

## KEY POINTS

- Three key dimensions of financial inclusion are especially relevant for empowering the poor: transactional accounts, savings, and borrowing. There is significant scope for improving all three dimensions. For example, 1.3 billion Asian adults—or 46% of the adult population—have accounts in formal financial institutions, a much lower figure than the 90% in high-income countries.
- In order for finance to empower Asia's poor, policy efforts must give due regard to the last mile, i.e., not just broadening access to finance, but inducing the actual, beneficial use of finance. Examples include financial literacy and other financial education programs and encouraging banks and other institutions to design simple-to-use financial products for poor clients with little education.
- Better data for financial inclusion is required to inform decision making. Until recently few countries tracked the outreach of their financial systems, and no national reporting comparable to that on financial performance is available presently. Therefore, both national and international data efforts will allow for a more granular assessment of financial inclusion challenges.

## FINANCIAL INCLUSION IN DEVELOPING ASIA: TRANSACTIONAL ACCOUNTS, SAVINGS, AND BORROWING

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### INTRODUCTION: INCLUSIVE FINANCE FOR EMPOWERING THE POOR

Developing Asia has made enviable headway in the fight against poverty, largely as a result of sustained rapid economic growth. Indeed, the scale and speed of poverty reduction in the region has been almost unprecedented.

Asia now, however, finds itself facing another difficult challenge, a challenge it shares with the rest of the world. Inequality has increased in economies that collectively account for more than 80% of the region's population (Figure 1).

They encompass all income and development levels, from Bangladesh and the Lao People's Democratic Republic, to the People's Republic of China (PRC) and India, to the Republic of Korea. As a result of growing concerns over rising inequality, inclusive growth that spreads productive opportunities and the fruits of growth more evenly across the entire population has emerged as a top nationwide strategic priority.

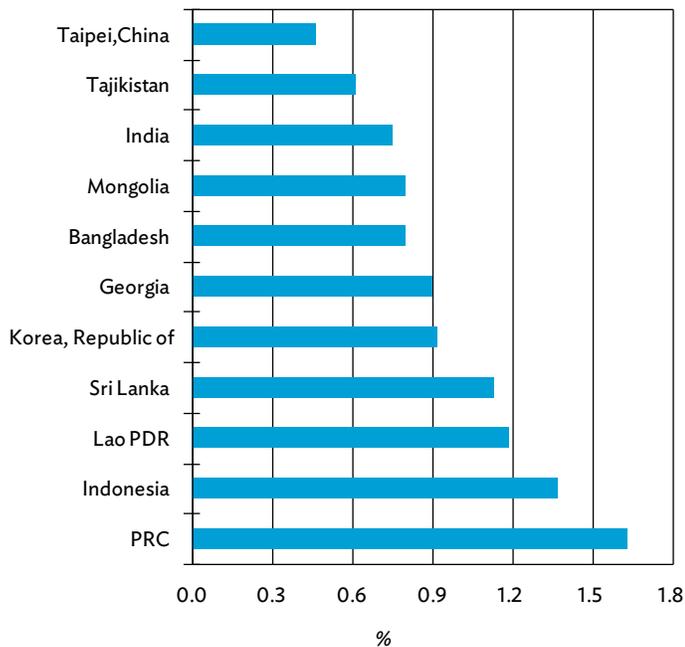
One key ingredient of inclusive growth is an inclusive financial system that expands access to financial services to poor households. Access to finance enables the poor to protect themselves against adverse shocks and to balance their consumption and thus improve their welfare.

It also expands their human capital and productive opportunities, for example, by financing education or financing the purchase of tools and equipment. In fact, there is growing empirical evidence that financial exclusion can lead to poverty traps and to inequality.<sup>1</sup> In short, both theory and evidence suggest that financial inclusion can be a

<sup>1</sup> World Bank. 2014. *Global Financial Development Report 2014: Financial Inclusion*. Washington, DC.

powerful tool for empowering the poor, for augmenting their earning potential, and for improving the quality of their lives.

**Figure 1: Annualized Gini Coefficient Change in Developing Asia, 1990–2010**



Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.

