Financial Inclusion: Can It Meet Multiple Macroeconomic Goals?

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EXECUTIVE SUMMARY

Financial inclusion is distinctly moving up the reform agenda, both in individual countries and at the international level. To date, more than 60 governments across the world have set financial inclusion as a formal target. This year’s post-2015 Development Agenda squarely puts financial inclusion as a key objective for United Nations member countries.

What is financial inclusion? Put simply, it is the access to and use of formal financial services by households and firms. It is seen by policymakers as a way to improve people’s livelihoods, reduce poverty, and advance economic development. Despite progress, large gaps remain in financial inclusion: across regions, income, gender, and many other dimensions. At the same time, solid evidence has been lacking on the macroeconomic effects of financial inclusion. This is, in part, because consistent macro-level data on financial inclusion across countries have been in short supply, until recently. Also, barring a few exceptions, it was not on macroeconomists’ radar until the U.S. sub-prime crisis of 2007 unleashed its full force.

Since financial inclusion is a multidimensional concept, its macroeconomic effects depend on its nature. This paper examines the linkages of financial inclusion with economic growth, financial and economic stability, and inequality; it offers three key policy-relevant findings.

First, financial inclusion increases economic growth up to a point. Greater access of firms and households to various banking services, as well as increasing women users of these services, lead to higher growth. Further, sectors dependent on external finance grow more rapidly in countries with greater financial inclusion. However, the marginal benefits for growth wane as both inclusion and depth increase. As such, these benefits could be low, and even negative, for some advanced economies.

Second, new evidence shows that financial stability risks increase when access to credit is expanded without proper supervision. Financial buffers decline with broader access to credit, other things being equal. In countries with weaker supervision, the erosion of buffers is larger. On the other hand, countries with strong supervision could see some financial stability gains from higher inclusion. The paper also reveals large supervisory gaps across countries, signaling the potential risks to financial stability from an unchecked broadening of access to credit.

And finally, in contrast to credit access, increasing other types of access to financial services does not impact financial stability adversely. Increasing access to automated teller machines (ATMs), branches, and transaction accounts fall in this category. Moreover, closing gender gaps in account usage and promoting diversity in the depositor base would help to improve growth without impairing financial stability. Therefore, these services can be promoted extensively, from a financial stability perspective.

Overall, financial inclusion can meet multiple macroeconomic goals, but macroeconomic gains wane as both financial inclusion and depth increase, and there are trade-offs with financial stability.