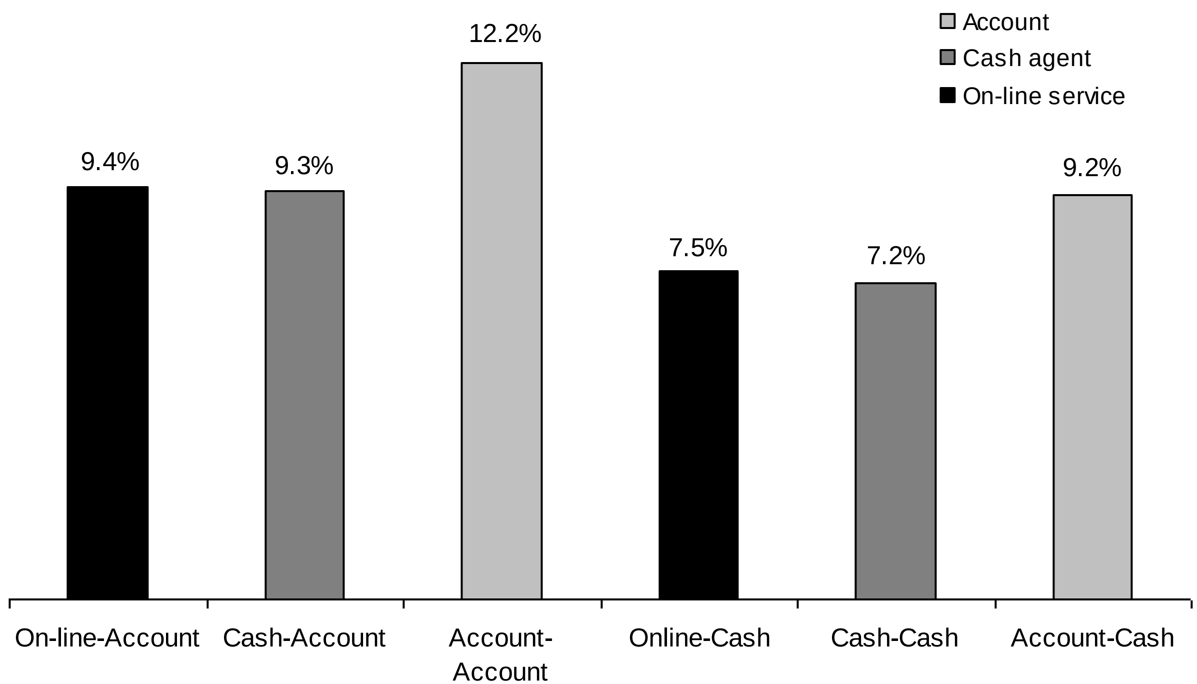
# Remittances and financial inclusion

**Remittances costs depend on several variables:**

- Commercial banks are the most expensive remittance channel (12.1%) while post offices are the cheapest (4.7%)
- Money transfer organizations, present in 85% of migration corridors, have an average cost of 6.6.%
- Account-account is more expensive than cash-cash services

Average remittance price by service model (% of remittance flow)

*Source*: Dalberg Global Development Advisors



# Remittances and financial inclusion

**Cost reduction is central to reaping developmental gains:**

- The combined use of banking, postal and telecommunication networks may lower costs and enhance the potential to reach low income recipients in remote locations
  - E.g., Some banks allow for remittance transfer without the need to open an account . This also promotes competition, incentivises cost-effective channels and formalizes informal channels;
- Improving transparency and information on the costs associated to each channel (e.g, price databases) will enable senders to choose the most cost-efficient options.
  - Hence, the importance of data collection and evaluation of available options
- Payment and settlement systems should facilitate cross-border payments
- Regulation should promote interoperability of platforms or even shared infrastructure to reduce operational costs, increase networks and financial access, facilitate competition and achieve economies of scale.