Note: A rising Gini coefficient indicates increased inequality.

Source: Asian Development Bank. 2012. *Confronting Rising Inequality in Asia*. Manila.

Financial inclusion is a concept that is related to but distinct from the broader concept of financial development or the expansion and deepening of a country’s financial system, i.e., banks and capital markets. Indeed, both theory and evidence suggest that financial development does not in and of itself reduce inequality.<sup>2</sup>

Therefore, extending financial services to the poor and underprivileged requires deliberate, additional efforts on the part of policy makers. Providing an enabling environment for cost-effective delivery channels such as mobile banking and banking agents—local retail stores that handle banking services on behalf of banks—is a good example.

Reflecting a growing recognition of the importance of financial inclusion, financial regulators from more than 20 countries made financial inclusion commitments under the 2011 Maya Declaration to (i) create an enabling environment that increases access and lowers costs of financial services, including through new technology; (ii) implement a proportionate regulatory framework that balances financial inclusion, integrity, and stability; (iii) integrate consumer protection and empowerment as a pillar of financial inclusion; and (iv) use data to inform policies and to track results.<sup>3</sup>

In this brief, we examine three key dimensions of financial inclusion that we believe to be especially relevant for empowering the poor: transactional accounts, savings, and borrowing.

We then set forth some broad policy options for leveraging finance as a tool for empowering the poor.

## TRANSACTIONAL ACCOUNTS: ENTRY POINT TO SAVINGS AND PAYMENTS WITH BENEFITS TO ACCOUNT HOLDERS AND THE OVERALL ECONOMY

In Asia, 1.3 billion adults, or 46% of the adult population, have accounts in formal financial institutions. The figure is higher than that in Latin America at 39% but much lower than the 90% in high-income countries.<sup>4</sup>

There is a considerable variation among countries and subregions closely correlated with per capita incomes and levels of development (Figure 2).

In the PRC, the Republic of Korea, Malaysia, Mongolia, Singapore, Sri Lanka, and Thailand, the majority of adults has bank accounts, yet in 17 out of 26 countries for which data are available, fewer than 40% have accounts.

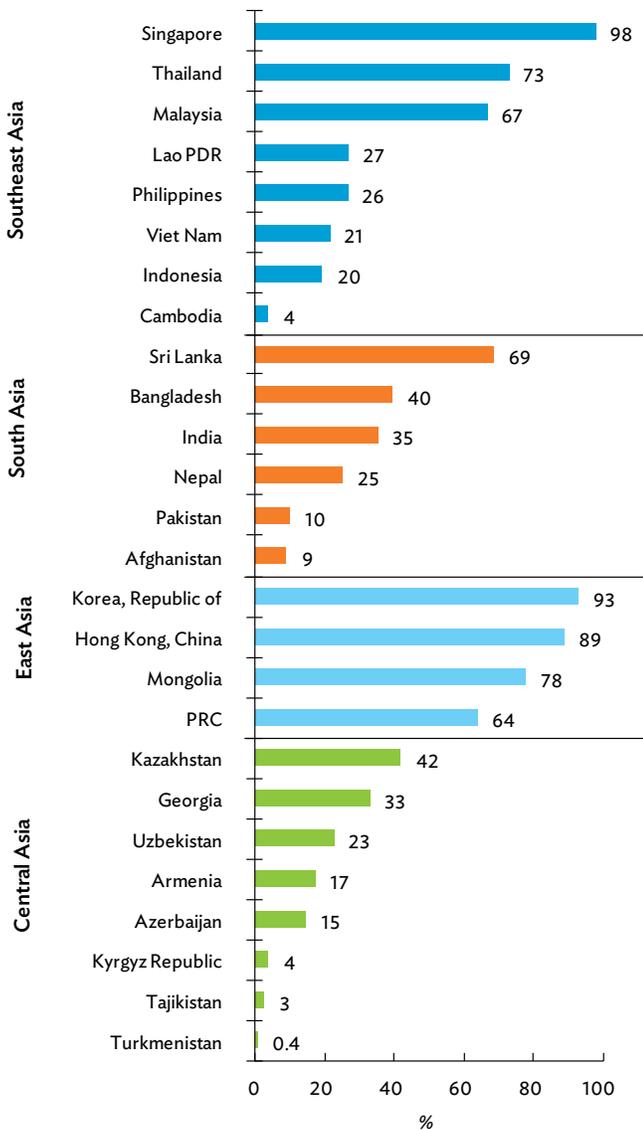
Access to basic transactional accounts benefits account holders as well as the economy as a whole. Account holders can benefit from lower-cost money transfers and convenience and from the safety that regulated systems offer compared to nonregulated alternatives. Using accounts to pay salaries; government social payments; and other inter-business, business–individual, business–government, and individual–government payments improves the transparency, accountability, and efficiency of the overall economy.

