Financial inclusion: challenges in OECD countries

By Fozan Fareed, Patrick Lenain, Enes Sunel and Douglas Sutherland, OECD Economics Department

Access to financial services is taken for granted by most people. Amenities such as bank accounts, credit cards, cash dispensers, consumer credit and mortgage loans – all essential to our daily lives – are widely available in OECD countries. When individuals face financial hardship, having access to savings set aside in a bank, or obtaining a consumer credit, is particularly useful. Also, digital payments have proved essential during the COVID-19 pandemic to observe safe distancing rules.

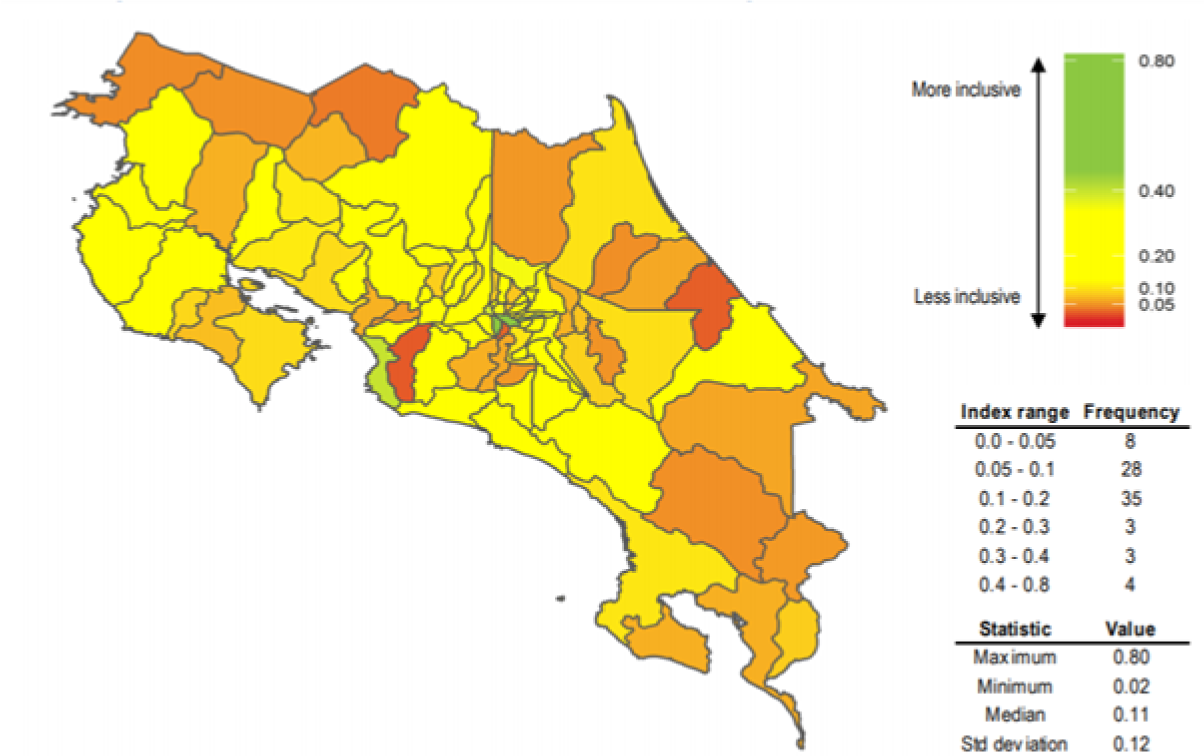
However, not everybody enjoys this kind of financial access. Worldwide, about 1.7 billion people did not have access to basic formal financial services in 2017. In OECD countries, many vulnerable people have insufficient knowledge to go beyond rudimentary transactions or are unable to accumulate savings. Not having access to money management can be a serious problem. People facing emergencies, like a large healthcare bill, may not be able to come up with the funds and remain untreated for their illness. Being unable to make online payments and contactless transactions will be a growing problem in the post-pandemic world. Governments often use electronic payments to make rapid social transfers during recessions (Duenwald et al., 2020), such as the US$1,200 payment sent to all U.S. citizens during the first wave of COVID-19, but may be unable to reach some people. The literature finds that financial inclusion matters for access to employment and income generation (Bruhn and Love, 2014), entrepreneurship creation (Fareed et al., 2017) and women empowerment (Karlan et al. 2017; Pitt et al. 2006). This blogpost highlights several insights from our recent research on three countries: Costa Rica [1] (Sunel, 2020), Mexico (Fareed et al, 2017) and the United States (Azzopardi et al. 2019).