# Remittances and financial inclusion

**Maximizing the development impact of remittances:**

- Remittances are mainly spent in household consumption, and health and education.
- Hence, the importance of channelling them to investments in productive activities, social services and infrastructure.
  - Financial counselling and diaspora funds could contribute to this channelling
  - This includes, for example, diaspora bonds that have been used by Ethiopia, India, Kenya, Nepal, and Philippines and that are in the process of being issued by Nigeria and Trinidad and Tobago. Specific Islamic financing products are another example.
  - Tax and credit incentives to induce migrants and diaspora to invest in their home countries could also be considered. These instruments have been used in Bangladesh and Brazil.
  - Several countries have integrated remittance products into national policies on financial inclusion. e.g. many public Indian banks offer accounts with no fees for remittances
- Internationally, progress still needs to be made on leveraging remittances for capital market access through recognition of the importance of remittances by credit rating agencies

# Policies and regulations

**Governments can play an important role ("supply side"):**

- Developing sound regulatory and institutional framework
  - Regulating aspects of business conduct and overseeing effective recourse mechanisms to protect consumers, including competition
  - Allowing competing financial services providers and consumers to take advantage of technological innovations
- Taking direct measures such as subsidies and mandatory requirements, including universal services obligations
  - Obligation to offer basic or low-fee accounts, prohibition to refuse basic financial services to poor clients and prohibition of not servicing particular areas
  - Exemptions from onerous documentation requirements
  - Priority sector lending, mandatory lending to SMEs, loan to poor people at lower interest rate with easy repayment and no profit margins
- Formulating financial inclusion strategies by consultative processes
- Example of financial inclusion promotion in China:
  - Universal access (minimal financial services in all towns and villages)
  - Exploring alternatives in presence (ATMs, mobile units) and in models (local banks, rural cooperatives and postal bank – 5th largest bank in China)
  - Guidelines to promote competition, agriculture-related credit and SME support

# Policies and regulations

**Policies could also aim at increasing demand for financial services ("demand side"):**

- Governments make payments through electronic transfers to bank accounts
- Supporting availability of information, including by setting standards for disclosure and transparency
- Improved financial literacy, capabilities and consumer empowerment could increase demand for financial services, such as through the institutionalization of financial training in the education system, dissemination of information outside the school system and designing reach out programmes

# Policies and regulations

**G-20 endorsed 9 principles for innovative financial inclusion:**

- Aimed at creating an enabling policy and regulatory environment;
  - Promotion of competition and provision of market-based incentives for access and usage of affordable financial services;
  - Protection and empowerment of consumers to have financial literacy and capability;
  - Promotion of technological and institutional innovation.

**Maya declaration envisages financial inclusion:**

- Governments from 108 developing countries adopted principles for the promotion of financial inclusion by their regulatory institutions. 46 of these made specific commitments for financial inclusion;
  - Enabling environment that makes full use of innovative technology;
  - Proportional regulation for financial inclusion, stability and integrity;
  - Consumer protection and empowerment;
  - Evidence-based financial inclusion policy that collects and analyses comprehensive data and produces comparable indicators.

# Trade policy and regulatory reform

**Trade policy and regulatory concerns:**

- Trade liberalization efforts need to be coordinated and synchronised with adequate domestic regulation to promote financial inclusion
- Trade liberalization could have bearing on national regulatory efforts including in universal access and financial regulations
- Trade dimension of effective regulation is relevant for financial inclusion, for instance through universal access requirements, particularly when there is substantial presence of foreign banks in domestic financial markets
- The shift in regulatory focus to macro-prudential objectives could also have some bearing in financial inclusion
  - Strengthening bank capital and liquidity standards under Basel III, and isolating essential banking services in retail banking from high-risk investment banking
  - E.g. the "Volcker rule" in the United States prohibits deposit taking banks from engaging in most forms of proprietary trading, to curtail the perceived implicit Government guarantee on deposits from being applied to proprietary trading;
  - While many developing countries are yet to apply Basel II and Basel III is not mandatory, these could form best practices to follow