<sup>2</sup> See, for example, ADB. 2015. *Financing Asia’s Future Growth*. *Asian Development Outlook 2015*. Manila

<sup>3</sup> World Bank. 2012. *Financial Inclusion Strategies Reference Framework*. [www.worldbank.org/financialinclusion](http://www.worldbank.org/financialinclusion) (see also [www.afi-global.org/gpf/maya-declaration](http://www.afi-global.org/gpf/maya-declaration)).

<sup>4</sup> Unless otherwise noted, data are from A. Demirgüç-Kunt and L. Klapper. 2013. *Measuring Financial Inclusion: Explaining Variation in Use of Financial Services across and within Countries*. *Brookings Papers on Economic Activity*, Spring, pp. 279–340.

**Figure 2: Share of the Population with an Account in a Formal Financial Institution (% age 15+)**



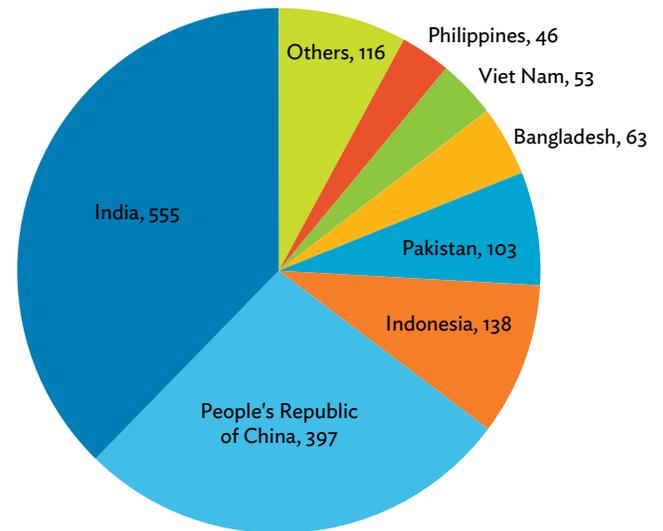
Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

Sources: A. Demirgüç-Kunt and L. Klapper. 2013. Measuring Financial Inclusion: Explaining Variation in Use of Financial Services across and within Countries. *Brookings Papers on Economic Activity*. Spring. pp. 279–340; authors' calculations.

Assessments of the impact on costs of shifting to electronic payments in various government social programs show cost reductions of 80% or more.<sup>5</sup>

Of the 1.5 billion people in Asia without access to an account, 92% live in Bangladesh, the PRC, India, Indonesia, Pakistan, the Philippines, and Viet Nam (Figure 3).

**Figure 3: Seven Countries Account for 92% of the 1.5 billion Unbanked in Developing Asia**



Sources: A. Demirgüç-Kunt and L. Klapper. 2013. Measuring Financial Inclusion: Explaining Variation in Use of Financial Services across and within Countries. *Brookings Papers on Economic Activity*. Spring. pp. 279–340; authors' calculations.

Improvements in technology, flexible regulations on know-your-customer requirements, and reliable personal and business identification systems combined with a commitment to improved transparency and accountability show that shifting to electronic payments and universal access to transactional accounts is within reach.

India's recent commitment to provide access to transactional accounts for all adults illustrates the importance of government policy in strengthening financial inclusion.

