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Ozili, Peterson K

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Achieving financial inclusion: whatever it takes

Peterson K Ozili

Abstract

This paper presents some policy ideas on how to achieve high levels of financial inclusion. It explores a number of policy options that can be used to achieve greater levels of financial inclusion. The paper argues that high levels of financial inclusion can be achieved by reducing interest rate; introducing conditional low interest rate; supporting monetary policies with welfare payments; reducing taxes; using targeted government spending; supporting fiscal policies with tax rebate, tax holiday or tax exemption; grant tax rebate to financial institutions; financial inclusion-environment decoupling; and de-risking the financial system.

Keywords: financial inclusion, unbanked adults, interest rate, monetary policy, fiscal policies, environment, financial system, financial institutions, digital finance, tax.

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1. Introduction

In this paper, I present a number of policy options that can be used to increase the level of financial inclusion. Financial inclusion refers to the provision of basic financial services and granting access to basic financial services so that people can use available financial services to improve their welfare (Ozili, 2018; Atkinson and Messy, 2013; Ozili, 2020). Financial inclusion contributes to economic growth in developing and developed countries. Financial inclusion also contributes to achieving the sustainable development goals.

There are different views on how to bring unbanked adults into the formal financial sector. Different views exist because there are many factors that policy makers take into account when formulating policies for financial inclusion. For this reason, there is no one-size-fits-all policy for financial inclusion that is applicable to all countries. In policy circles, for instance, policy makers need to compare the benefits and consequences of a wide range of policy options or ideas, and they tend to adopt financial inclusion policies that have significant benefits with minimal negative consequences. Meanwhile, in academia, several studies have identified some factors that contribute to greater levels of financial inclusion such as financial stability, regulatory sandboxes, innovation, financial education, financial literacy, fintech, digital finance, amongst others (e.g. Morgan and Pontines, 2014; Beck et al, 2015; Atkinson and Messy, 2013; Jenik and Lauer, 2017; Arner et al, 2020). Although these studies offer some insight into the determinants of financial inclusion, they often do not prescribe the exact channel through which each determinant affects the level of financial inclusion from a policy standpoint. I will give an example to illustrate this!

Take financial literacy, for example. How do you implement financial literacy as a policy goal? Should we require adults who are financially illiterate to attend a training or a course on how to manage money? Who will bear the cost of such training? What criteria would we use to determine who is financially literate or illiterate? In colleges and universities, should an additional module be introduced into the academic curriculum to teach young adults how to manage money in the early stages of their lives? The question is: how do you design a policy to increase financial literacy for financial inclusion in a country? Policy makers sometimes find it difficult to design policies that yield specific outcomes for financial inclusion. Due to this difficulty, policy makers

often prefer to use macro policies to increase the level of financial inclusion i.e., macro policies that affect the level of financial inclusion through indirect channels. In this paper, I present some of the options or ideas that policy makers can use to increase the level of financial inclusion.

This study contributes to the literature in the following way. It contributes to the literature that examine the determinants of financial inclusion. It contributes to this literature by suggesting ways to increase the level of financial inclusion. This paper also contributes to the economic literature. It contributes to the economic literature by showing how changes in macroeconomic policies can improve the livelihoods and welfare of poor households and individuals.

The rest of the paper is structured as follows. Section 2 presents a review of the literature. Section 3 offers some policy suggestions on how to achieve high levels of financial inclusion. Section 4 concludes.

2. Review of the policy literature

In the policy literature on financial inclusion, Zulkhibri (2016) suggests that policy instruments that encourage the redistribution of income can help to bring the excluded population into the formal financial system. Atkinson and Messy (2013) argue that financial inclusion is an international policy priority. They suggest that financial education policies will improve financial literacy and lead to greater financial inclusion. Ozili (2021a), in a review of existing financial inclusion studies, found that financial inclusion affects, and is influenced by, the level of financial innovation, the level of poverty, the stability of the financial sector, the state of the economy, financial literacy, and regulatory frameworks which differ across countries. Anarfo et al (2019) examine the bi-causal link between monetary policy and financial inclusion in 48 sub-Saharan African countries from 1990 to 2014. They find a bi-causal relationship between monetary policy and financial inclusion. The findings suggest that monetary policy affects financial inclusion, and monetary policy is also influenced by financial inclusion. Ozili (2022) shows that high economic policy uncertainty reduces the level of financial inclusion. Myers et al (2012) point out that in countries like Ireland, Spain, Canada and the UK, credit unions owned by members play a

