Financial Inclusion and Fintech in the CAREC Region

16-17 August 2023

Khalid Umar, Chief, Strategic Planning Division

Understanding Financial Inclusion (FI)

- **WBG** defines FI - **individuals and businesses have access to useful and affordable financial products and services** that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.
- Broadly recognized as the ability of the adult population, as well as micro, small and medium-size enterprises (MSME) to easily **own a bank account and access affordable, reliable, and sustainable financial services** offered by the formal financial sector such as banks, development finance institutions, and insurance companies.
- Overall, affordable financial services and products to all segments of society, particularly those **who have been traditionally underserved or excluded from the formal financial system** - Aims to empower people economically, reduce poverty, and foster inclusive economic growth.

FI and Economic Growth

- FI **important component of financial development** - it provides low-cost financial services - fosters economic growth.
- Policymakers view FI as **central to the economic development, poverty alleviation, and supporting social inclusivity** – efficient allocation of capital
- The evidence is lacking on the effect of FI on inclusive economic growth. Demirguc *et al*. (2017) identify two essential reasons for the lack of evidence.
  - First, FI is a **relatively recent phenomenon in economic discourse**, and it caught the limelight in the aftermath of the 2007-9 financial crisis. The data for a **comprehensive economic analysis of financial inclusiveness is limited**.
  - Second, FI as a policy instrument is **recently embedded in larger economic policy design;** hence the correlation between FI and the economic development remains unclear.
- Sahay *et al*. (2015) find that FI **promotes economic growth to a certain level** by broadening access to finance for households and businesses across different regions within the country and also to different age groups and genders, but the marginal benefits diminish after its coverage and depth increases.

Why Financial Inclusion Matters?

- FI has gained **significant attention** in recent years among policymakers, governments, development partners and the private sector as an **essential contributor to inclusive economic development**.

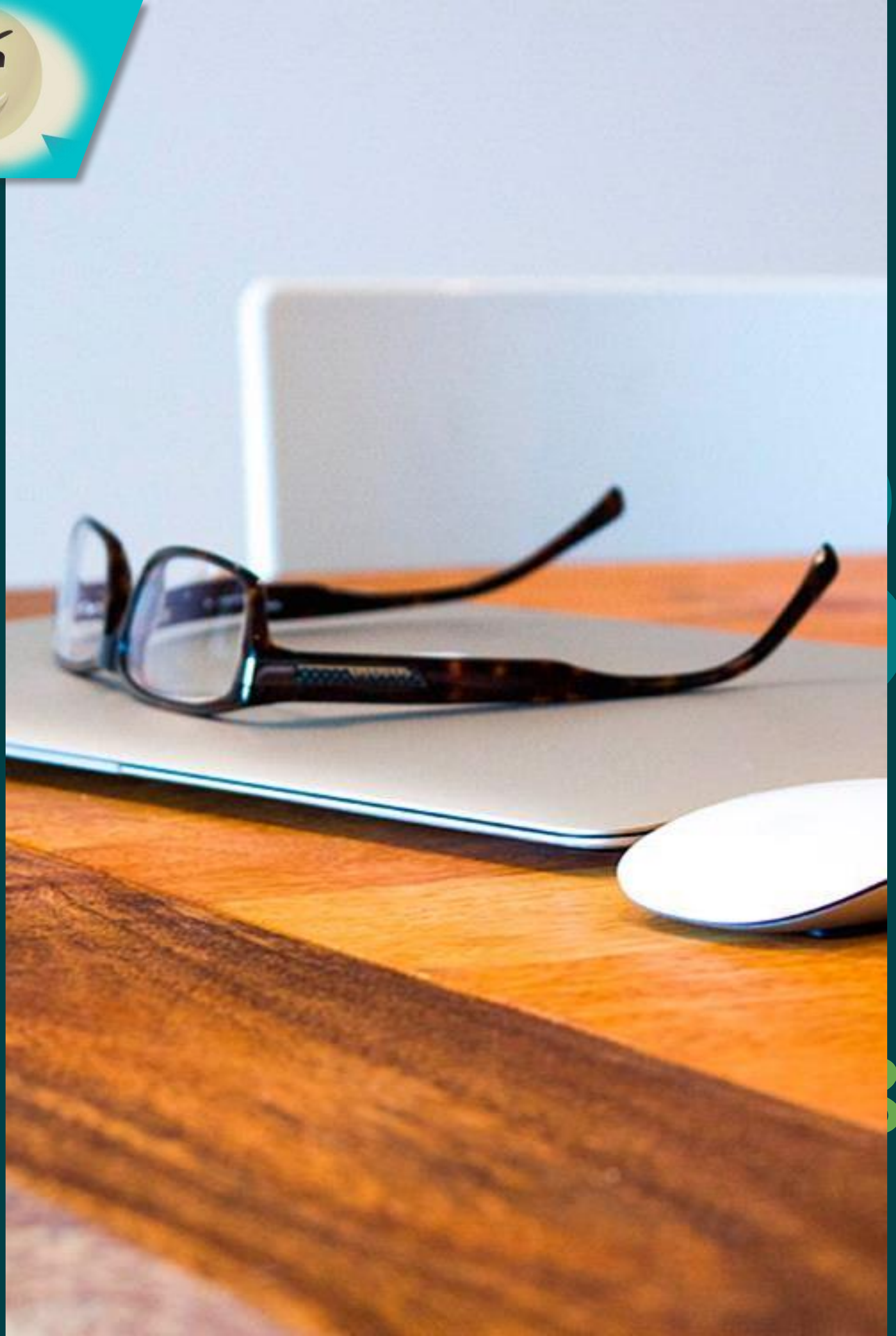
- The UN has identified FI as an enabler for 7 of the 17 **Sustainable Development Goals.**

- The **G20 committed to advance financial inclusion worldwide and the G20 High-Level Principles for Digital Financial Inclusion** recognizes the significant role of financial inclusion in promoting inclusive economic growth.

- The **WBG** considers financial inclusion a **key enabler to reduce extreme poverty** and boost shared prosperity. Access to a transaction account is a primary step towards broader financial inclusion. It allows people to:

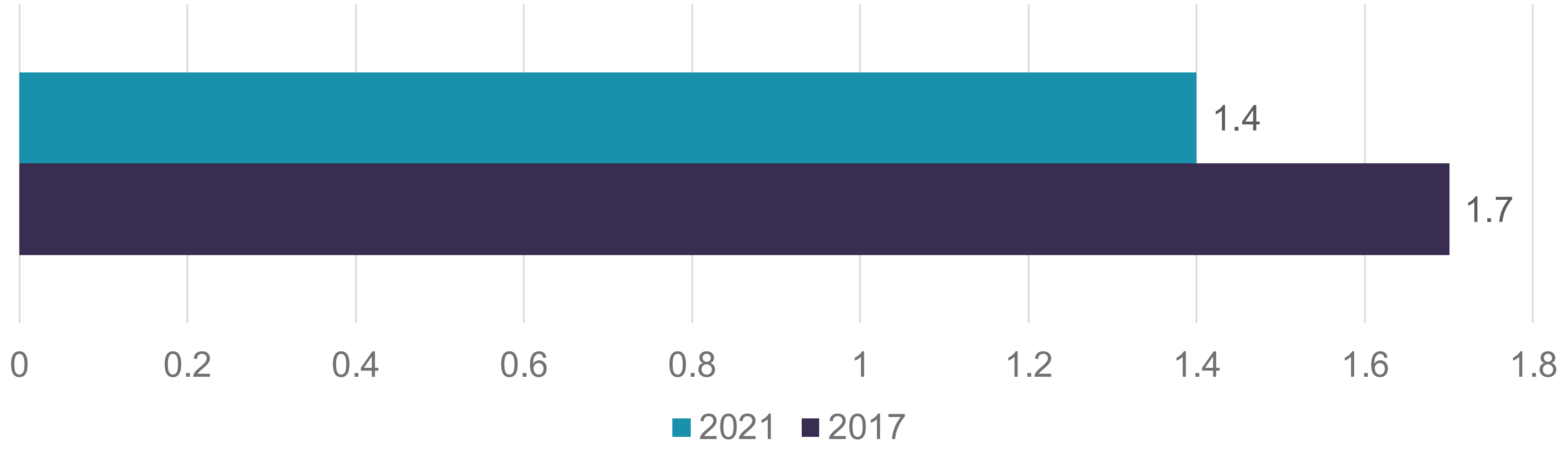
  - **Save money** with a formal financial institutions, **Make and receive payments, Borrow money** to finance day to day living needs such as health, education, etc

  - **Hedge against unexpected emergencies**, Facilitates to benefit from other services such as insurance.