<sup>5</sup> K. Lindert et al. 2007. The Nuts and Bolts of Brazil's Bolsa Família Program: Implementing Conditional Cash Transfers in a Decentralized Context. *SP Discussion Paper*. No. 0709. Washington, DC: World Bank; S. Duryea and E. Scharfrodsky. 2007. *Financial Services for the Poor: Welfare, Savings and Consumption*. Washington, DC: Inter-American Development Bank.

## SAVINGS: MOBILIZING SAVINGS FOR INCLUSIVE GROWTH

While savings rates in Asian economies are high, a large proportion of the population saves outside the financial system. Mobilizing savings through an effective, modern financial system can mobilize resources for inclusive growth.

In Asia, we found that 32% of adults report saving money but only 21% of them save in financial institutions. Savings rates measured in Asia are higher than those in Latin America (26%), but significantly, there are about 300 million Asian adults saving outside financial institutions representing approximately half of the total world population that does so.

Patterns differ widely across economies, reflecting the levels of both economic development and financial system maturity (Figure 4).

At the extremes are Singapore where 61% of adults report saving, 96% of whom use formal financial institutions; and Georgia where only 7% of the population reports saving, of whom only 15% do so

formally. Even countries with similar savings rates diverge widely in terms of reliance on formal financial institutions.

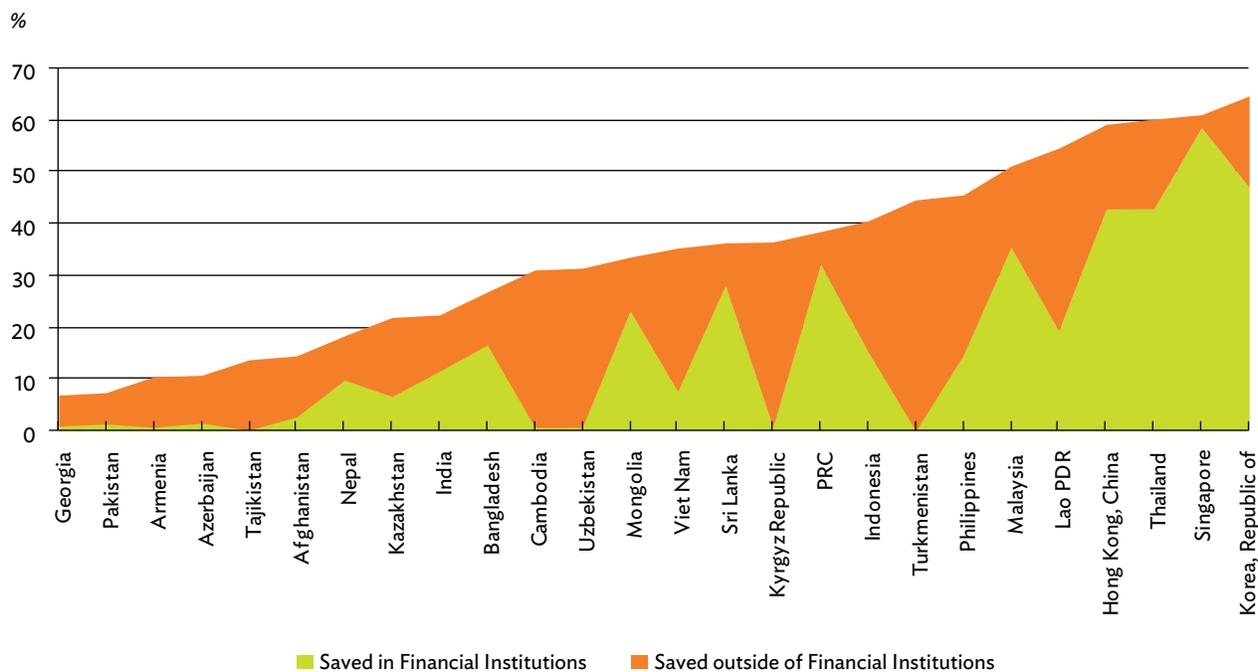
In Sri Lanka, 36% of adults report saving money, 77% of whom save in financial institutions. In Viet Nam, a similar share of 35% of adults report saving money, but only 22% of them use financial institutions. In the Kyrgyz Republic, even more strikingly, of the 36% of adults saving money, only 2% used formal financial institutions.

