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CONTEMPORARY STUDIES IN ECONOMIC AND  
FINANCIAL ANALYSIS VOLUME 109B

# THE NEW DIGITAL ERA: OTHER EMERGING RISKS AND OPPORTUNITIES

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United Kingdom – North America – Japan  
India – Malaysia – China

Emerald Publishing Limited  
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2022

Editorial matter and selection © 2022 Simon Grima, Ercan Özen and Hakan Boz.  
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**British Library Cataloguing in Publication Data**

A catalogue record for this book is available from the British Library

ISBN: 978-1-80382-984-5 (Print)

ISBN: 978-1-80382-983-8 (Online)

ISBN: 978-1-80382-985-2 (Epub)

ISSN: 1569-3759 (Series)



ISOQAR certified  
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Environmental  
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ISO 14001:2004.

Certificate Number 1985  
ISO 14001



INVESTOR IN PEOPLE

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**SECTION A**

**OTHER EMERGING RISKS AND  
OPPORTUNITIES**

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# CHAPTER 1

## ACHIEVING FINANCIAL INCLUSION: WHATEVER IT TAKES

Peterson K. Ozili

### ABSTRACT

*Purpose:* This chapter examines some policy ideas on how to achieve high levels of financial inclusion. It explores policy options that can be used to achieve greater levels of financial inclusion.

*Methodology:* The chapter uses a discursive approach to analyse the steps to achieving full financial inclusion.

*Findings:* The chapter offers some suggestions on how to achieve full financial inclusion. They include reducing interest rates, introducing conditional low-interest rates, supporting monetary policies with social security payments, reducing taxes, using targeted government spending, supporting fiscal policies with conditional tax rebate and tax exemptions, financial inclusion–environment decoupling, de-risking the financial system, and ring-fencing banking for the poor.

*Originality:* This study contributes to the financial inclusion literature by exploring additional ways to achieve high levels of financial inclusion.

**Keywords:** Financial inclusion; interest rate; monetary policy; fiscal policies; environment; financial system; financial institutions; digital finance

## 1. INTRODUCTION

In this chapter, I explore policy options that can be used to achieve greater levels of financial inclusion. Financial inclusion refers to the provision of basic formal financial services and granting access to basic formal financial services so that people can use available financial services to improve their welfare (Ozili, 2018).

Financial inclusion has become a policy priority in many developing and emerging countries. Financial inclusion has been a part of the sustainable development goals and is a top policy agenda in some developing countries. While there is a consensus on the need to bring unbanked adults into the formal financial sector (Atkinson & Messy, 2013; Ozili, 2020b), there are different views on how best to achieve this. Hence, the different views are taken into account by policymakers as a result of many factors. For this reason, there is no one-size-fits-all policy for financial inclusion that is applicable to all countries.

In policy circles, there are several policy options that policymakers can use to achieve financial inclusion goals, but each policy option has its benefits and consequences. Faced with this trade-off, policymakers tend to adopt financial inclusion policies that have significant benefits with fewer consequences.

Meanwhile, in academia, several studies have identified some factors that contribute to greater levels of financial inclusion such as financial stability, regulatory sandboxes, innovation, financial education, financial literacy, fintech, digital finance, amongst others (e.g. Arner, Buckley, Zetsche, & Robin, 2020; Atkinson & Messy, 2013; Beck, Senbet, & Simbanegavi, 2015; Jenik & Lauer, 2017; Morgan & Pontines, 2014). While these findings offer some insights into the determinants of financial inclusion, they often do not prescribe the exact channel through which each factor or determinant affects the level of financial inclusion from a policy standpoint. I will give an example!

Take financial literacy, for example. How do you implement financial literacy as a policy goal? Should we require adults who are financially illiterate to attend training or a course on how to manage money? Who will bear the cost of such training? What criteria would we use to determine who is financially literate or illiterate? In colleges and universities, should an additional module be introduced into the syllabus to teach young adults how to manage money in their day-to-day lives? The question is how do you design a policy to increase financial literacy for financial inclusion in a country. Policymakers sometimes find it difficult to design policies that yield specific outcomes for financial inclusion. This difficulty makes them prefer to use macro policies to increase financial inclusion in specific ways. In this chapter, I present some of the strategies that policymakers can use to achieve greater levels of financial inclusion.

This study contributes to the literature in the following way. It contributes to the literature that examines the determinants of financial inclusion. It contributes to the literature by suggesting ways to increase the levels of financial inclusion. This chapter also contributes to the economic literature by showing how changes in macroeconomic policies can positively affect the livelihoods and welfare of poor households and individuals.

The rest of the chapter is structured as follows. Section 2 presents the literature review. Section 3 offers some policy suggestions on how to achieve high levels of financial inclusion. Section 4 concludes.

