Financial Inclusion and Australia's International Development Policy

Submission from CGAP

*The **Consultative Group to Assist the Poor (CGAP)** is a global partnership of more than 30 leading development organizations that works to advance the lives of poor people through financial inclusion. As a donor coordination mechanism, CGAP derives strength and diversity from its broad membership base representing foundations, bilateral and multilateral aid agencies, and development finance institutions. DFAT, a longtime CGAP member, has been a leading voice for financial inclusion in the funder community, notably with regard to advancing women's inclusion and digital innovations in the Pacific. CGAP is grateful for the opportunity to provide input into DFAT's new international development policy and hopes that a market systems approach to financial inclusion remains integral to Australian development policy, for reasons outlined below.*

Why Financial Inclusion Matters Today

Financial services are foundational to achieving a wide array of development goals, and over the past decade, a growing body of research has demonstrated how financial services can improve the lives of low-income people. Numerous studies have demonstrated that access to bank accounts and payment services have a measurable impact on poverty by improving the ability of poor people to draw on wide social networks in times of trouble, significantly improving their resilience to shocks, and reducing the chances that they fall deeper into poverty. In Kenya, research has shown that expansion of mobile money has lifted nearly 200,000 out of poverty, especially households headed by women. Financial services—and increasingly digital financial services—also have demonstrated a direct impact on health, education, gender equality, and food security (see Box 1). Financial inclusion—defined as individuals and businesses having the opportunity to access and the ability to use a diverse range of appropriate financial services that are responsibly and sustainably provided by formal financial institutions—is therefore a development imperative.

Box 1. Financial Inclusion Supports Achievement of the SDGs

While the United Nations Sustainable Development Goals (SDGs) do not identify financial inclusion as an independent objective, certain SDG targets formally reference financial services, and there is empirical evidence that financial inclusion supports a range of SDGs:

EDUCATION: Savings and other financial products help families plan for and manage education expenses. Remittance products that are earmarked for schooling have increased education expenditures in El Salvador and the Philippines (Ambler, Aycinena, and Yang 2015; De Arcangelis et al. 2015). In Nepal, households with savings accounts increased education spending by 20 percent (Prina 2015).

GENDER EQUALITY: Women represent 1.1 billion of the unbanked adults today. By giving women access to an account, their decision-making power in the household improves. Moreover, research shows that female-controlled finances are more likely to be spent on necessities such as food and water and for school fees and health care. In Kenya, women with savings accounts invested 45 percent more in their businesses (Dupas and Robinson 2013).

FOOD SECURITY: Financial services for farmers can lead to bigger investments in the planting season, leading to higher yields and improvements in food security. When Malawian farmers had their earnings directly deposited into a new bank account, they spent 13 percent more money on equipment and increased the value of their crop output by 21 percent (Brune et al, 2015).

HEALTH: Financial services help people manage medical expenses and invest in good health. In Nepal, households with savings accounts suffered smaller income reductions when hit with a health shock (Prina 2015). In Kenya, health savings increased by 66 percent when people were given a safe place to save (Dupas and Robinson 2013).

Read more: CGAP's "Achieving the Sustainable Development Goals: The Role of Financial Inclusion"

Financial Inclusion: Taking Stock

Progress has been made, but there is still much to do. According to the World Bank's Global Financial Inclusion Database (Findex), the number of adults globally owning an account is now at 69 percent, an 18-percentage point increase since 2011. The number of adults without an account is 1.7 billion, down from 2.5 billion in 2011. Technology and mobile money helped drive these improvements in access, particularly in Sub-Saharan Africa where the share of adults owning mobile money accounts continues to increase.

Some regions have continued to make important gains, even ahead of the global average. Account ownership in East Asia and the Pacific is now 70.6 percent, rising from 55.1 percent in 2011, albeit much of this progress was driven by China. Other East Asian countries continue to lag, with Cambodia, Lao PDR, and Myanmar each below 30 percent. And while there are no Findex data available for Pacific Island Countries (PICs), comparable data suggest that access across PICs as a group is on par with Sub-Saharan Africa, around 41 percent.