Access to savings products in the formal financial system has important benefits for individuals as well as for the overall economy.

For individuals, saving in the formal system offers financial returns and safety. For the broader economy, mobilizing savings through an effectively functioning financial system allows the channeling of resources for investment and economic growth.

A safe and sound overall financial system is a fundamental prerequisite for effective intermediation and mobilizing savings. Adequate financial sector regulation and supervision, a comprehensive and effective deposit protection regime, and strong consumer protection mechanisms are essential elements of the modern financial system.

**Figure 4:** Percentage of Adults Saving in and outside Formal Institutions, Selected Developing Asian Economies



Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.

Sources: A. Demirgüç-Kunt and L. Klapper. 2013. Measuring Financial Inclusion: Explaining Variation in Use of Financial Services across and within Countries. *Brookings Papers on Economic Activity*. Spring. pp. 279–340; authors’ calculations.

Most governments in Asia have made significant improvements in overall financial sector regulation and supervision allowing them to withstand the global financial crisis of 2008 and to put in place a strong foundation for a more inclusive sector. Yet, as experience around the world and in Asia shows, financial stability is necessary but is not the only element required for an inclusive financial system.

For the 300 million adults in Asia who keep their savings outside banks and other formal financial institutions, more needs to be done. Balancing inclusivity and stability for deposits will remain a key challenge for financial regulators.

Greater competition in the banking sector and regulations broadening access to savings products, such as mandatory reductions in minimum balances, can significantly improve access to savings services. Private service providers, in turn, need to develop products that address the needs of this significant market.

### **BORROWING: HIGH RELIANCE ON INFORMAL BORROWING INDICATES SIGNIFICANT UNMET DEMAND FOR CREDIT SERVICES**

In Asia, 38% of adults report borrowing, which is fewer than in other regions. In high-income countries, 83% of adults report having a loan or a credit card; in Latin America, the corresponding figure is 44%.<sup>6</sup>

Borrowers in Asia are more likely to rely on informal sources than borrowers in high-income countries where 80% rely on formal sources, largely credit cards. In Asia, only 38% used financial institutions or credit cards for borrowing compared with 60% in Latin America. Significant reliance on informal borrowing indicates a potentially unmet demand for credit products from formal financial institutions.

Economies vary greatly in terms of their reliance on borrowing and on borrowing from financial institutions (Figure 5). While borrowing is nearly universal in Cambodia, the Republic of Korea, and the Philippines, fewer than 20% report borrowing in Uzbekistan.

Individual borrowing is used for consumption smoothing, which includes health, school, and life-event expenses. The need

to borrow is partly determined by the social and institutional structure within an economy. Where schooling is provided for free, there is no need to borrow for school fees, but in countries where this is not the case, school fees and related expenses represent a major expense. In the Philippines, 21% of adults report borrowing for school expenses followed by Nepal (12%) and Thailand (11%).

Health costs are another category where the existence of effective national health insurance reduces the need to borrow. At present, health expenses are most often identified as the reason for individual borrowing in Asia. In Cambodia, 36% of adults borrowed to cover health-related expenses, and in the Philippines that figure was 28%.

Overall in Asia, 11% borrowed for health expenses. Research has shown that consumers who are able to borrow often spend money on transport and food. In a recent study, those with loans were more likely to keep their jobs and were less likely to fall below the poverty line and experience severe hunger.<sup>7</sup>

Reliance on informal sources in many countries in Asia, especially on private, unregulated lenders, indicates that the current formal financial system is not able to meet the demand and provide suitable finance products for the poor.

As a result, in some economies, moneylenders are an important source of finance, e.g., they represent 13% in Cambodia, 20% in Nepal, and 13% in the Philippines.

