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Inclusive finance for inclusive growth and development

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This article analyses the role of inclusive finance for inclusive growth and development. An inclusive financial market provides affordable and equitable access to financial products for all households and entrepreneurs, especially the most marginalised. By empowering people to exploit a wider set of economic opportunities, inclusive finance can therefore be a pivotal tool in driving economies on a sustainable growth trajectory. Access to financial services, primarily to credit, can enable agents to make longer-term consumption and investment plans, participate in productive economic activities and cope with adverse shocks.

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Introduction

Inclusive finance aims at promoting the availability of banking services to the broadest segments of society at affordable terms in order to contrast financial exclusion defined as "the inability, difficulty or reluctance of particular groups to access or use mainstream financial services that are relevant, appropriate to their needs and allow them to lead a normal life in the society which they belong to" [1•,p. 9].

Whilst financial inclusion is universal access, at affordable costs, to a large variety of financial products offered by mainstream retail financial institutions [2,3•], inclusive finance enhances the access to financial services for the most disadvantaged segments of the society. Through inclusive finance, people living in poverty or in marginalised groups are offered a set of financial instruments and services to run their businesses, stabilise consumption and shield themselves from adverse shocks.

Inclusive finance is an innovative concept, and its central role has been widely recognized by world leaders and policymakers since it is closely interrelated with the more general notions of inclusive economic growth and sustainable development, as highlighted in the 2015 United Nations Global Sustainable Development Report. The commitment to 'leave no-one behind' is one of the core targets in the post-2015 Millennium Development Goals Framework[4] of the 2030 Agenda to promote a broader access and usage of financial services. Indeed, when access to finance and the available range of services are limited, many individuals, families and firms are not likely to gain from financial development, leaving much of the population in absolute poverty [4].

Inclusive finance encompasses the provision of loans and other basic financial services often through microfinance institutions, and its macroeconomic effects are multifaceted. An inclusive financial system generates not only lower socio-economic inequality [5,6•], but also a more prosperous economy and higher economic growth [7–9]. Further, inclusive finance plays a significant role in moderating the impact of macroeconomic shocks on households and small and medium-sized enterprises. In line with many theoretical models some empirical studies show that inclusive finance, by relaxing financial constraints, helps firms to access external funds in order to meet their liquidity needs not only in normal times but also when they are affected by adverse unexpected shocks. Analogously, an enhanced financial access allows households to smooth consumption and insure themselves against unfavourable events, so they are less likely to fall into poverty [10,11].

The promotion of inclusive financial markets has made microfinance – a source of credit for low-income and disadvantaged groups – the most prominent anti-poverty program to enhance economic and social development. Microfinance bridges the gap between the formal financial sector and individuals or small businesses perceived as riskier and therefore as less attractive customers. Whilst

[4] *Transforming our World: the 2030 Agenda for Sustainable Development*, UN General Assembly Resolution 70/1, 25th September 2015. Available at: https://sustainabledevelopment.un.org/post2015/transformingourworld/publication.

financial inclusion seeks to make sure that everyone has access to a variety of financial tools, microfinance supports marginalised people along the lines of the inclusive finance goals. As originally envisaged, micro-finance is the provision of micro loans to disadvantaged individuals who wish to develop or extend a basic income-generating activity in order to facilitate their escape from poverty [12].

Supporters of microfinance intervention claim that it played a pivotal role in many developing economies in creating new job opportunities and in boosting incomes of the most marginalised segments of the population – especially women – thereby supporting a 'bottom-up' socio-economic and sustainable development process [13,14]. On the environmental side, microfinance is predominantly 'green' as most of the microfinance institutions provide credit to low and moderate income individuals who plan to start or expand environmentally sustainable small-scale projects based on the use of renewable and energy-efficient technologies.

Despite the above arguments, there are serious concerns on the benefits of micro-finance and micro-credit interventions, which have resulted in high-interest, often exploitative lending to low-income households [12,15•].

The most striking example of financial inclusion resulting in detrimental outcomes for borrowers comes from the U.S. subprime crisis. Promoted and blessed as a vehicle for financial inclusion, subprime lending resulted in an unquestionable blowout of predatory lending and fraud [16,17]. Financial institutions not only unremittingly extracted gains from vulnerable families, but also engaged in fraudulent activity, misguiding both investors and regulatory authorities. The negative consequences of this behavior for borrowers and the world economy are manifest.[5]

Inclusive finance for inclusive growth and development

Inclusive growth is economic growth that creates opportunities in terms of labour, business, and assets for all segments of the population [18–21]. Specifically, "inclusive growth deals with policies that allow people from different groups – gender, ethnicity, religion – and across sectors – agriculture, manufacturing industry, services – to contribute to, and benefit from economic growth" [22••,p. 612]. Access to financial services, primarily to credit, enables agents to make longer-term consumption and investment plans, and to participate in productive economic activities. Indeed, recent survey evidence shows that access to financial products has a direct impact on innovation and productivity which is found to enhance economic growth [23,24,25,26••]. There may be also a reverse causation effect insofar higher growth, by relaxing credit constraints, deepening the availability and reducing the cost of financial services, allows more people to be financially included.

Figure 1 depicts the relationship between Gross Domestic Product (GDP) and access to financial services here defined as access to basic banking services (current account and payment services) and credit.[6] Household's access to financial services has a significant and positive relationship with a nation's economic performance. There is also a possibility of reverse causation as explained above: a higher economic stance within an economy may allow for greater financial inclusion. However, here we simply show that GDP positively correlates with access to financial services thus suggesting that broader access to finance is more conducive to increasing wealth.

Inclusive development is, instead, defined as "development that includes marginalized people, sectors and countries in social, political and economic processes for increased human well-being, social and environmental sustainability, and empowerment" [27••,p. 456]. Inclusive finance is a key tool for inclusive development since it provides access to financial facilities in a fair, equitable and affordable manner not just to improve people's lives but also to foster participation of all members of a society, especially of the poorest, in productive and sustainable economic activities. By empowering individuals to compete for and take advantage of economic opportunities, inclusive finance can, therefore, be a powerful driver for higher, equitable and inclusive growth.

Indeed, recent literature [27••,28••,29,22••] argues that there is the urgent need to find and inform policies that promote growth and inclusion simultaneously. Authorities should move "beyond the question of whether growth (still) 'is good for' poverty reduction [30] to a question of whether and how the poor can participate in and contribute to growth, and how institutions – formal and informal – can enhance this" [22••,p. 615], through, for example, more inclusive financial markets. With improved access to formal borrowing, families can smooth their consumption both in durable and non-durable goods and investments, including education and health. They can also insure against unfavourable and unexpected events and, therefore, avoid falling deeper into poverty, which is often the case with such negative events. This aspect is crucial since there is also an important gender

[5] A comprehensive list of criminal and civil cases pursued by the U.S. Justice Department against a broad range of banks is available at: http://www.nytimes.com/interactive/business/financial-crisis-cases.html?_r=0.

[6] Data are collected from the *Life in Transition Survey* II (LiTS II) a survey implemented jointly by the EBRD and the World Bank in late 2010. The analysis is carried out across 18 European transition economies and 5 Western 'comparator' countries: France, Germany, Italy, Sweden and the United Kingdom. Data are available at: http://www.ebrd.com/what-we-do/economic-research-and-data/data/lits.html.