Despite top-line improvements in account access in recent years, serious gaps remain among certain population segments. The global gender gap is not narrowing, with the 9 percentage-point gap in developing countries remaining unchanged between 2011 and 2017, and evidence that the gender gap may be widening in some markets such as Bangladesh and Jordan. PICs show great variation in gender gap, with Samoa demonstrating slightly better access to accounts (2 points) for women than for men, while Fiji maintains a 16-point gap in favor of men. Visiting a financial institution can be intimidating and expensive, and many products simply aren't designed to meet the needs of poor customers. For women, these factors can be compounded by social norms that make it difficult to travel or publicly transact with male employees. Yet the positive potential of financial inclusion for women is clear, beyond gender equity in and of itself: Finances controlled by women are more likely to be spent on food, health, child welfare, and their own businesses, expenses directly linked to SDG attainment.

Furthermore, account **usage** continues to lag, suggesting that access has not yet translated into lasting value for many users, and concerning for the providers who need a solid business case for serving the mass market. According to Findex, 26 percent of bank accounts in developing countries are inactive (defined as no activity, whether deposit or withdrawal, in the past 12 months). More worrisome for those who have positioned digital solutions as affordable and scalable to serve low-income and remote populations, nearly two-thirds of mobile money accounts are inactive globally according to the GSMA. At this juncture, improved understanding of the root causes of barriers in access to and usage of financial services in specific market contexts is essential for maximizing their value to poor men and women and harnessing the full potential of financial inclusion for development.

Innovation and disaggregation of the financial services value chain will continue. Opportunities for the private sector to enter the financial services space have expanded dramatically in heterogeneous ways around the globe. Connectivity and digitization lower transaction costs and create data trails that enable firms to innovate by developing new business models that serve poor customers. Innovations like distributed ledger technology, big data, artificial intelligence and cloud computing have the potential to enable other firms to create step changes in improving the cost dynamics for serving the poor.

New entrants are completely disrupting and disaggregating the value chain for delivery of financial services. Providers now include banks, microfinance institutions, cooperatives, mobile network operators (MNOs), payments services providers, merchant aggregators, retailers, financial technology companies (FinTechs), energy services providers, search engines, and social networks. Bank branches and ATMs have been replaced by agents managed by MNOs in Africa, with specialized agent network management companies are expected to gradually take over this role from MNOs. And FinTechs are providing services that replace parts of traditional banking that are not handled efficiently or at costs that favor the poor, particularly in the areas of payments, international money transfers, and retail lending. Distribution that enables the digitization and de-digitization of cash remains a key challenge in many markets. But the increased diversity of providers offers a tremendous opportunity for new partnerships to be formed that support innovative solutions to serve the poor.

Governments will continue to play an important role. Policymakers have an increasingly important role to play in ensuring access to financial services for all. Along with the private sector, policymakers can incentivize broader and interconnected market systems to achieve safe and more efficient product delivery. For example, East Africa has shifted from open experimentation to a more coordinated effort to build interoperable services for cross-border remittances and other services, affording key lessons for other markets and regions. Governments are increasingly channeling payments to citizens through digital infrastructure and, in some markets, citizens are using the same channels to pay government taxes and fees. Competition policy and consumer protection are increasingly in focus in markets around the world.

Global financial standard-setting bodies (SSBs) have significant influence on country-level policy environments, affecting both the business case for formal financial service providers and the value proposition for customers. Over the past decade, SSBs have demonstrated an understanding of the linkages between financial inclusion, stability, integrity, and consumer protection. The rapid development of digital financial services requires that they adapt and prepare for new and shifting risks.