Credit to the private sector, as a share of gross domestic product, has expanded in most of Asia bringing the regional average from 70% in 2002 to 86% in 2012. Recent reports by the authorities in a number of jurisdictions expressed concerns over the growth of credit, possible asset bubbles, and levels of indebtedness within some market segments.

Household credit accounts for a small share of overall credit in most Asian economies, but it has expanded rapidly, often at rates higher than overall credit growth albeit from a low base. In some economies including Malaysia, Singapore, and Thailand, the ratio of household debt to gross domestic product has reached 50% or higher.

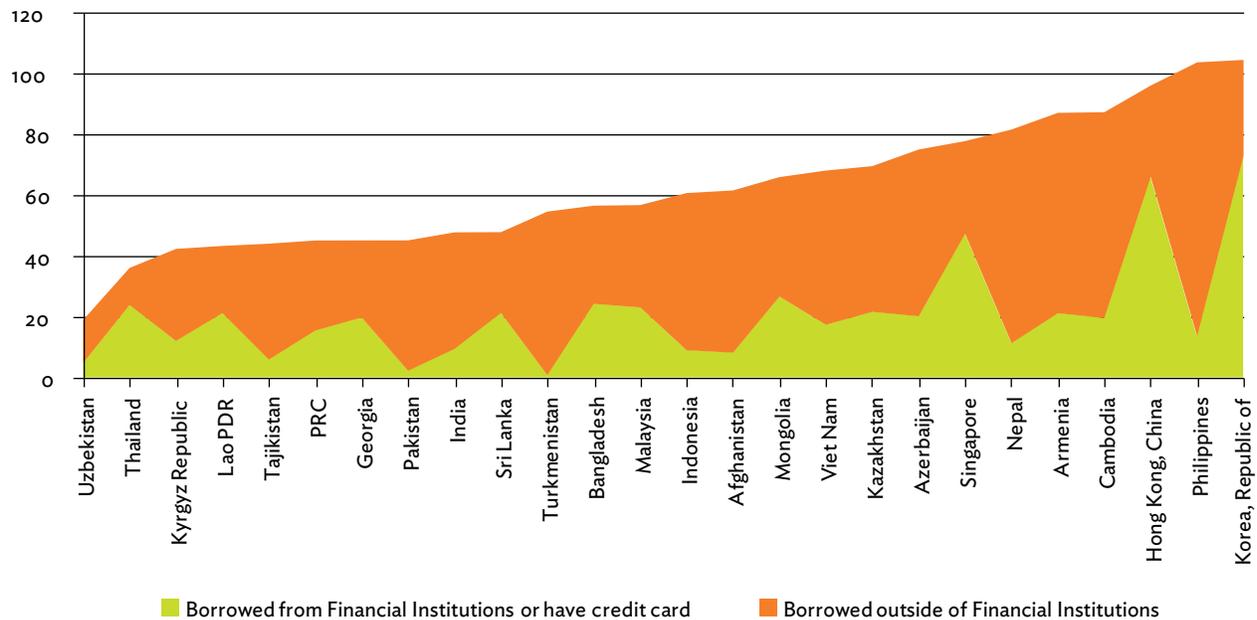
In the PRC, the ratio is low at about 20%, but it has doubled since 2008.<sup>8</sup> Efforts to broaden access to underserved segments need to be combined with the effort to carefully manage risks in market

<sup>6</sup> Borrowing includes having a credit card or loan from a financial institution, store, employer, private lender, or friend. Country averages are computed as the sum of shares of individuals relying on each source of funds; as individuals use multiple sources, the total can exceed 100%.

<sup>7</sup> D. Karlan and J. Zinman. 2010. Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts. *Review of Financial Studies*. 23 (1). pp. 433–464.

<sup>8</sup> International Monetary Fund. 2014. *Regional Economic Outlook: Asia and Pacific 2014*. Washington, DC. <https://www.imf.org/external/pubs/ft/gfsr/2006/02/pdf/chap2.pdf>

**Figure 5: Percentage of Adults Borrowing from and outside Formal Institutions in Selected Developing Asian Economies**



Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.