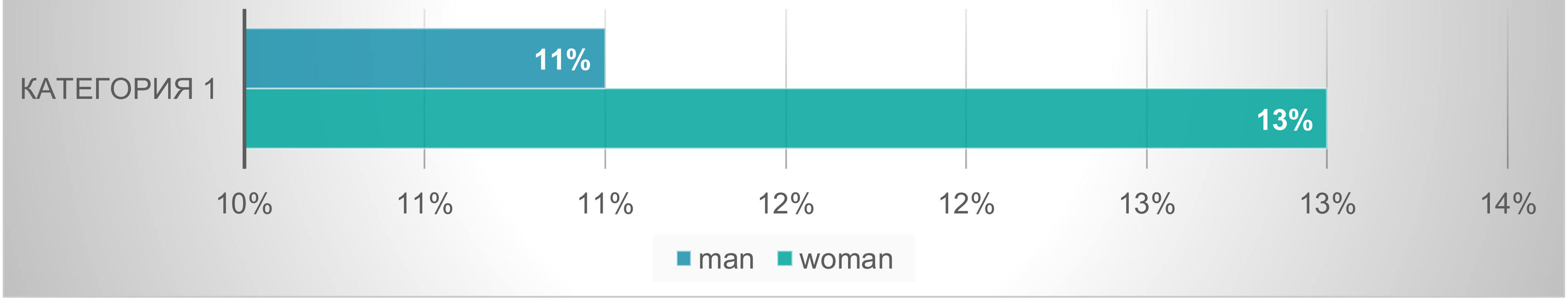


Financial Inclusion – Global Trends

Number of unbanked individuals in the world (population in 2017 and 2021 in billion people)

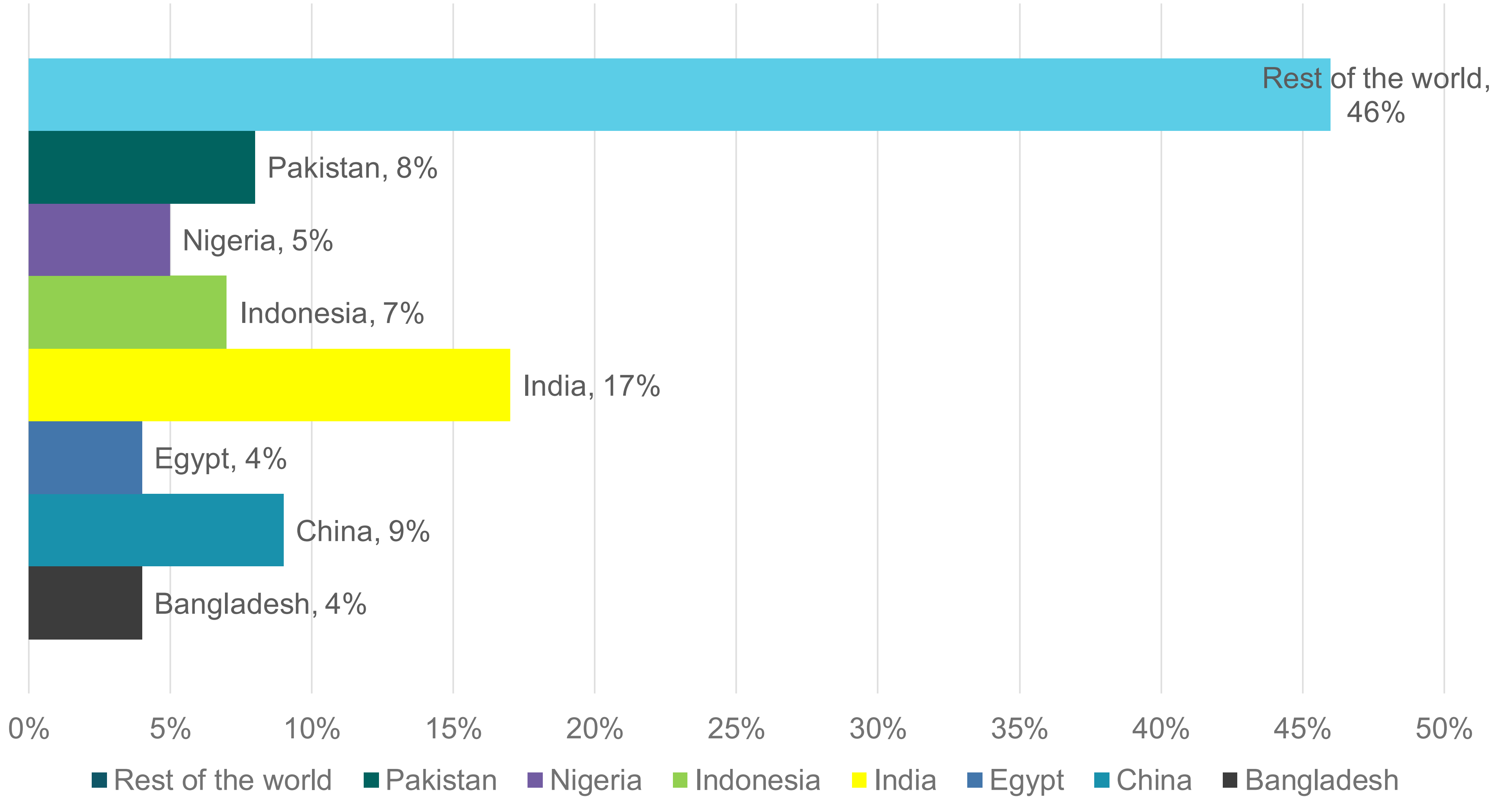


Overall percentage of unbanked individuals, men, and women in the world (%, 2021)



Source: Speaker's calculations based on World Bank's Global Findex Data 2021

Geographic concentration of unbanked individuals (%, 2021)



Source: Speaker's calculations based on World Bank's Global Findex Data 2021

Notes: The top five economies hosting the largest share of the world's unbanked were the same in 2017 and 2021

FI in the CAREC Region

The Central Asia Regional Economic Cooperation (CAREC) program is an intergovernmental initiative of the Asian Development Bank (ADB) consisting of a committed partnership of 11 countries, namely, **Afghanistan, Azerbaijan, the PRC, Georgia, Kazakhstan, Kyrgyzstan, Mongolia, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan.** The CAREC program combines efforts to promote regional economic cooperation.

The CAREC region (excluding the PRC) is home to approximately **370 million people producing nearly USD 875 billion** of annual value added (GDP).