Forces Shaping the Future

As the world rapidly changes, CGAP has identified several key forces important to the lives of poor people and to the future of financial services:

Rising inequality. Over the past 40 years, global poverty has decreased dramatically. Today fewer than 1 billion people live in poverty compared with nearly 2 billion people in 1975, and this despite substantial population growth. However, improvements in global poverty rates and income levels have not been equal across the globe. Poverty reduction has been accompanied by substantial increases in inequality. Data show that inequality continues to rise in many countries in terms of both income and assets. Inequality is a growing challenge not only between countries, but within countries, and it is challenging the prevailing liberal economic consensus.

Increased migration flows. Economic opportunity, jobs, and the promise of a better life will continue to entice people to relocate, particularly to cities. Forces such as climate change and conflict will accelerate people's drive to migrate, and people living in small island states in the Pacific, in South Asia, and in Sub-Saharan Africa are expected to be affected disproportionately. As of 2015, there were an estimated 244 million international migrants globally living outside their countries of origin, and more than 740 million internal migrants.

Emergence of the digital economy. The Internet, mobile phones, and diverse tools that collect, store, analyze, and share information digitally are spreading quickly. The number of Internet users tripled in a decade to reach 3.2 billion by 2016. On average, 8 in 10 individuals in the developing world own a mobile phone, including those at the base of the economic pyramid. In fact, more households in developing countries own a mobile phone than have access to electricity or improved sanitation. The spread of smartphones will link millions more low-income people to the Internet, dramatically improving their ability to access information and services in a user-friendly format.

Despite rapid progress in digital and Internet penetration, there is risk of a digital divide. In developing countries, a large portion of the population remains untouched by digital technologies: nearly 2 billion do not own a mobile phone, and nearly 60 percent of the world's population does not have Internet access. As access grows in developing countries, some groups are more likely than others to be left behind: low-income populations, women, and rural communities are likely to lag in their access to the networks that are transforming the global economy.

Increasing globalization of data and information. The digital economy is generating massive volumes of data. Mobile phone data, social media, SMS, emails, Internet search data, and financial transactions all provide diverse sources of data that reveal new insights that businesses and governments can use to better serve people who are digitally connected. But the rise of data also creates new challenges. Individuals who do not have a data footprint will increasingly be at risk of economic and social exclusion. For customers, data present risks around privacy, anonymity, consent, security, and potential discrimination. Data are often held by a small group of companies such as MNOs, Internet service providers and social media companies, which may be reluctant to share data to preserve their competitive advantage, encouraging monopolies. This also challenges nation states. People and organizations are interacting beyond national borders, sharing ideas and finding solutions to challenges with or without state involvement, resulting in empowerment of non-state actors and making concentrating power in the hands of a few transnational corporations.

Widespread changes in livelihoods and work. According to the World Bank, demographic trends require the creation of 600 million new jobs globally in the next 15 years to maintain stable rates of employment. While some countries will face challenges in maintaining current employment levels in the face of growing automation, others will have to run even faster to keep up. Migration, digital technologies and globalization of data have the potential to create new employment opportunities. As more people move to cities, they will be looking for nonagricultural work in domestic service and knowledge industries, or in the outsourced industries from other countries. Developing countries may not benefit from globalization if their skill development and technology fail to keep pace with technological advances. Digital technologies are also disrupting work patterns. There are more irregular contracts and short-term work, blurring the lines even further between informal and formal and limiting job security and protection. At the same time, digital technologies may offer alternatives for organizing the informal sector, creating some of the same advantages that normally come with formal labor, such as choice of working times and tracking of hours worked and wages earned (i.e., the Uber effect).

Implications for Financial Inclusion

The forces outlined above have important implications for financial inclusion in developing countries. Some of these can be anticipated and mitigated, while others will catch us completely by surprise. But for the markets CGAP and DFAT care about, it seems quite clear that adaptation will be required on all sides.

