GLOBAL CENTER ON COOPERATIVE SECURITY

POLICY BRIEF

Bridging the Gap

Realizing the Promise of Financial Inclusion to Address Conditions Conducive to the Spread of Terrorism and Achieve the Sustainable Development Goals

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At the halfway point of the 2030 deadline for the UN Sustainable Development Goals (SDGs), the international community is faced with a stark reality: much of the progress made since 2015 was hindered or even reversed due to the growing impacts of climate change, a proliferation of conflict globally, and the COVID-19 pandemic.[1] To recoup these losses and make progress in the remaining seven years, international, national, and local stakeholders should prioritize cross-cutting factors that support and contribute to improvements in multiple issue areas addressed in development efforts.

Financial inclusion is one such factor, listed as a target in seven SDGs and featuring prominently as an enabler for many others.[2] The World Bank defines financial inclusion as "individuals and businesses [having] 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."[3] It can be as basic as ensuring that people are able to access a deposit or savings account and use it in a manner that best serves their needs, or it can include other financial services, such as loans, credit, insurance, and payment channels. This brief summarizes key evidence of the success of financial inclusion efforts and reflects on the barriers to achieving widespread financial inclusion. It underscores that provision of financial services alone is insufficient to realize the full development potential of financial inclusion and notes that parallel efforts must be made to invest in financial literacy and economic empowerment, especially for women and youth.

Financial inclusion has increased notably in the past decade, with account holders rising from 51 percent of the population in 2011 to 76 percent in 2021.[4] Notably, the gender gap in account ownership across developing economies has fallen to only 6 percent after remaining at 9 percent for many years. A significant driver has been the expansion of digital financial services, including online accounts, mobile money, and to a lesser extent virtual assets such as cryptocurrencies. The percentage of adults making or receiving digital payments grew from 35 percent in 2014 to 57 percent

1 United Nations, *The Sustainable Development Goals Report 2022*, 2022, p. 2, https://unstats.un.org/sdgs/report/2022/The-Sustainable-Development-Goals-Report-2022.pdf.

2 Financial inclusion targets are included under Goal 1 (no poverty), Goal 2 (zero hunger), Goal 3 (good health and well-being), Goal 5 (gender equality), Goal 8 (decent work and economic growth), Goal 9 (industry, innovation, and infrastructure), and Goal 10 (reduced inequalities).

3 World Bank, "Financial Inclusion: Overview," 22 March 2022, https://www.worldbank.org/en/topic/financialinclusion/overview.

4 Asli Demirgüç-Kunt et al., *The Global Findex Database 2021: Financial Inclusion, Digital Payments, and Resilience in the Age of COVID-19* (Washington: World Bank, 2022), pp. 33–35, https://openknowledge.worldbank.org/bitstream/handle/10986/37578/9781464818974.pdf.

in 2021, driven in part by the proliferation of mobile money services, especially in sub-Saharan Africa, as well as the COVID-19 pandemic catalyzing online bill and merchant payments.[5]

Despite this progress, more than 1.5 billion adults globally are considered "unbanked," with women, less educated adults, and lower-income adults still disproportionately affected by financial exclusion.[6] A growing body of empirical data shows positive benefits of expanding financial access in specific contexts, leading to calls to scale up global financial inclusion efforts as a mechanism to accelerate achievement of the SDGs.[7] The Addis Ababa Action Agenda encourages the development of strategies to improve financial inclusion and financial literacy and notes the importance of leveraging available technologies to increase levels of financial inclusion.[8] Since 2012, more than 55 countries have made commitments to financial inclusion, and more than 60 have launched or begun developing a national strategy.[9] The United Nations also has worked to increase financial inclusion through global programming over the last decade, including programs designed to address financial inclusion on a regional scale and to promote the financial inclusion of youth.[10] Many of these programs are conducted by or in cooperation with the UN Capital Development Fund, and their goals are further supported by the UN Secretary-General's Special Advocate for Inclusive Finance for Development.

Increasing financial inclusion has far-reaching benefits beyond the SDGs, including supporting efforts to prevent violent extremism. Exclusion, financial or otherwise, allows injustice and inequality to grow, contributing to the grievances that are often exploited by violent extremists. Violent extremism is not caused by poverty or other economic issues alone, but violent extremist groups exploit socioeconomic marginalization in conjunction with real and perceived failures of the state to generate sustainable growth. Examinations of the personnel files of the Islamic State of Iraq and the Levant suggest that the lack of economic inclusion was a risk factor, specifically for foreign recruits.[11] The UN Development Programme (UNDP) has highlighted the role of complex economic factors in the decision to join violent extremist groups in Africa.[12] In the 2023 UNDP survey of violent extremist recruits, more than 25 percent of voluntary recruits cited employment opportunities as the primary reason for joining, making it the most commonly cited reason.[13]

Realizing the promise of financial inclusion toward advancement of the SDGs requires bridging the gaps between financial service providers and potential account holders. Digital finance offers significant promise, but the rapidly evolving nature of the landscape also presents risks.