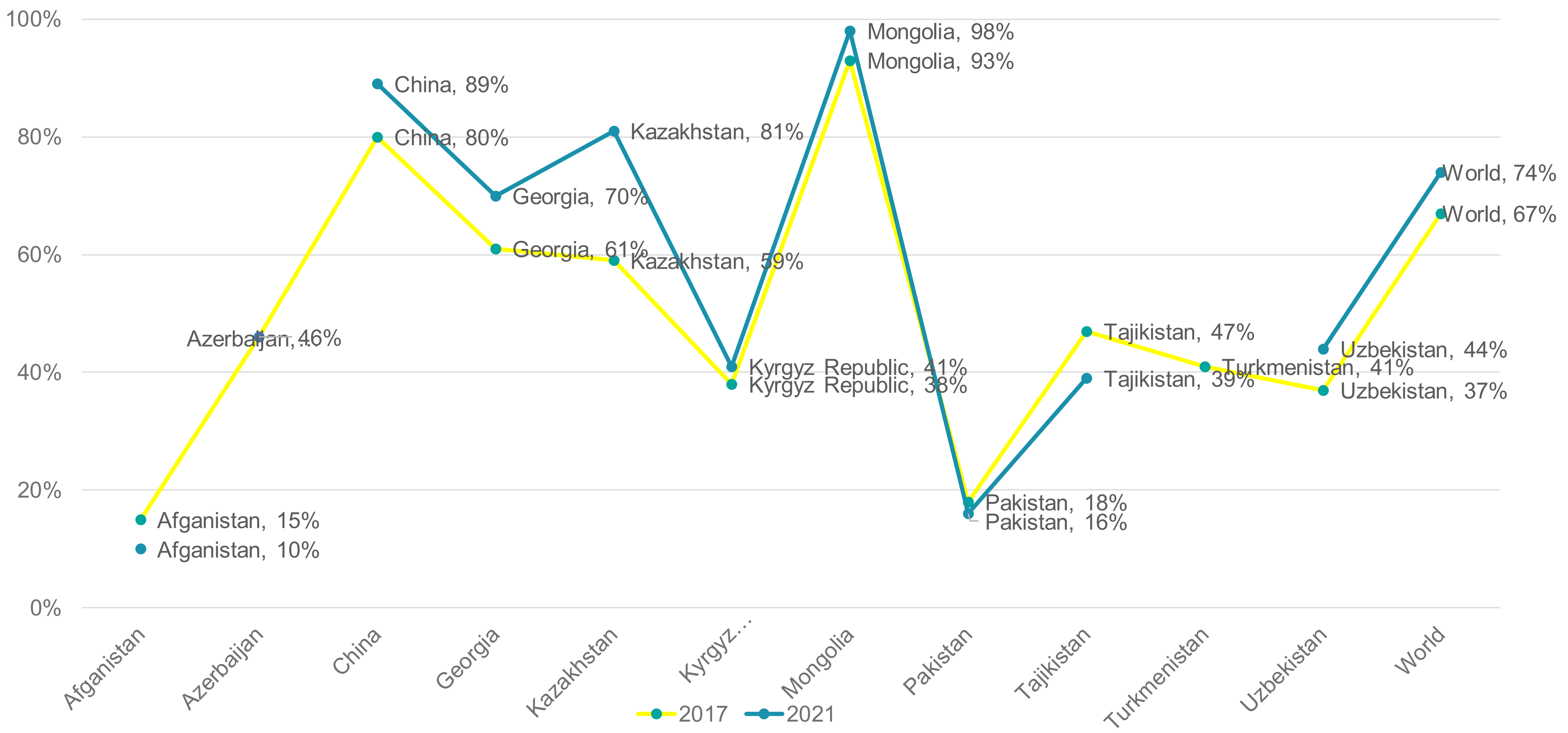
CAREC countries are at different stages of development. They widely vary in population, from Pakistan with over 235 million people to Mongolia with just over three 3 million people. Based on per capita income, the CAREC region comprises low-income countries (Afghanistan, Tajikistan), lower-middle-income countries (Kyrgyzstan, Pakistan, Uzbekistan), and upper-middle-income countries (Azerbaijan, Georgia, Kazakhstan, Mongolia, and Turkmenistan).

FI in the CAREC Region

INDICATORS	AFG	PAK	AZE	GEO	KAZ	KRZ	MON	TAJ	TKM	UZK
GDP growth rate (annual %)	-20,7 (2021)	6.2 (2022)	4.6 (2022)	10.1 (2022)	3.2 (2022)	7.0 (2022)	4.8 (2022)	8.0 (2022)	-3.4 (2020)	5.7 (2022)
GDP, total (current US$) (in billions)	14,58 (2021)	376.53 (2022)	78.72 (2022)	24.61 (2022)	220.62 (2022)	10.93 (2022)	16.81 (2022)	10.49 (2022)	45.61 (2020)	80.39 (2022)
Population, total (in millions)	41,1 (2022)	235,8 (2022)	10,1 (2022)	3,7 (2022)	19,6 (2022)	6,8 (2022)	3,3 (2022)	10 (2022)	6,4 (2022)	35,6 (2022)
Population ages 0-14 (% of total population)	43,1 (2022)	36,5 (2022)	23,4 (2022)	21,2 (2022)	29,6 (2022)	34,4 (2022)	32,4 (2022)	36 (2022)	31,1 (2022)	30,2 (2022)
Population ages 15-64 (% of total population)	54,4 (2022)	59,1 (2022)	69,4 (2022)	64,1 (2022)	62,2 (2022)	61 (2022)	62,9 (2022)	60,2 (2022)	63,7 (2022)	64,6 (2022)

Source: World Bank's World Development Indicator (WDI)

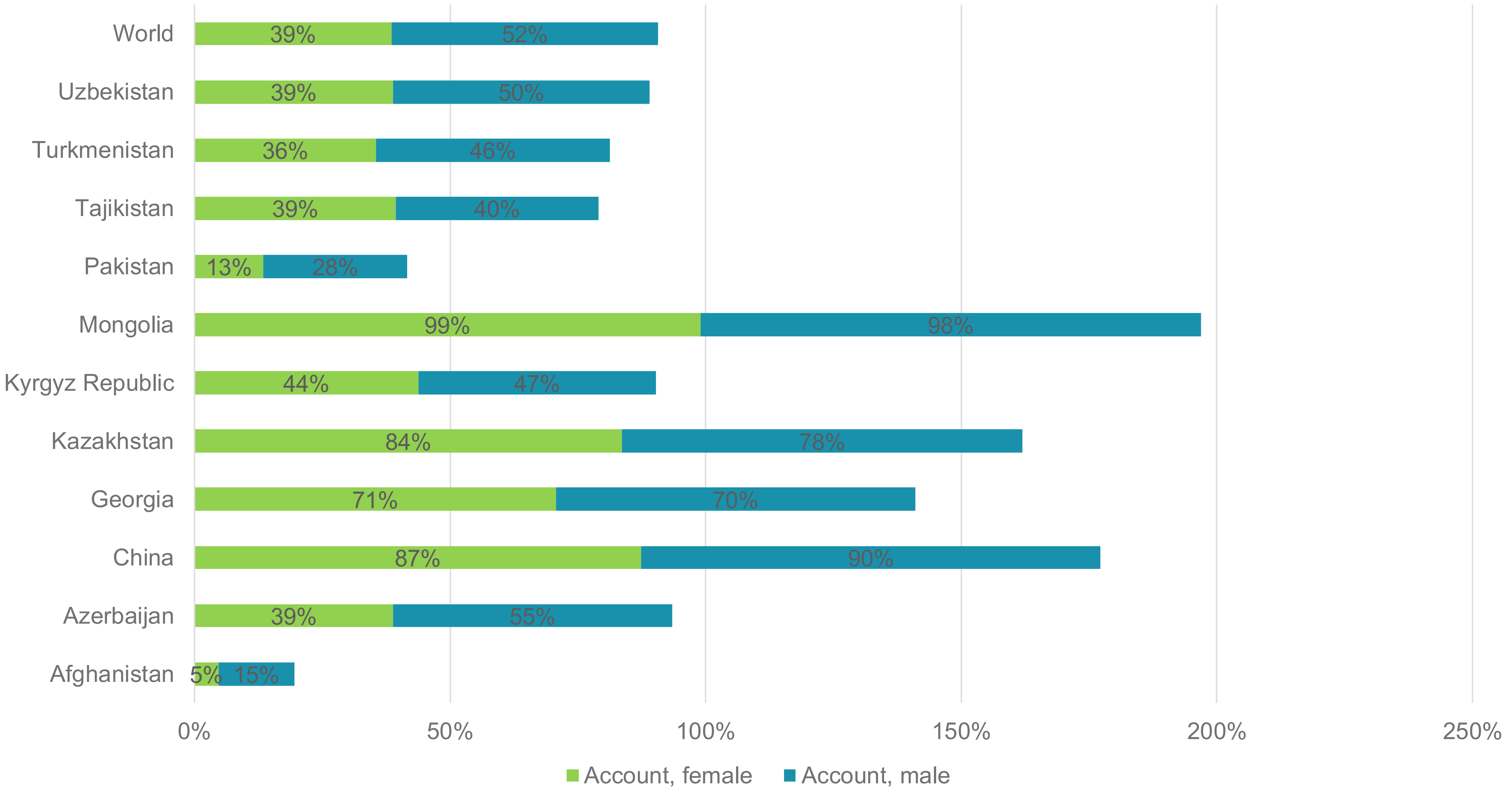
Financial institutions bank account ownership country-wise in the CAREC region (2017 and 2021 in %)