## 2. LITERATURE REVIEW

In the policy literature on financial inclusion, [Zulkhibri \(2016\)](#) suggests the policy instruments that encourage the redistribution of income can help to bring the excluded population into the formal financial system. [Atkinson and Messy \(2013\)](#) argue that financial inclusion is an international policy priority. They suggest that financial education policies will improve financial literacy and lead to greater financial inclusion. [Ozili \(2020a\)](#), in a review of existing financial inclusion studies, found that financial inclusion affects, and is influenced by, the level of financial innovation, the level of poverty, the stability of the financial sector, the state of the economy, financial literacy, and regulatory frameworks which differ across countries.

[Anarfo et al. \(2019\)](#) examine the bi-causal link between monetary policy and financial inclusion in 48 sub-Saharan African countries from 1990 to 2014. They find a bi-causal relationship between monetary policy and financial inclusion which suggest that monetary policy affects financial inclusion, and financial inclusion is also influenced by monetary policy. [Ozili \(2022\)](#) shows that high economic policy uncertainty reduces the level of financial inclusion. [Myers, Cato, and Jones \(2012\)](#) point out that in countries like Ireland, Spain, Canada and the UK, credit unions owned by members play a significant role in reaching under-served and excluded communities even though credit unions faced financial and operational problems. [Ozili \(2018\)](#) argues that digital devices that are connected to the internet can be used to deliver basic financial services to under-served adults, and this can increase financial inclusion.

[Ozili's \(2020b\)](#) special agent theory of financial inclusion argues that a government can increase financial inclusion by using a special agent that is often a financial institution. Meanwhile, [Ozili \(2021b\)](#) shows that agents of financial inclusion may incorporate economic and social constraints in the delivery of formal financial services, such as high interest rates, bank charges and high transaction cost, and these constraints limit the ability of poor banked adults to use basic financial services to the fullest.

[Ait Lahcen and Gomis-Porqueras \(2021\)](#) analyse various policies aimed at increasing financial inclusion and find that a direct transfer to bank account holders yields the highest welfare and lowest consumption inequality. [Myers et al. \(2012\)](#) show that not having access to mainstream financial services, such as a bank account or a credit card, leads to a variety of social and economic exclusions in countries like Ireland, Spain, Canada and the UK.

Overall, the policy literature on financial inclusion shows that policies can be designed to address financial inclusion problems.

## 3. POLICY OPTIONS TO ACHIEVE FULL FINANCIAL INCLUSION

### 3.1. Reduce Interest Rates

Reducing interest rate is a monetary policy tool. Governments can lower interest rates to increase the level of financial inclusion. Low-interest rate will increase aggregate demand for goods and services in the economy and will reduce the

cost of borrowing funds. Loans will become cheaper for small businesses, and this can encourage small businesses to obtain loans from formal financial institutions. With low-interest rates, individuals in rural and urban communities will be more willing to take loans from local financial institutions and use the loans to launch their own business and employ workers in the local community. Employed workers can be required to open a salary account in a formal financial institution for the payment of wages and salaries. This will bring local workers into the formal financial sector through bank account ownership for each worker for the payment of wages and salaries, thereby, leading to greater financial inclusion.

Lower interest rates can also encourage both small and large companies to expand and grow their businesses which will increase the level of employment and increase the demand for financial services through increase in demand for salary accounts. Keeping interest rates at low levels for a considerable period of time will not only have positive effects on firms but will also increase the demand for financial services by members of the population. Reducing interest rates works best in countries where the cost of doing business and the cost of funds are high.

### *3.2. Conditional Low-Interest Rates*

This is a type of conditional monetary policy targeting for financial inclusion. Governments, through the central bank, can grant loans with special low-interest rates to businesses that want to invest in projects in rural communities if the government is convinced that such projects will have positive effects for financial inclusion. Governments should assess all requests for development loans, and determine whether the applicants qualify for special-rate development loans on the basis of whether the proposed projects will help in reducing the level of poverty and improve the welfare of poor people. Some corporate applicants may use the special-rate loan to set up a food bank, microfinance institution, rural bank or social banks in remote communities.

A special low-interest rate such as a single-digit interest rate on loans can increase the demand for development loan. Formal financial institutions can take advantage of the special low rates to extend basic financial services to rural communities by opening bank branches in rural communities or setting up bank correspondents in areas where formal financial institutions do not exist. Special low rates tend to be effective in developing countries that have high poverty levels.