Sources: A. Demirgüç-Kunt and L. Klapper. 2013. Measuring Financial Inclusion: Explaining Variation in Use of Financial Services across and within Countries. *Brookings Papers on Economic Activity*. Spring. pp. 279–340; authors’ calculations.

segments that may have already accumulated substantial amounts of debt.

While household credit expansion is desirable, it should not become the source of costly credit boom-and-bust cycles. Expanding access to credit needs to be matched by the development of effective financial consumer protection frameworks and institutions.

## EMPOWERING THE POOR THROUGH FINANCE: POLICY DIRECTIONS

Policy efforts to promote financial inclusion are gaining momentum both nationally and internationally. The Group of Twenty (G20) endorsed “Principles for Financial Inclusion in 2010,” and more countries are joining the Maya Declaration.<sup>9</sup>

The United Nations, Organisation for Economic Co-operation and Development, and multilateral development institutions have committed to support financial inclusion initiatives.

As governments begin to address the challenge and to achieve the goal of universal financial inclusion, the broad policy areas of focus outlined below should be included.

A crucial, but often underappreciated, ingredient of effective, empowering financial inclusion is the “last mile.” If financial inclusion is to be more than just a statistic—the number of poor rural households that have an account in a bank or other formal financial institution—its beneficiaries must be able and willing to actually use finance for consumption and production. An idle bank account does nothing to improve the welfare or expand the

<sup>9</sup> Global Partnership for Financial Inclusion. 2011. *G20 Principles for Innovative Financial Inclusion*. Bangkok. <http://www.gpfi.org/sites/default/files/documents/G20Principles%20for%20Innovative%20Financial%20Inclusion%20-%20AFI%20brochure.pdf>

productive opportunities of the account holder. Furthermore, it imposes unnecessary additional costs on banks.

Therefore, in order for finance to empower the poor, policy efforts must give due regard to the last mile not just by broadening access to finance but also by inducing the actual, beneficial use of finance. Examples include financial literacy and other financial education programs, encouraging banks and other institutions to design simple-to-use financial products for poor clients with little education; and the use of debit cards to facilitate conditional cash transfers to millions of poor rural women in Pakistan and the Philippines.

- **Creating an enabling environment for innovation in financial service delivery to increase access to and reduce costs of financial services.** An enabling environment includes legal and regulatory frameworks for financial service delivery as well as broader systems such as national identification cards.
- **Implementing a proportional framework that advances synergies in financial inclusion, integrity, and stability.** Maintaining financial stability is a precondition for financial inclusion. As the regulatory framework for the financial sector is reformed and strengthened, regulators need to take

into account impacts on financial access and incorporate necessary mitigation measures.

- **Integrating consumer protection and empowerment as a key pillar of financial inclusion.** Effective consumer protection and the availability of financial education are especially important for previously excluded populations with no prior knowledge of financial service products.
- **Measurement and data for financial inclusion to inform decision making.** Until about 5 years ago, few countries tracked the outreach of their financial systems, and no national reporting comparable to that on the financial performance is available presently. Important progress has been made in recent years with many countries introducing consumer finance surveys or surveys on access to finance. Since 2009, the International Monetary Fund has collected broad outreach data through its Financial Access Survey that now covers 189 economies. With funding from the Bill & Melinda Gates Foundation, the World Bank developed the Global Findex Database using a survey of 150,000 individuals in 147 countries available in 2011.<sup>10</sup> An updated database was recently released this year.<sup>11</sup> Further efforts, both national and international, will allow for a more granular assessment of financial inclusion challenges to better guide and inform policies going forward.

<sup>10</sup> A. Demirgüç-Kunt and L. Klapper. 2013. Measuring Financial Inclusion: Explaining Variation in Use of Financial Services across and within Countries. *Brookings Papers on Economic Activity*. Spring, pp. 279–340.

<sup>11</sup> A. Demirgüç-Kunt et al. 2015. The Global Findex Database 2014: Measuring Financial Inclusion around the World. *Policy Research Working Paper 7255*. Washington, DC: World Bank.

### About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to the majority of the world's poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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