significant role in reaching under-served and excluded communities even though credit unions faced financial and operational problems. Ozili (2018) argues that digital devices that are connected to the internet can be used to deliver basic financial services to under-served adults, and this can increase financial inclusion. Ozili (2020)'s special agent theory of financial inclusion argues that a government can increase financial inclusion by using a special agent. The special agent is often a financial institution. Meanwhile, Ozili (2021b) shows that agents of financial inclusion may incorporate economic and social constraints in the delivery of formal financial services, such as high interest rates, bank charges and high transaction cost, and these constraints limit the ability of poor banked adults to use basic financial services to the fullest. Ait Lahcen and Gomis-Porqueras (2021) analyze various policies aimed at increasing financial inclusion. They find that a direct transfer to bank account holders yields the highest welfare benefit and it reduces consumption inequality. Myers et al (2012) show that not having access to formal financial services, such as a bank account or a credit card, leads to social exclusion and economic exclusion in countries like Ireland, Spain, Canada and the UK. Overall, the policy literature on financial inclusion show that polices can be designed to increase the level of financial inclusion.

3. Policy options to achieve high levels of financial inclusion

#1. Reduce interest rate

Reducing interest rate is a monetary policy tool and it affects the level of financial inclusion through indirect transmission mechanisms. Governments can lower the interest rate to increase the level of financial inclusion. A reduction in interest rate will reduce the cost of borrowing funds. Loans will become cheaper for households and small businesses, and this can encourage unbanked households and small businesses to obtain credit from formal financial institutions. With low interest rate, unbanked individuals in rural and urban communities will be willing to take a loan from local financial institutions and use the loan to start a small business and employ few workers in the local community. Employed workers may be required to open a formal salary account for the payment of wages and salaries. This will bring local workers into the formal

financial sector through account ownership to receive wages and salaries, thereby, leading to financial inclusion. Low interest rate can also encourage both small and large companies to expand and grow their businesses which will increase the level of employment, increase the demand for financial services through increase in demand for salary accounts, and can potentially increase aggregate demand for goods and services in the economy. Keeping interest rates at a low level for a considerable period of time will not only have a positive effect on firms, it will also increase the demand for financial services by unbanked members of the population. Reducing interest rate to increase financial inclusion is mostly effect in developed countries.

#2. Use conditional low interest rate to promote financial inclusion

This is a type of conditional monetary policy targeting for financial inclusion. Central banks can choose to grant development loan at a very low interest rate to financial institutions on the condition that they will carry out in projects that promote financial inclusion and improve the livelihoods of people in rural communities. Under this approach, the government will have to assess all request for development loan by financial institutions, and determine which financial institutions will receive the low interest rate development loan provided that they are able to demonstrate how their proposed projects will promote financial inclusion and improve the livelihood of people in rural areas. A special low interest rate such as a single-digit interest rate on loans can increase the demand for development loan. Formal financial institutions can take advantage of the low interest rate development loan to extend basic financial services to rural communities by opening new bank branches in rural communities or by setting up bank correspondent agents in rural areas where it is not feasible to open a bank branch. A conditional interest rate policy tends to be more effective in developing countries that have a large rural population.

#3. Support monetary policy with welfare payments

Monetary policy alone may not yield the desired results for financial inclusion in the short term due to inflation expectations and the extended time lag in a country's monetary transmission system as the time lag may be longer in some countries and shorter in other countries. For this reason, there is need to support monetary policy with welfare payment to poor households in

the short term. Governments should support monetary policy efforts with welfare payments to poor households. The welfare benefits paid into the bank account of poor households will not only bring poor households into the formal financial system, it will also give them some money to feed their families and to meet other basic expenses to improve their welfare.

#4. Reduced taxes

Reducing taxes have an indirect positive effect on financial inclusion. When the tax rate is reduced, there will be increase in aggregate demand for goods and services in the economy. This will motivate suppliers to produce more goods and services, and increase business profit. Some of the increase in profit can be reinvested into firms for business expansion and growth. As businesses expand their operations, they will employ more workers in urban and rural communities. The workers will be required to open a salary account in a formal financial institution for the payment of wages and salaries. This will bring the workers into the formal financial sector through bank account ownership for each worker, thereby, leading to financial inclusion. This approach for financial inclusion may be more effective in promoting financial inclusion in countries were employers are required by law to pay wages and salaries into the bank account of their employees rather than paying salaries directly to employees in cash. Today, there are many countries that have not made wage and salary payment into workers' bank accounts a legal requirement. In such countries, using fiscal policy to promote financial inclusion by reducing taxes may be ineffective.