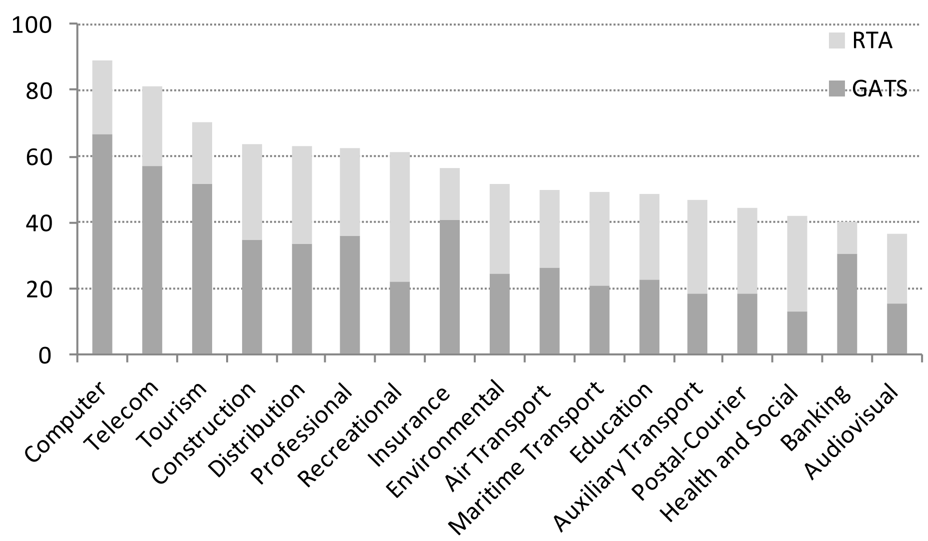
# Trade policy and regulatory reform

**GATS and RTA commitments vary across sectors and modes:**

- Financial services have a relatively high level of GATS commitments but see the least improvements in RTAs (particularly in banking);
- Developing countries have been cautious in banking commitments through mode 1, reflecting the concern that is harder to regulate banks that are not established through commercial presence and fear of opening the capital account as it would be required by mode 1 commitments (cross-border deposit taking and lending);

Average level of GATS and RTA commitments for all countries

*Source*: UNCTAD based on WTO



# Trade policy and regulatory reform

**Recent RTAs have moved towards deeper liberalization:**

- Commitments may be based on applied levels of market access conditions, including through stand-still requirements that do not allow to decrease the conformity of the measure;
- "Ratchet clause" that automatically incorporates further future liberalization measures;
- National treatment may be horizontally applied to all sectors/modes;
- "(Third-Party) MFN" clause aims that a RTA party obtains best possible preferential treatment available in other RTA partners;
- Some of these approaches are being replicated in the plurilateral Trade in Services Agreement (TISA);
- Recent mega-RTA negotiations aimed to address the potential anti-competitive effect of state-owned enterprises (SOEs) by eliminating their possible structural advantages and establishing "competitive neutrality" between SOEs and private companies. Many countries have stressed the importance of SOEs in delivering public policy goals, including access to financial services.

# Trade policy and regulatory reform

**Trade policy can be relevant for remittances and financial inclusion:**

- Trade and cooperation agreements at regional (e.g. ASEAN) and multilateral levels, and regulatory cooperative schemes, provide a platform through which to promote the temporary movement of natural persons (hence, remittances and financial inclusion)
  - GATS commitments on mode 4 which so far have been scarce and focused on higher-skilled categories
  - These efforts may expand quotas, provide objective criteria for economic needs tests, and recognise qualifications
  - The setbacks in the Doha Round have implications (e.g. LDC services waiver)
- Commercially meaningful commitments in mode 4 could bring $150 billion in development gains for developing countries, including a great part with the form of remittances but without including other benefits such as poverty reduction impacts.

# Conclusion

**Financial inclusion is central to poverty reduction, and inclusive and sustainable development:**

- A myriad of factors contributed to lack of access to financial services, including physical, economic, regulatory and cultural;
- Women, youth, rural population and informal workers are more severely penalised;
- The use of new technology, such as mobile money, and innovative business models, has exhibited potential for financial inclusion;
- Governments have an important role in setting up sound regulatory frameworks and incentives to increase supply and affordability of financial services, and to expand demand for financial services, for instance through financial education and empowerment;
- Remittances are the major source of external private financial inflows into developing countries, and a promising source of demand for financial services. Hence, safer, faster and less costly remittances could contribute significantly to financial inclusion.

# Thank You