Source: Speaker's calculations based on World Bank's Global Findex Data 2021

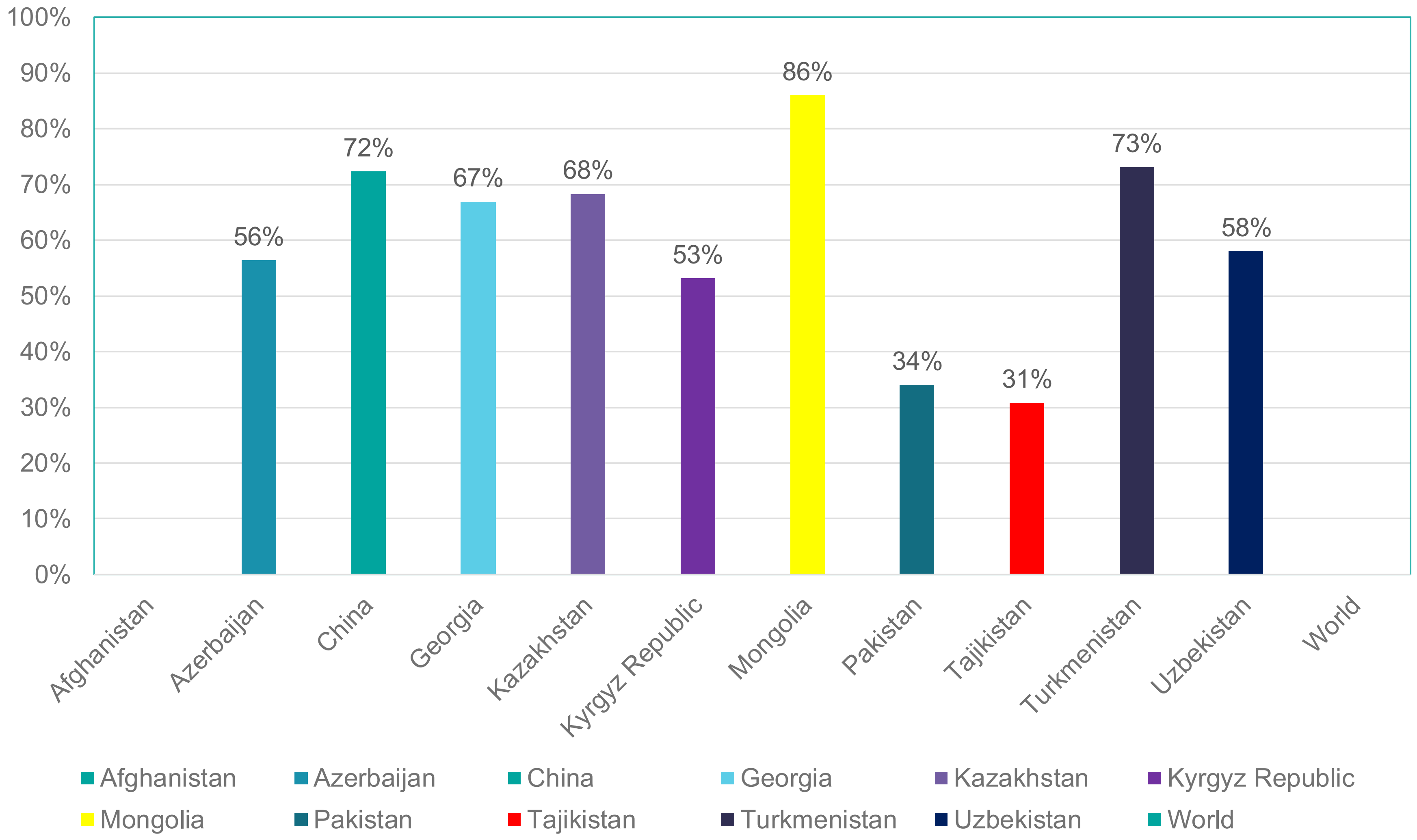
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Account, female and male in the CAREC region (% age 15+)



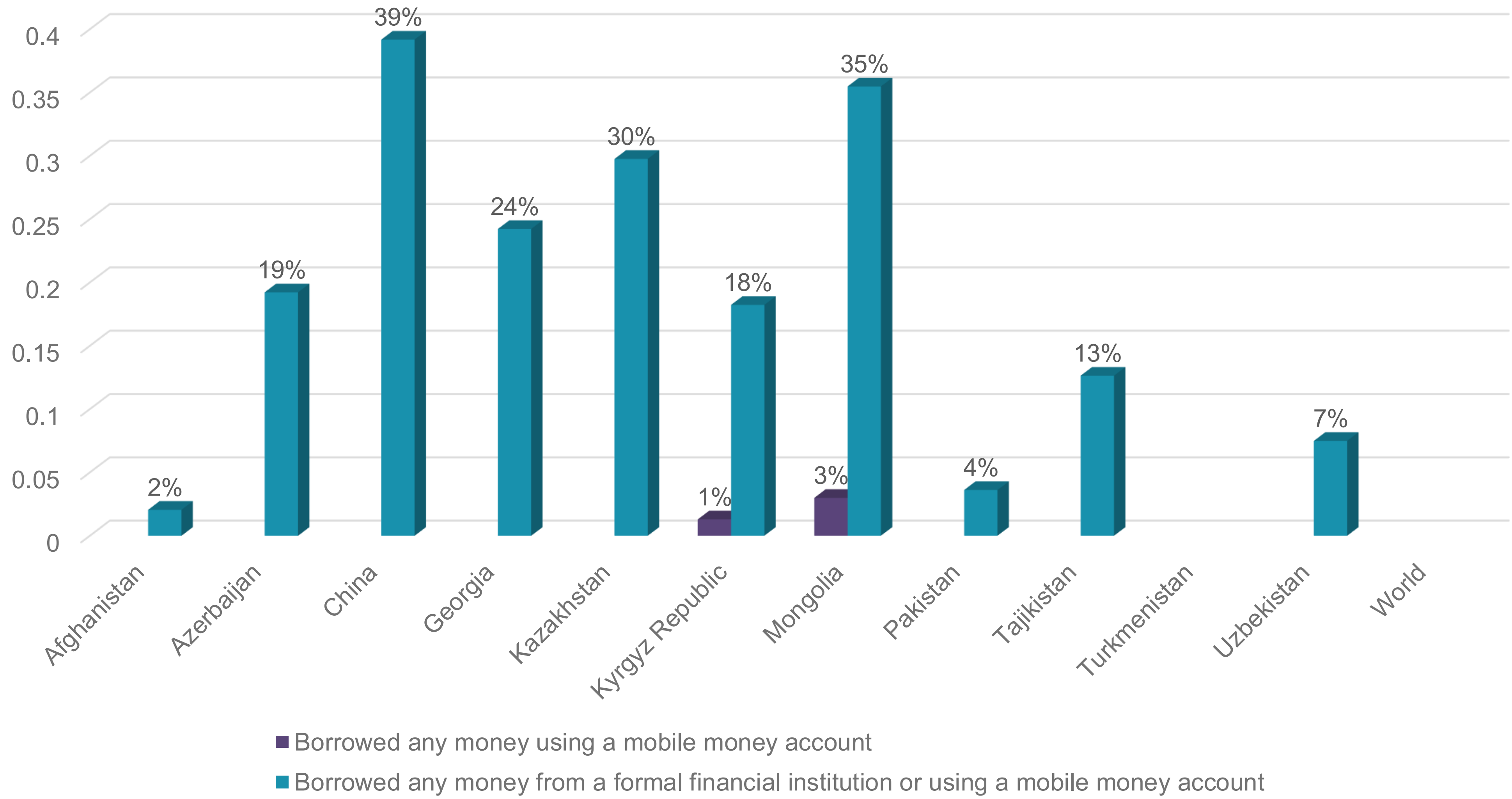
Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Made a deposit with a financial institution account (% age 15+)