Costa Rica: almost one third of adults without financial access

Despite progress made during the past decade, more than 30% of Costa Ricans aged over 15 do not have an account with a financial institution. Insurance penetration is also very limited and stagnant. This low level of financial access is partly explained by the high cost of banking services, which act like a tax on financial transactions. The lack of competition between banks has impaired the reduction of banking costs and intermediation margins seen in other countries, and Fintech have not been allowed to operate fully to provide low-cost solutions to (especially underbanked) consumers.

To get a sense of regional disparities, we built an index summarising the prevalence, at the level of counties, of financial access points, credit operations, bank accounts and financial transactions (Figure 1). Access to financial services is typically low in counties where the population is not dense, but some highly-populated counties, such as Alajuelita and Desamparados in the province of San José and San Rafael and San Pablo in the province of Heredia, also display very low financial inclusion scores. For micro-entrepreneurs, this makes business operations very challenging, especially for women entrepreneurs. Priority groups such as Indigenous people also suffer more than others from financial exclusion. In response, the authorities have launched a National Financial Education Strategy to boost financial literacy of vulnerable populations and linked conditional cash transfer programme beneficiary accounts to debit card accounts to increase financial account ownership.

Figure 1: Financial inclusion disparities in Costa Rica



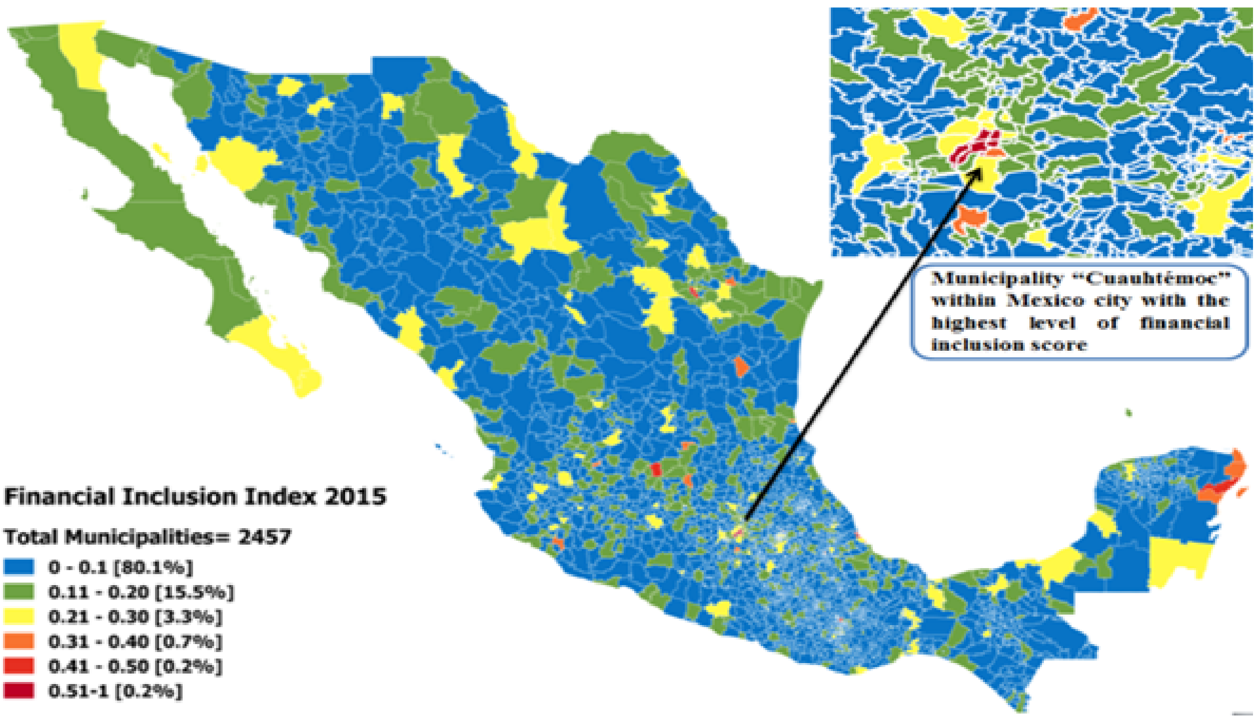
Source: Banco Central de Costa Rica; Instituto Nacional de Estadística y Censos; and Superintendencia General de Entidades Financieras.