### *3.3. Support Monetary Policies with Social Security Payments*

Monetary policies may not yield the desired results in the short term due to high inflation and the extended time lag in a country's monetary transmission mechanism. The time lag may be longer in some countries and shorter in other countries. For this reason, there is a need for governments to support monetary policies with social security payments in the short term. Governments should support monetary policies with social security benefits paid into the bank account of poor households in urban and rural areas. Paying monthly social security payments in the bank accounts of poor households will not only bring poor households into

the formal financial system, but it will also give them some money to feed their families and to meet other basic expenses to improve their welfare.

### *3.4. Reduced Taxes*

Governments can lower the tax rate to increase the level of financial inclusion. When the tax rate is reduced, the aggregate demand for goods and services in the economy will increase. Reduced tax rate will increase business profit which can be reinvested into firms for business expansion and growth. As businesses expand their operations, they will employ more workers in urban and rural communities. The workers will be required to open a salary account in a formal financial institution for the payment of wages and salaries. This will bring the working population into the formal financial sector through bank account ownership for each worker, thereby, leading to greater financial inclusion.

This type of fiscal policy approach for financial inclusion may be more effective in countries where employers are required by law to pay wages and salaries into the bank account of their employees rather than paying salaries directly to employees in cash. Today, there are many countries that have not made wage and salary payment into bank accounts a legal requirement. In such countries, using fiscal policy to promote financial inclusion by reducing taxes may be ineffective.

### *3.5. Targeted Government Spending*

Another fiscal policy approach for financial inclusion is to increase government spending in rural communities. Governments can do this by providing banking infrastructure in rural communities such as creating public banks or special microfinance institutions that provide affordable financial services to poor households. Governments can also spend more money in building good roads and electricity infrastructure in rural communities. Poor roads and lack of electricity have been the most commonly reported reasons why large companies do not expand their businesses to rural villages. Providing good roads and power supply will not only encourage financial institutions to expand their business to rural communities, but it will also have positive effects on the local economy in rural areas and bring financial services closer to the people in rural communities, thereby increasing the likelihood of owning a bank account in a financial institution in the rural area. Increased government spending for financial inclusion is more effective in developing and poor countries, particularly, in countries that have underdeveloped financial sectors and high poverty levels.

### *3.6. Support Fiscal Policies with Conditional Tax Rebates and Tax Exemptions*

Fiscal policies alone won't work. Why? Because existing structural barriers and other frictional problems may prevent fiscal policies from yielding the expected fiscal outcome. For this reason, there is a need for governments to supplement fiscal policies with conditional tax rebates or conditional tax exemptions (or tax holidays) particularly for companies, poor households and small businesses.

In the case of companies, the government can encourage companies to expand their businesses to remote communities by building factories and opening office branches in these communities, and in exchange, the government can grant such companies a special tax rebate or tax holiday, for example, such companies may be exempted from paying taxes for the first 3 years after expanding their businesses to remote villages or communities. This type of conditional fiscal policy can be used to persuade banks and other financial institutions to expand their businesses to remote communities, so that households in such communities can have access to basic financial services, thereby bringing financial services closer to the people, thus increasing the level of financial inclusion.

For small businesses, providing conditional tax exemption is necessary to uplift small businesses. Conditional tax exemption policies, such as granting income tax exemptions to small businesses whose income falls below a certain threshold, can uplift small businesses facing economic hardship. With such tax exemptions, business owners can borrow money from banks to expand their small businesses without paying taxes. They will pay taxes only when their income level begins to increase up to the taxable threshold.

For poor households, conditional tax exemption also has benefits to poor households. With tax exemptions, poor households whose income falls below a certain threshold and who do not want to start a small business can at least have some cash savings which they can save into their bank accounts. Moreover, when these groups of households know that they are exempted from taxes, they will be more willing to own a bank account to keep their little cash savings, thereby, leading to greater financial inclusion. This approach is currently being practiced in the United Kingdom. In the UK, citizens who do not earn up to 10,000 pounds in the tax year are not taxed. If they have been taxed by their employees, they are eligible for tax rebates. This is a type of tax exemption for greater financial inclusion targeted at poor households who earn very little income.

### *3.7. Inclusion–Environment Decoupling*

Inclusion–environment decoupling refers to increasing the level of financial inclusion without a corresponding increase in environmental pressure or degradation. Inclusion–environment decoupling is achieved when growth in environmental pressure (and pollution) is less than the increase in the level of financial inclusion over a given period. Such decoupling can be absolute or relative. Absolute decoupling occurs when the relevant indicator of environmental pressure (e.g. pollution) is stable or decreasing while the level of financial inclusion is growing. Relative decoupling occurs when the growth rate of the environmental pressure (or pollution) indicator is positive but less than the growth in the level of financial inclusion.

In many economies, increasing the level of financial inclusion may increase the pressure on the environment when governments and corporations begin to build new financial institutions, new bank branch networks and building new information technology and telecommunications infrastructure that operates on energy