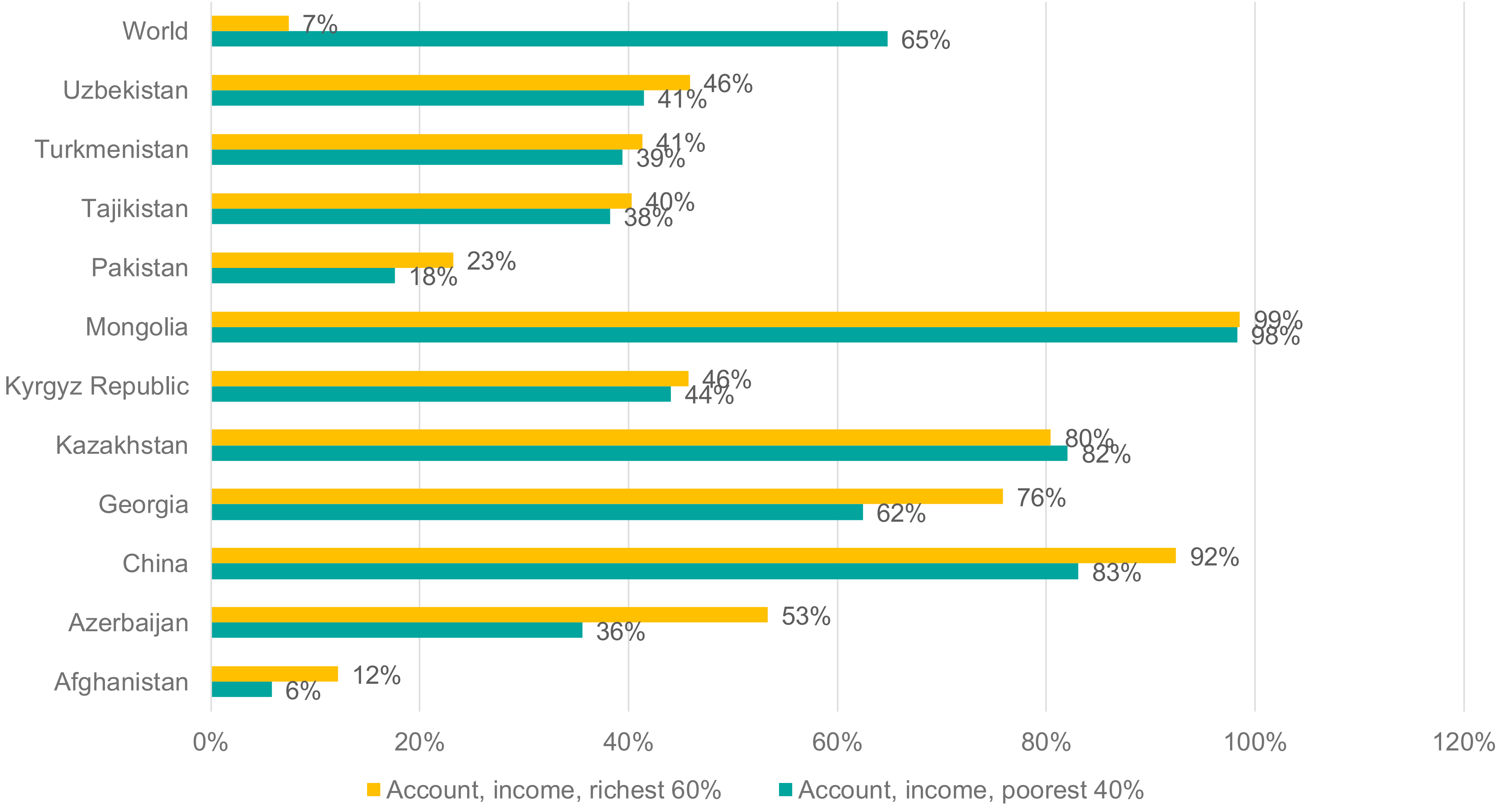
Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Borrowed any money from a formal financial institution or using a mobile money account in the CAREC region (% age 15+)



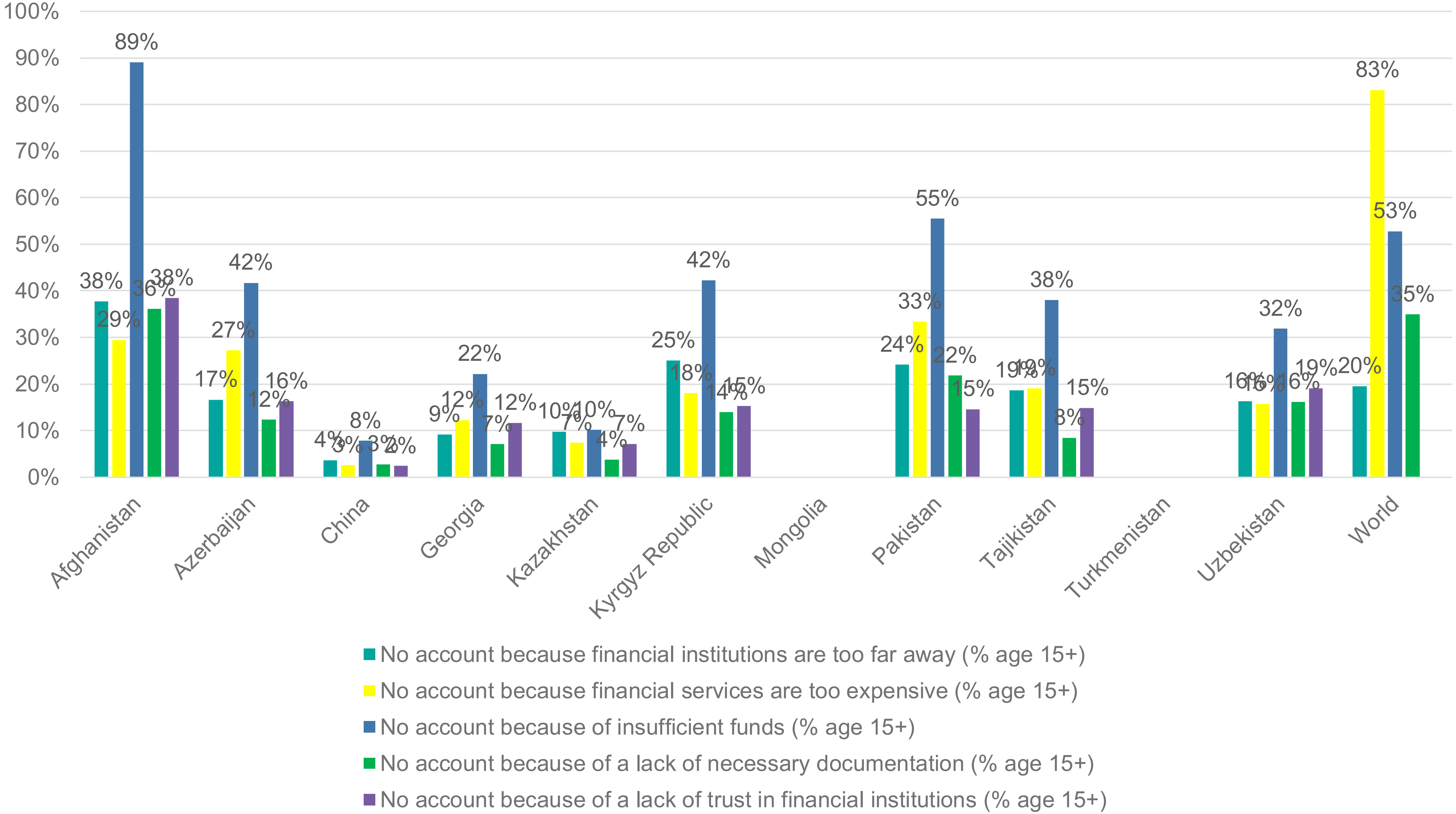
Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, other countries 2021

Account, income, poorest 40% and richest 60% in the CAREC region



Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

People without an account for various reasons in the CAREC region (% aged 15+)



Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, other countries 2021

Fintech or Financial Technology for FI

WEF defines Fintech as

the **innovative use of technology in the design and delivery of financial services and products**. It covers a wide spectrum of companies, products, and technologies that aim to provide alternatives to traditional financial services

According to European Commission (EC)

Digital finance is the term used to **describe the impact of new technologies on the financial services industry.** It includes a variety of products, applications, processes and business models that have transformed the traditional way of providing banking and financial services.

The Bali Fintech Agenda broadly define fintech as

- **"advances in technology that have the potential to transform the provision of financial services, spurring the development of new business models, applications, and processes, and products."**

Fintech or Financial Technology for FI

- Financial technologies present a **tremendous opportunity for reaching out to the financially excluded and underserved segments of the population**, particularly in remote regions and communities.
- Fintech has the potential to transform the financial inclusion landscape **by offering cost-effective and easily accessible financial services.**

- **Mobile phone penetration and high-speed Internet availability in many developing economies are igniting a financial inclusion revolution.**