Mexico: over half of Mexicans without a formal bank account

Financial inclusion is even lower in Mexico: more than half of Mexicans aged 15 and over do not have a formal bank account. The penetration of credit, insurance and mobile banking also remains low as compared to regional peers. About 7 million people (6% of the country’s population) live more than 4 miles from the nearest financial access point such as a bank or an ATM according to the financial regulator CNBV. Outside large urban areas, access to financial services is limited and there are prominent regional disparities as highlighted by our financial inclusion index (Figure 2). This is a particular problem for women, who lack access to the banking system and therefore face challenges to launch an entrepreneurship project.

Lack of trust in banks, financial literacy and product design are significant barriers for the many unbanked in Mexico. High commissions and interest rates and poor financial infrastructure are highlighted as some of the main reasons that impede financial inclusion. Addressing these challenges would enable Mexicans, especially women entrepreneurs, to gain access to formal financial services and therefore benefit from new economic opportunities. The authorities have launched a number of actions to address these challenges, for instance the National Financial Inclusion Strategy (NFIS) provides a roadmap to accelerate access to financial services for the currently unbanked segment of the population.

Figure 2: Financial inclusion disparities in Mexico



Source: Author's Calculations based on CNBV's data at the municipality level.
Note: Financial inclusion index ranges from 0 (low) to 1 (high). See Fareed et al. (2017) for details.

United States: 28% of Americans are

financially vulnerable

Although financial inclusion is high in the United States, financial vulnerability remains a severe problem for many people, especially low-income households, racial groups, and remote locations. Instead of using an arbitrary definition of financial vulnerability or a single indicator, such as indebtedness, we apply a hierarchical ascending clustering (HAC) and K-means clustering analysis to the Federal Reserve's Survey of Consumer Finance. The analysis identifies clusters of households with high financial vulnerability: about 28% of the households in 2016 can be classified as financially vulnerable.

Our econometric estimates show that Black and African Americans and Hispanics are financially more vulnerable than non-Hispanic white Americans, after controlling for other characteristics. A higher education level of the household head also appears to be statistically significant and is negatively linked with financial vulnerability. On average, having a college degree decreases the probability of being financially vulnerable. Financial literacy is also an area of concern: only 57% of adults in the United States can be considered financially literate according to the Global Financial Literacy Survey. Moreover, an increase in the age of the household head decreases the chances of being financially vulnerable. Such large differences among clusters of households reflect on the social disparities that affect the U.S. population.

Conclusion

Financial inclusion disparities exacerbate existing wealth inequalities and make it extremely difficult for the financially vulnerable to catch up, threatening social cohesion. Our research on Costa Rica and Mexico shows that access to financial services remains a challenge for many people, while large groups of U.S. households can be characterized as financially vulnerable. Since our research was conducted, it is possible that the COVID-19 pandemic has worsened these difficulties: many households have lost their jobs and micro-entrepreneurs have been impacted by government shutdown orders, increasing their financial difficulties. Because low-income households are being hit the hardest, it is more important than ever to facilitate access to financial instruments and encourage money management skills. Our findings suggest that the focus needs to be on closing gender and racial gaps, improving financial literacy, using Fintech responsibly to reach out to financially excluded people, and conducting further research to understand why some households are more at risk than others.

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[1] Costa Rica was invited to join the OECD as its 38th member in May 2020.

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