#5. Targeted government spending

Another fiscal policy option for financial inclusion is to increase government spending in rural communities. Governments can do this by providing banking infrastructure in rural communities such as creating one or more public bank or specialized microfinance institutions to provide affordable financial services to poor households in rural communities. Governments can also spend more money in building good roads and electricity infrastructure in rural communities. Poor roads and lack of electricity are some of the commonly reported reasons why large financial institutions do not expand their businesses to rural areas, thereby discouraging financial institutions from opening branches into rural areas. Providing good roads and power supply will

not only encourage financial institutions to expand their business to rural communities, it will also have positive effects for the local economy in rural areas. It can encourage financial institutions to expand to rural areas and bring financial services closer to the people in rural communities, thereby increasing the likelihood of owning a bank account in a financial institution in the rural area. A policy designed to increase government spending for financial inclusion tend to be more effective in developing and poor countries.

#6. Grant tax rebate to financial institutions

Government can grant tax rebate to financial institutions and encourage them to expand their business to remote communities by opening branches in remote communities so that poor households in remote communities can have access to basic financial services. This will bring financial services closer to the people, and increase the level of financial inclusion.

#7. Financial inclusion-environment decoupling

Financial inclusion-environment decoupling refers to increasing the level of financial inclusion without a corresponding increase in environmental pressure or degradation. Financial inclusion-environment decoupling can be absolute or relative. Absolute financial inclusion-environment decoupling occurs when the relevant indicators of environmental pressure is stable or decreasing while the level of financial inclusion is increasing. Relative financial inclusion-environment decoupling occurs when the growth rate of the environmental pressure (or degradation) indicator is positive but less than the increase in the level of financial inclusion. In many economies, increasing the level of financial inclusion may increase pressure on the environment when the government and private corporations build new financial institutions, information technology infrastructure, and telecommunications infrastructure that operate on energy from fossil fuel which can lead to the emission of pollutants in the environment and affect people living in communities where these structures exist. A country should strive to achieve high levels of financial inclusion without putting much pressure on the environment. This means protecting the environment while achieving high levels of financial inclusion.

#8. De-risking the financial system

The financial system and financial markets are full of risk. This is a fact because our deposits in our bank account are at risk because banks can fail. Stocks in the stock market are at risk because stocks can lose their value. There is also the risk of bank customers experiencing unauthorized debits on their accounts. There is the risk that the collapse of one bank can lead to the collapse of many banks. Clearly, it is easy to see that the financial system is risky. Bringing poor unbanked people into the formal financial sector means that they will be exposed to multiple risks in the financial system. These group of individuals have little money and are unable to afford the services of a professional financial advisor to give them good financial advice. They cannot afford to buy insurance protection to mitigate the risks that affect them, which further increases their risk exposure in the financial system. What is more worrisome is that the risk in the financial system, when they materialize, will affect the poor and the rich differently. Poor people tend to suffer more compared to rich people during crises in the financial sector. As poor people and vulnerable individuals begin to realise that financial institutions can fail, they may be reluctant to keep all their life savings in their formal account in a bank as a precaution. There is a need to ring fence banking for poor and low income customers and shield them from some risks in the financial system. However, in banking, there is the argument that deposit insurance should give poor people and vulnerable people a sense of safety for their deposits in banks. Even though deposit insurance schemes provide some protection to bank customers, it is important to also understand that trust in financial institutions can be easily eroded. Some people believe that deposit insurance only protects people that have substantial amount of money in banks not people that have little money in banks, and that when a banking crisis or financial crisis occurs, the people with large amount of money will take away their money first. Then the left-over money will be shared to people that have little money in banks and it may not be enough.

4. Conclusion

This paper offered some suggestions on how to increase the level of financial inclusion. It offered policy options or ideas that can help policy makers to increase the level of financial inclusion. Some suggested policy options or ideas for achieving high levels of financial inclusion include reducing interest rate; introducing conditional low interest rate; supporting monetary policies with welfare payments; reducing taxes; using targeted government spending; supporting fiscal policies with tax rebate; tax holiday or tax exemption; financial inclusion-environment decoupling; and de-risking the financial system.

The implication of the findings is that the suggested policy ideas can help in improving access to formal financial services especially for low income and poor households. Policy makers can use these policy ideas or modify them to fit the realities of their economies during implementation. While considering these policy options, policy makers should also identify and remove structural barriers or constraints in the financial sector that could make banked adults exit the financial sector.

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