5 Ibid., p. 2.

6 Ibid., pp. 33–35.

7 Leora Klapper, Mayada El-Zoghbi, and Jake Hess, "Achieving the Sustainable Development Goals: The Role of Financial Inclusion," Consultative Group to Assist the Poor (CGAP), April 2016, https://www.cgap.org/sites/default/files/Working-Paper-Achieving-Sustainable-Development-Goals-Apr-2016_0.pdf.

8 UN Inter-agency Task Force on Financing for Development, "Achieving Financial Inclusion," n.d., https://developmentfinance.un.org/achieving-financial-inclusion (accessed 2 March 2023).

9 World Bank, "Financial Inclusion."

10 UN MPTF Office Partners Gateway, "Pacific Financial Inclusion Joint Programme," n.d., https://mptf.undp.org/fund/jxb00 (accessed 2 March 2023); UN Capital Development Fund, YouthStart homepage, n.d., https://www.uncdf.org/youthstart/homepage (accessed 2 March 2023).

11 Shanta Devarajan et al., *Economic and Social Inclusion to Prevent Violent Extremism*, World Bank, October 2016, https://documents1.worldbank.org/curated/en/409591474983005625/pdf/108525-REVISED-PUBLIC.pdf.

12 UN Development Programme (UNDP), *Journey to Extremism in Africa: Drivers, Incentives and the Tipping Point for Recruitment*, 2017, https://journey-to-extremism.undp.org/content/v1/downloads/UNDP-JourneyToExtremism-report-2017-english.pdf; UNDP, *Journey to Extremism in Africa: Pathways to Recruitment and Disengagement*, 2023, https://journey-to-extremism.undp.org/content/v2/downloads/UNDP-JourneyToExtremism-report-2023-english.pdf.

13 UNDP, *Journey to Extremism in Africa: Pathways to Recruitment and Disengagement*, pp. 71–72.

PROMISE OF FINANCIAL INCLUSION FOR THE SDGS

At an individual level, financial inclusion is described as enabling individuals to store funds, build savings, cope with unexpected economic shocks, benefit from insurance products, and make investments in businesses or personal well-being. A growing body of research closely links these benefits with poverty reduction (Goal 1), food security (Goal 2), health (Goal 3), and education (Goal 4).[14] More broadly, financial inclusion contributes to gender equality efforts, reduced levels of violence and instability, and improved access to justice.

Women in particular are seen to benefit from financial inclusion because it can correlate with financial independence and economic empowerment. For example, use of savings products that encouraged regular deposits helped women in the Philippines increase household decision-making power and shift household spending.[15] A program in India that disbursed money to women directly into their own accounts and not into that of a male head of household increased financial control, influenced employment-related gender norms, and incentivized women to seek employment.[16] In Chile, microfinance and free savings accounts helped low-income women navigate economic emergency and reduce reliance on debt.[17]

Digital financial products are seen as especially promising for addressing the needs of unbanked and underbanked communities. These technologies can make it easier and more cost effective for banks and account owners, helping to extend the reach of financial services to new clients.[18] For example, mobile banking means that people in remote villages do not need to travel long distances to access banking services.

An often-cited example of the benefits of digital financial inclusion come from a 2016 study on the mobile money system M-Pesa in Kenya, where the ability to save, send, and receive money reportedly helped lift 194,000 households out of poverty.[19] Subsequent studies have shown that workers who were paid via direct deposit rather than cash had higher savings and that digitizing payments by the government helped ensure these payments reached their intended beneficiaries.[20]

The 2016 study on M-Pesa found that digital banking technology benefited women and female-headed households, allowing them to manage their financial resources more easily. Access to financial services also provided women with the opportunity to change jobs or career paths, including moving from subsistence agriculture and multiple part-time jobs to work in business and sales.[21] The M-Pesa study, among others, indicates that financial inclusion at a more basic level, such as account ownership and use, can be incredibly helpful in reducing poverty. Mobile banking technology is a key tool in expanding and bolstering individual account access and use.