The poor will have to adapt to an increasingly complex world. Climate change and improved access to information will increasingly push people towards cities. This will change their lives in ways both positive and negative. They will need to adapt to a connected global economy, leapfrogging the traditional route of industrial development straight into the information age. This will create opportunities for some, but challenges for others. New skills will be central to this transition. The financial inclusion community will need to look for ways to support this massive change, equipping poor people to thrive in urban environments and supporting the livelihoods of those who remain in rural areas, often the elderly or women. The development of appropriate financial services use cases will be crucial, as will building out a large-scale and low-cost infrastructure that supports delivery of these services. Domestic and international remittances, savings, livelihood-enhancing loans, and products linked to education and skills development will be critical to adapting to new urban environments. Those remaining in rural areas will need access to similar use cases and will also require access to essential services like clean water, energy, health, and education, as well as agricultural supply and insurance services. In order to develop appropriate products and services, much more work needs to be done in understanding the needs of excluded segments.

Providers will need to refine their business models in ways that achieve both scale and depth of penetration. This will be particularly difficult in smaller, poorer countries. Many mobile money providers are struggling to make the economics work. Running agent networks is expensive, and as long as people use cash, they must get cash into and out of the digital ecosystem. To drive efficiency into the system and bring down costs, providers will need to find ways to cooperate with their competitors, building shared infrastructure and interoperable solutions. This will have the effect of broadening the ecosystem and bringing it to sufficient scale to reach the mass market and the poor. To deepen the ecosystem and build the new use cases, businesses must be viable. Large infrastructure providers will need to open up their rails to third parties allowing independent developers to build the products and services that customers want at a faster pace and at lower cost. Providers will also need to think more broadly, finding creative ways to increase customer usage. Providers will need to make better use of the data at their disposal – both in the development of their own services, and in making data available to others who may be able to provide the service more innovatively or efficiently than they can. Partnerships will be crucial to building an integrated digital ecosystem. And an integrated digital ecosystem will be critical to building the scale that is required to bring costs down to a level where it is possible to sustainably serve the poor.

Governments will need to adapt to a rapid pace of change in the development of digital ecosystems and financial services. National governments and global bodies will need to build a deeper understanding of the multiplicity of new players providing services and understand the ways in which they can both promote the use of financial services and protect the stability of the financial system along with the rights of customers. This will require much better data, skills, and practices across a range of governmental and intergovernmental agencies – from financial sector regulators and supervisors, to competition authorities, consumer financial protection authorities, and government agencies looking for more efficient ways to make payments to their citizens (or accept payments from their citizens), to regional and global bodies adjusting to the emerging new world. Google, Facebook, WeChat and other BigTech players will present challenges that go beyond their borders, and that will require transnational collaboration among regulators and policymakers. The pace of innovation in financial services is accelerating and many governments in developing countries are ill-prepared to oversee and utilize novel forms of financial services delivery. Technology offers solutions for addressing some of these challenges, but there will be a steep learning curve, and dialogue and new approaches to collaboration between the public and private sectors will be increasingly important.

Donors will need to continue to adapt, but even more rapidly. Many donors have begun to reorganize their work in relation to the 2030 Agenda for Sustainable Development. The Addis Ababa Action Agenda (AAAA) defines the financing framework for the SDGs and donors are seeking ways to better leverage the private sector. Donors and other development actors are experiencing many of the same challenges as governments in understanding the new players and their shifting roles in this increasingly complex landscape. Pressures on donor operational budgets have meant trying to do more with less. How can they leverage the private sector without increasing the trends that foster monopolistic players? How can they adapt their roles in this increasingly digital and complex environment with less technical staff and budgets shifting to non-financial services sectors such as health or education? Donors and development actors will need to identify ways of working that allow them to access deep technical expertise, while influencing colleagues in other sectors.

Using a market systems approach and partnering with market facilitators is one important way in which donors can improve their ability to adapt to this changing landscape. DFAT is a leading proponent of a market systems approach to development, and CGAP encourages DFAT to continue aligning its new international development policy with this approach. By continuing to apply an adaptive, flexible, context-sensitive approach, donors like DFAT can catalyze sustainable change and build inclusive financial systems that advance opportunity and resilience for poor and excluded populations.