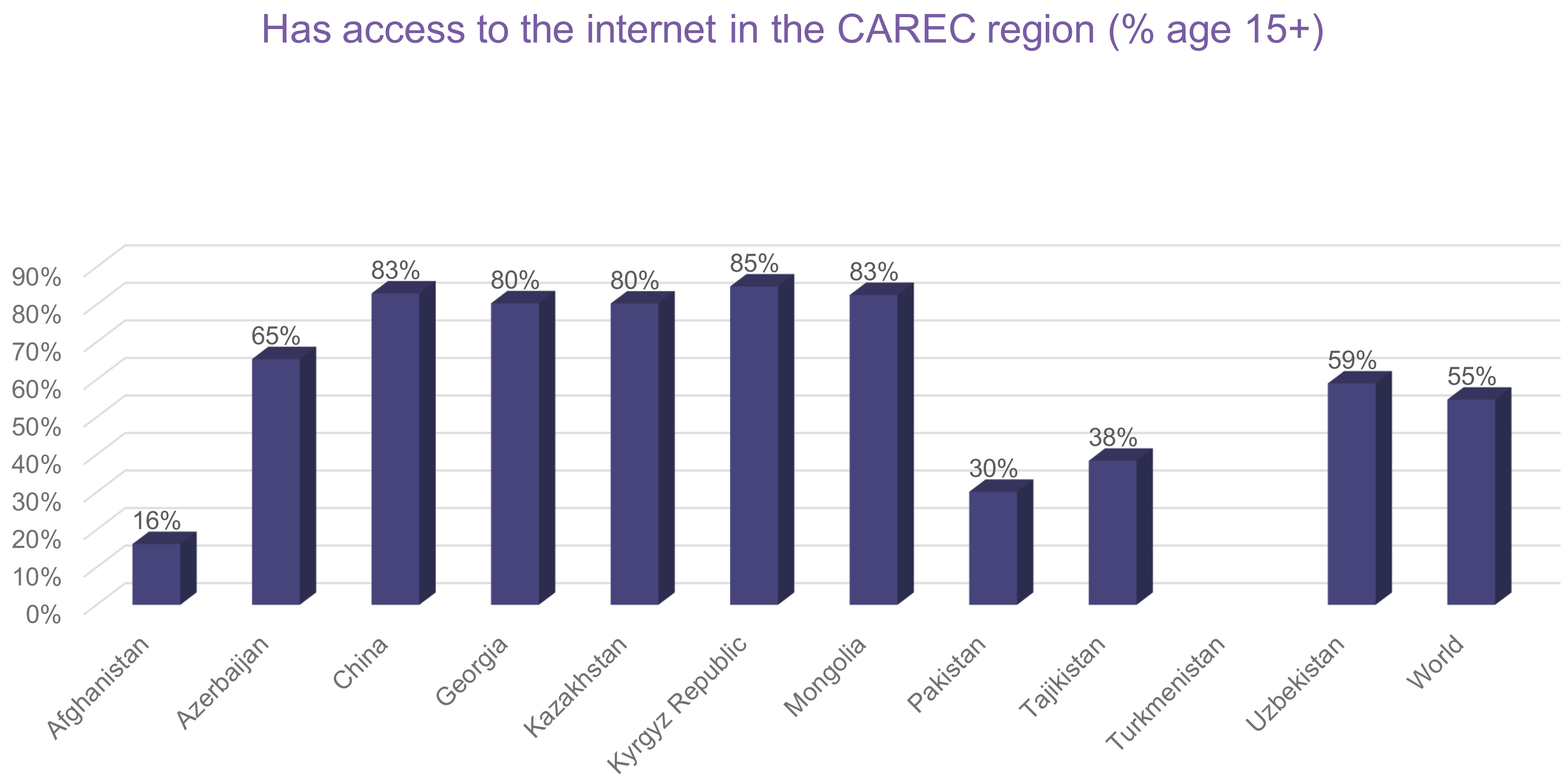
- The outbreak of the **COVID-19 pandemic**, with restricted physical contact, has further magnified the importance of technological innovation, particularly in social safety payments from **governments to person (G2P)** and internal and cross-border remittances. Likewise, domestic and **cross-border remittance** also benefits from technology by a reduction in transaction costs.

The promise of digital finance

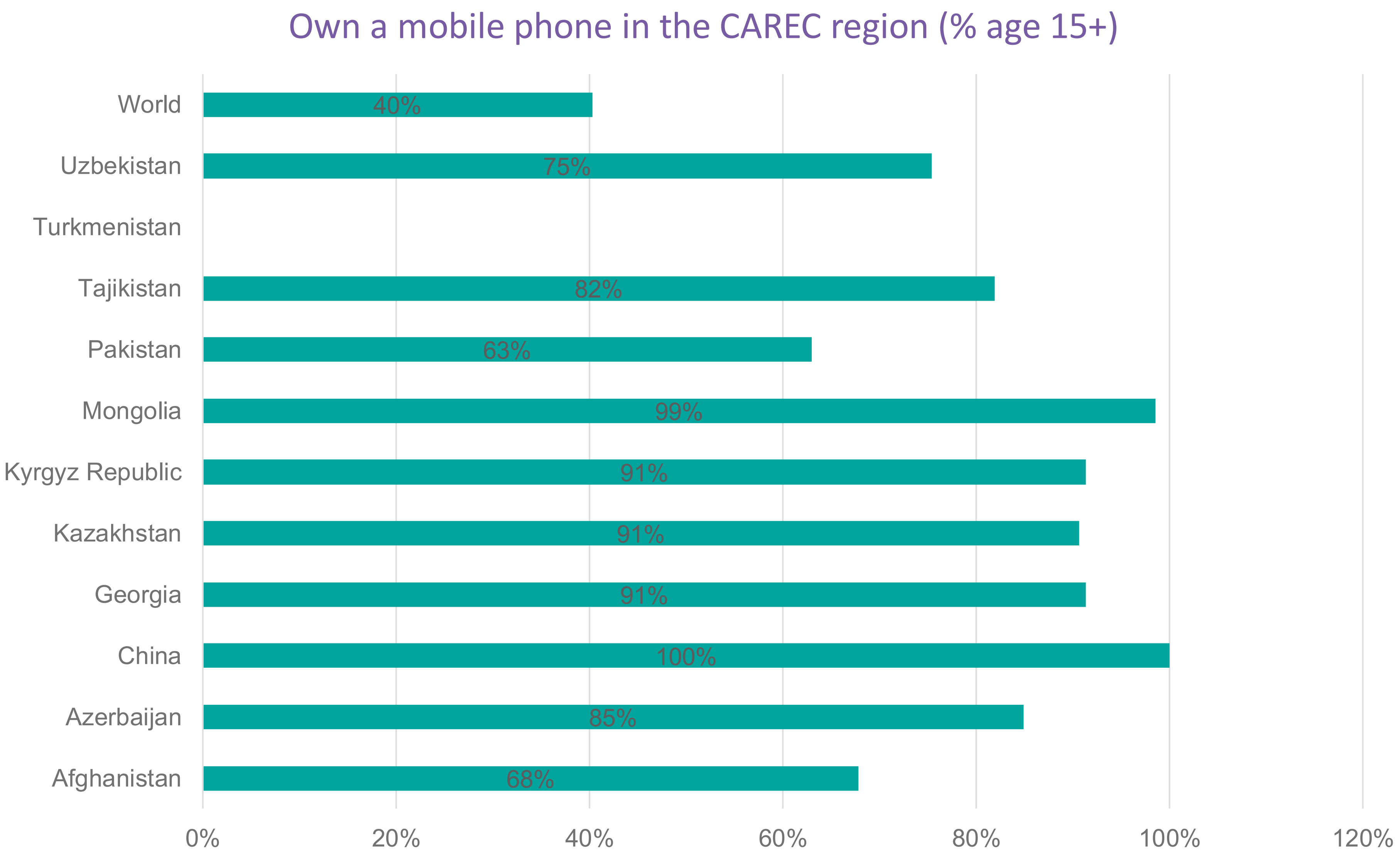
- According to MGI calculations, (digital finance) can potentially bring 1.6 billion people into the financial mainstream in emerging economies, with more than half of them being women. MGI estimates that new loans extended to households and businesses could reach a staggering figure of USD 2.1 trillion, which could lift hundreds of millions of people out of poverty, and boost government savings by up to USD 110 billion by reducing leakages and increasing tax collection. The increased access to finance via Fintech is expected to increase savings for the service providers to the tune of USD 400 billion and prop up their balance sheets by USD 4.2 trillion in new deposits.