Beyond the individual and household levels, financial inclusion can benefit small businesses by providing them with access to services and human and investment capital. This improved access allows small business owners and entrepreneurs not only to grow their businesses but also create jobs and bolster economic

14 Klapper, El-Zoghbi, and Hess, "Achieving the Sustainable Development Goals."

15 Nava Ashraf, Dean Karlan, and Wesley Yin, "Female Empowerment: Further Evidence From a Commitment Savings Product in the Philippines," *World Development* 38, no. 3 (March 2010): 333–344.

16 Erica Field et al., "On Her Own Account: How Strengthening Women's Financial Control Impacts Labor Supply and Gender Norms," *American Economic Review* 111, no. 7 (July 2021): 2342–2375, https://www.aeaweb.org/articles/pdf/doi/10.1257/aer.20200705.

17 Ibid.

18 Ibid.

19 Tavneet Suri and William Jack, "The Long-Run Poverty and Gender Impacts of Mobile Money," *Science*, 9 December 2016, 1288–1292.

20 Joshua Blumenstock, Michael Callen, and Tarek Ghani, "Why Do Defaults Affect Behavior? Experimental Evidence From Afghanistan," *American Economic Review* 108, no. 10 (October 2018): 2868–2901; Jenny C. Aker et al., "Payment Mechanisms and Antipoverty Programs: Evidence From a Mobile Money Cash Transfer Experiment in Niger," *Economic Development and Cultural Change* 65, no. 1 (October 2016): 1–37, https://doi.org/10.1086/687578; Karthik Muralidharan, Paul Niehaus, and Sandip Sukhtankar, "Building State Capacity: Evidence From Biometric Smartcards in India," *American Economic Review* 106, no. 10 (October 2016): 2895–2929.

21 Suri and Jack, "Long-Run Poverty and Gender Impacts of Mobile Money."

growth overall (Goal 8). For small businesses and entrepreneurs, access to credit can help start or expand operations by enabling investment, which in turn can create new job opportunities. In Mongolia, a randomized study linked the availability of credit with the ability of women to expand businesses, including a 10 percent higher probability of entrepreneurship in treatment villages where they could access group loans.[22] Access to credit led to a 6 percent increase in self-employment, inventory, and business ownership in a randomized study in Bosnia and Herzegovina.[23]

In some cases, financial inclusion can improve investment outcomes by helping mitigate risk. For example, insurance products were shown to improve farming outcomes in Ghana, India, and Kenya.[24] Access to microcredit increased the ability of entrepreneurs in Mexico and the Philippines to cope with risk.[25] Further, bringing entrepreneurs into the formal financial system fosters better-connected and more globalized markets, helping link investors with entrepreneurs in more diversified emerging markets.[26] In order to achieve financial inclusion at the individual or business level, governments and financial institutions must first establish and uphold a financial system that is accessible to the entire population, with a focus on bringing previously excluded groups into the formal financial system. To achieve this, there must be strong political support for financial inclusion at large and a willingness to adapt existing policies and regulations to make such a system possible or to adopt new ones. Without political backing, it will be difficult to make financial inclusion programs attractive for investors and funders, who are critical for programs run by nongovernmental organizations or private sector entities.

PERSISTENT BARRIERS

Although notable progress has been made, friction points must be addressed to realize equitable gains from financial inclusion investments. Surveys of unbanked populations indicate that barriers to account ownership remain lack of money, distance to the nearest financial institution, and insufficient documentation.[27] These barriers are most prominent in developing countries, where account ownership among adults is 6–66 percent, compared to 74–100 percent in high-income countries.[28]

Widespread mobile phone usage provides a critical opportunity to overcome some geographic and infrastructure barriers to the provision of financial services. Policy and regulatory factors, however, shape the environment in which digital financial services are provided; and many countries have yet to strike the balance between fostering innovation, protecting consumers, and disrupting illicit finance. Regulatory frameworks to prevent and detect instances of money laundering and terrorism financing in digital finance are evolving but often lag behind technological advancement, unintentionally stifling innovation or creating inhospitable business conditions.[29]

Digital finance, especially cryptocurrencies, presents unique consumer risks, including for data security,

22 Orazio Attanasio et al., "Group Lending or Individual Lending? Evidence From a Randomized Field Experiment in Mongolia," *American Economic Journal: Applied Economics* 7, no. 1 (January 2015): 90–122.

23 Britta Augsburg et al., "Microfinance at the Margin: Experimental Evidence From Bosnia and Herzegovina," *WZB Discussion Paper,* no. SP II 2014-304 (February 2014).

24 Klapper, El-Zoghbi, and Hess, "Achieving the Sustainable Development Goals," p. 4.

25 Dean Karlan and Jonathan Zinman, "Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts," *Review of Financial Access* 23, no. 1 (January 2010): 433–464; Manuela Angelucci, Dean Karlan, and Jonathan Zinman, "Microcredit Impacts: Evidence From a Randomized Microcredit Program Placement Experiment by Compartamos Banco," *American Economic Journal: Applied Economics* 7, no. 1 (January 2015): 151–182, https://www.povertyactionlab.org/sites/default/files/research-paper/182_61%20Angelucci%20et%20al%20Mexico%20Jan2015.pdf.

26 Timothy Adams, "Why Financial Inclusion Matters," Center for Financial Inclusion, 22 October 2018, https://www.centerforfinancialinclusion.org/why-financial-inclusion-matters.

27 Demirgüç-Kunt et al., *Global Findex Database 2021*, p. 4.

28 Ibid., p. 16.

29 Mercy Buku, "Risk-Based Supervision for Digital Financial Services," *Global Center on Cooperative Security Policy Brief*, February 2022, https://www.globalcenter.org/wp-content/uploads/22Feb_Risk-Based-Supervision-of-Digital-Financial-Services_FINAL-1.pdf.

identity theft, and fraud, that may be disproportionately experienced by those currently financially marginalized.[30] The recent collapse of several cryptocurrency exchanges underscores volatility in the market and the potential for the sector to reinforce, rather than revolutionize, the privileged relationship between the elite and global finance.

Practical barriers affect an individual's ability to access and utilize digital financial services, especially in the communities that stand to benefit most from financial inclusion efforts. For example, unreliable or expensive internet services can hinder access to digital financial services in the most remote communities. Current standards for customer due diligence center on providing documentation such as national ID cards, which may not be available or feasible to attain for underbanked populations. Small and medium-sized businesses often have more limited access to the financial sector due to a lack of information about the services available and high costs associated with lending to smaller firms.[31]

Further, social and cultural factors affect the customer's adoption and usage of and trust in digital financial services or its providers.[32] Individuals in older age groups are generally less likely to own or open a mobile money account because they may prefer more traditional methods of making transactions or lack familiarity, confidence, or digital literacy to effectively use mobile money services.[33] About two-thirds of unbanked individuals indicated they would need help in order to use an account at a traditional financial institution, and one-third of mobile money account holders in sub-Saharan Africa need help from a family member or agent to utilize their account.[34]

CONCLUSION

Moving people into the financial mainstream is a practicable goal. A growing body of evidence underscores that bringing previously marginalized people into the mainstream can have life-changing impacts. The SDGs took a critical step forward in recognizing the cross-cutting power of financial inclusion in supporting sustainable development, helping to break down siloes between the development and financial services sectors. Financial inclusion can also break down the siloes between the development and peace and security sectors. Inclusion, financial and otherwise, can reduce the inequalities and injustices that drive radicalization to violent extremism.

To fully realize the benefits of financial inclusion for achieving the SDGs, there is a need to break a third silo: engagement with consumers. Financial service providers will have the greatest impact on expanding access to service when they understand the unique consumer needs of underserved populations, map friction points in likely use cases, and adapt products to emphasize aspects of financial inclusion that yield the greatest promise. With support from donors and national governments, development practitioners can contribute to these efforts by identifying target communities, providing start-up capital to reduce the costs, evaluating successes, and offering cross-cutting analysis on factors of success that can help identify and tweak approaches to effectively scale up to ensure long-term business viability.

Finally, financial inclusion initiatives must emphasize that simply registering individuals for an account with a financial institution is not enough to ensure financial inclusion. Financial institutions must ensure that new financial technologies are accessible, affordable, and usable for a majority of unbanked individuals if they are to increase levels of financial inclusion significantly.

30 Mercy Buku and Rafe Mazer, "Fraud in Mobile Financial Services," CGAP, April 2017, https://www.cgap.org/research/publication/fraud-mobile-financial-services.

31 "Background," United Nations, n.d., https://www.cepal.org/en/inclusion-financiera-pymes/background (accessed 3 March 2023).

32 Buku, "Risk-Based Supervision for Digital Financial Services."

33 Demirgüç-Kunt et al., *Global Findex Database 2021*, p. 27.

34 Ibid., p. 4.

In order to see continued benefits, it is crucial that account holders continue to use their accounts to store money, make transactions, and access further, more diversified financial products and insurances. To do so, governments and financial institutions must provide access to adequate financial literacy services so customers can protect themselves against risk.

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- Combating illicit finance that enables criminal and violent extremist organizations.
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