- *Source: Digital Finance for All: Powering Inclusive Growth in Emerging Economies by McKinsey Global Institute , September 2016*

Fintech in the CAREC Region

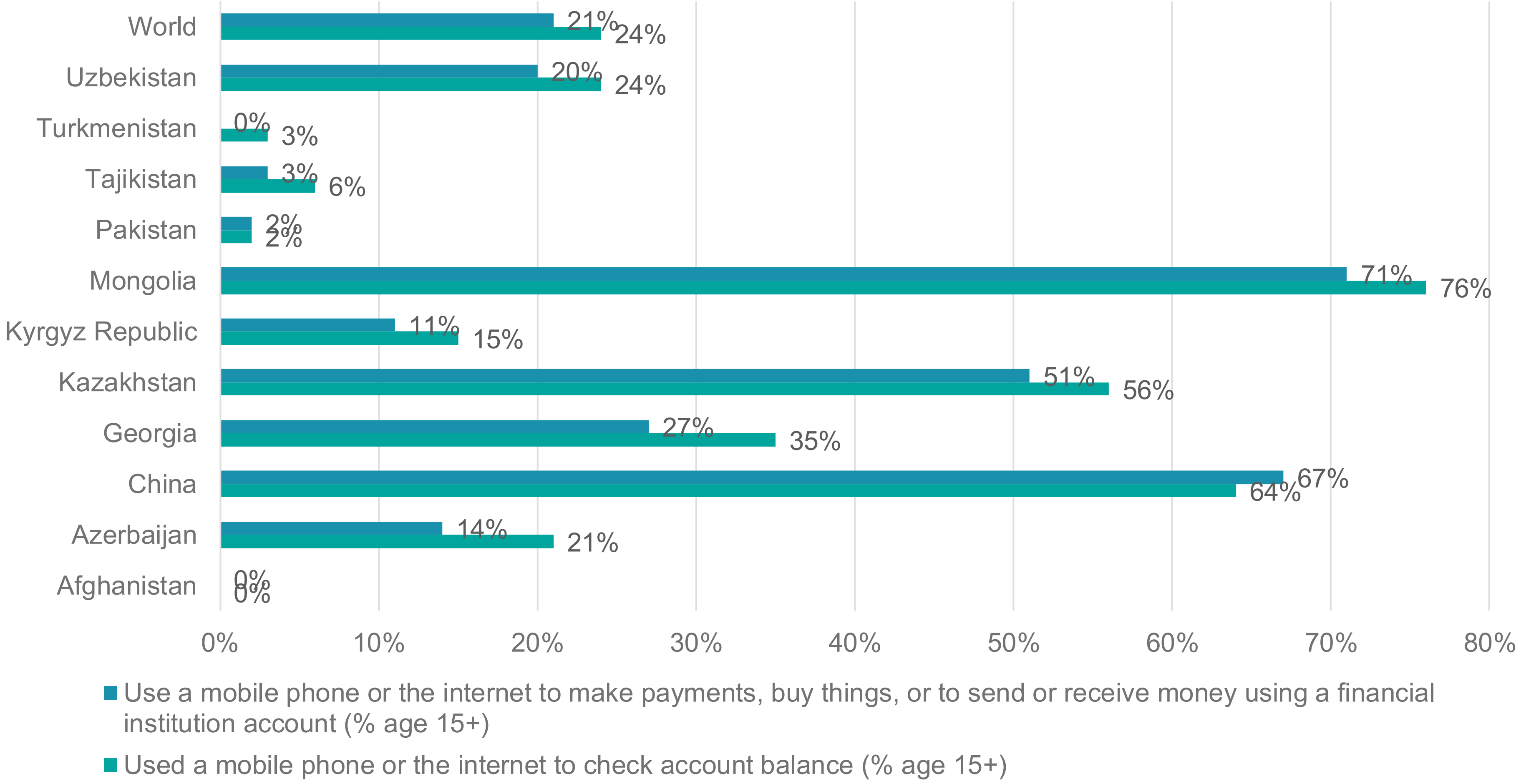


Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, other countries 2021



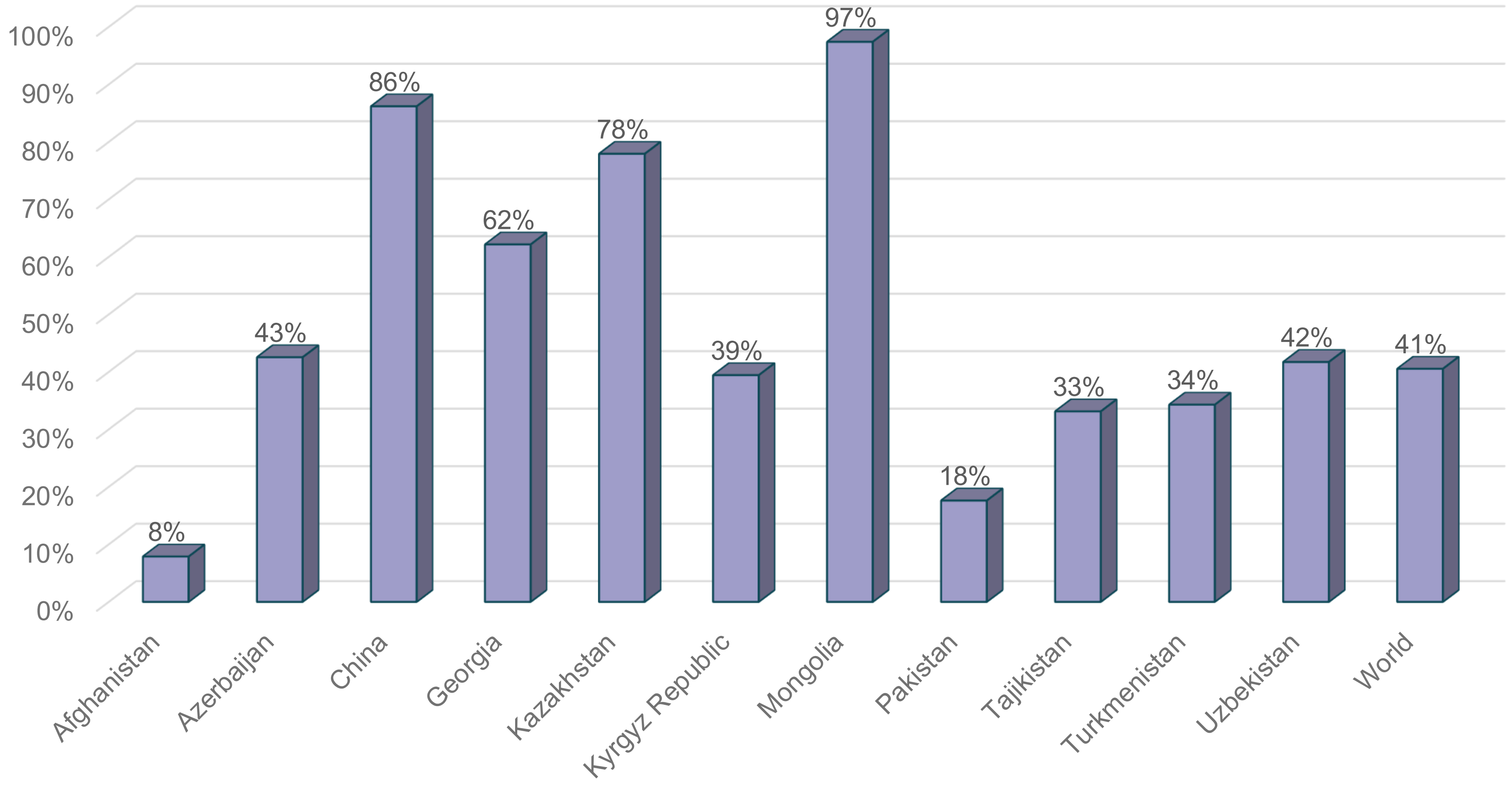
Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, other countries 2021

Used a mobile phone or the internet to check account balance and to make payments, buy things, or to send or receive money using a financial institution account in the CAREC region (% age 15+)



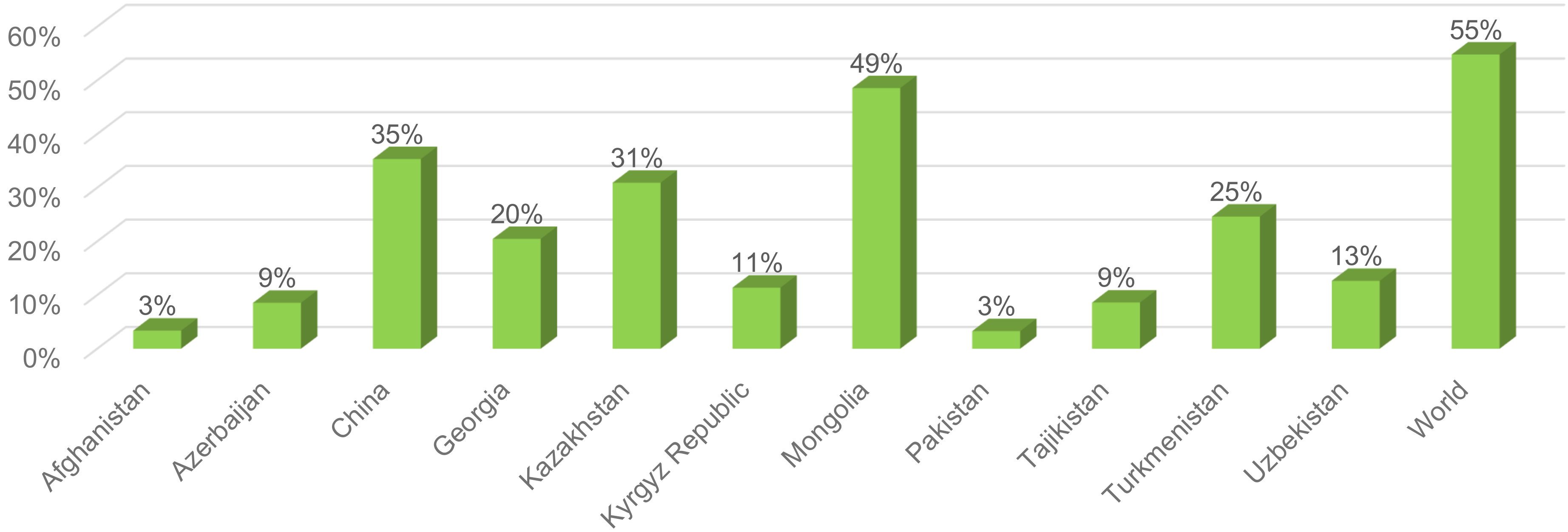
Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Made or received a digital payment in the CAREC region (% age 15+)



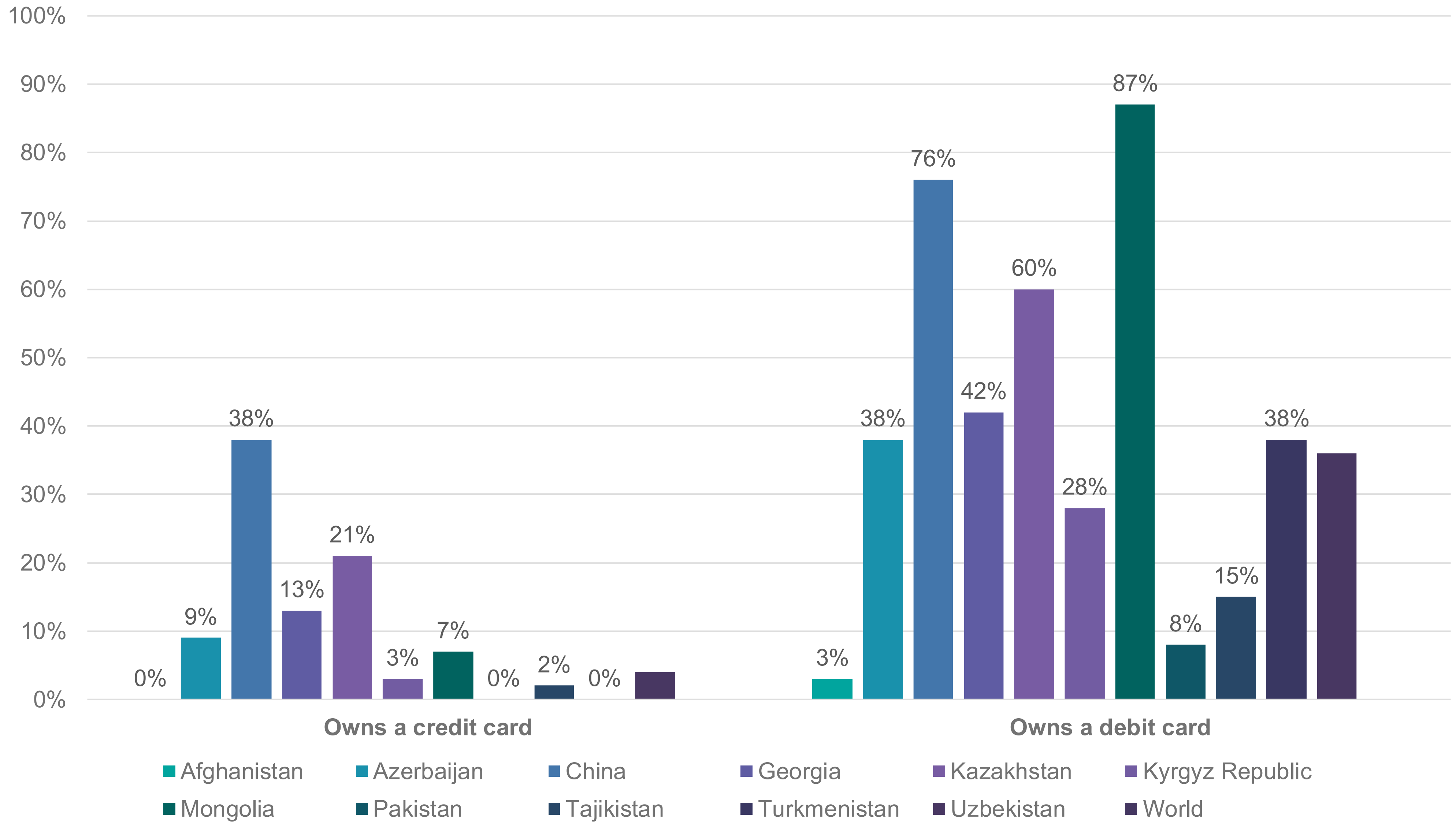
Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Received wages: into a financial institution account in the CAREC region (% age 15+)



Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Owns a credit card and owns a debit card in the CAREC region (% age 15+)



Source: Speaker's calculations based on World Bank's Global Findex Data 2021
Notes: Azerbaijan data for 2022, Turkmenistan for 2017, other countries 2021

Factors for low FI

- **Weak Physical Infrastructure**: In rural and remote areas, the absence of banking infrastructure, such as branches and ATMs, makes it challenging for people to access formal financial services.
- **Limited Financial Literacy:** Many individuals lack basic financial knowledge, making them hesitant to use formal financial services or unaware of the benefits they offer.
- **High Costs of Services**: Formal financial services can be costly for low-income individuals, leading them to rely on informal and often more expensive financial channels.
- **Insufficient Documentation**: Stringent identity and documentation requirements can hinder people from opening bank accounts or accessing financial services.
- **Low Income and Unstable Employment**: Low-income individuals often struggle to meet minimum balance requirements or face irregular income patterns, which can deter them from maintaining formal accounts.
- **Discrimination and Exclusion:** Certain marginalized groups, such as women, ethnic minorities, and people with disabilities, may face discrimination and exclusion from financial services.

Source: Umar, Khalid. 2020. ***Financial Inclusion and Fintech in CAREC: Constraints and Prospects. Working Paper,*** CAREC Institute.
https://www.carecinstitute.org/publications/working-paper-financial-inclusion-and-fintech-in-carec-constraints-and-prospects/

Factors for low FI

- **Regulatory Barriers**: Complex and restrictive regulations can limit the ability of financial institutions to reach underserved populations, creating a barrier to financial inclusion.
- **Lack of Trust**: Some people may be distrustful of formal financial institutions due to past negative experiences or cultural reasons.
- **Geographical Barriers**: In countries with vast and challenging landscapes, it can be difficult to establish a widespread financial network.
- **Digital Divide**: Inadequate access to technology and the internet can prevent people from benefiting from digital financial services and innovations.
- **Informal Financial Alternatives**: In many communities, informal financial mechanisms, such as rotating savings and credit associations (ROSCAs) or moneylenders, are prevalent, offering immediate and easily accessible financial support, albeit with high costs.

Source: Umar, K. 2020. Financial Inclusion and Fintech in CAREC: Constraints and Prospects. Working Paper, CAREC Institute.
https://www.carecinstitute.org/publications/working-paper-financial-inclusion- and-fintech-in-carec-constraints-and-prospects/

What needs to be done!

- Addressing these factors requires **a multi-pronged approach involving governments, financial institutions, and other stakeholders**. Policymakers need to create an enabling environment with appropriate regulations and incentives to encourage financial inclusion. Financial education programs can enhance financial literacy, while technological advancements can pave the way for innovative digital financial solutions to reach underserved populations. Moreover, collaboration between public and private sectors can help bridge the gap and extend the benefits of formal financial services to the unbanked and underbanked populations.
- China, Pakistan, Tajikistan and Uzbekistan have adopted standalone NFIS
- Mongolia and Kyrgyz republic are in the process of formulating NFIS

Source: AFI, National financial inclusion strategies: current state of practice (2022)

Thank You