Financial Exclusion of Poor

Lecture 8

Introduction

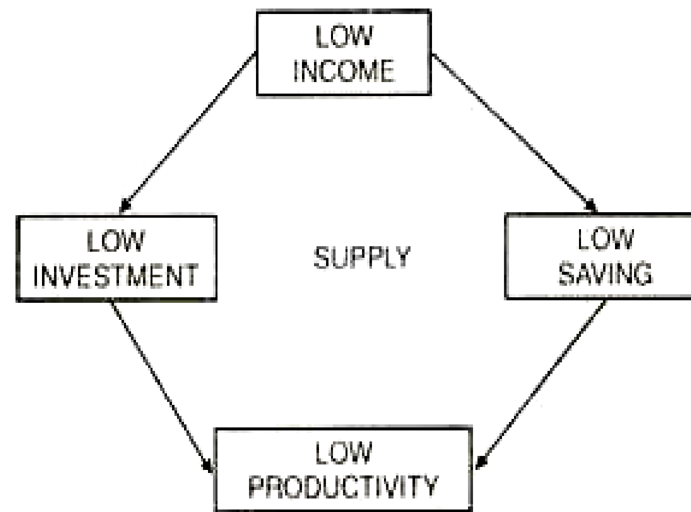
- There is a growing recognition across the EU that having access to a bank account and the financial services that banks and other financial institutions provide, including credit facilities, is, in many countries, a necessary condition for social inclusion. (European Commission Employment, Social Affairs and Equal Opportunities Social Situation Observatory – Living Conditions and Income Distribution 2010, p.3)
- People who have difficulty in obtaining a bank account or access to credit, therefore, tend to be those who are out of work or who have particularly low levels of income, which are independent causes of social exclusion.

Some excluded groups from the financial market

- Marginal farmers
- Laborers
- Urban slum dwellers
- Migrants
- Ethnic minorities

Financial exclusion

- Financial exclusion is a broad term for the barriers faced by the poor
- It is defined as “those processes that serve to prevent certain social groups and individuals from gaining access to the financial system” (Leyshon and Thrift, 1995)
- However, financial inclusion is one of the powerful weapons in poverty irradiation



Forms of financial exclusion

(1) Access exclusion: the restriction of access through the processes of risk management

eg. Repaying capacity, permanent income

(2) Condition exclusion: where the conditions attached to financial products make them inappropriate for the needs of some people

eg. Asking guarantors, bonds/surety

(3) Price exclusion: where some people can only gain access to financial products at prices they cannot afford

eg. high interests and instalments

(4) Marketing exclusion: whereby some people are effectively excluded by targeting marketing and sales

eg. loans and credit card promotions

(5) Self-exclusion: people may decide that there is little point applying for a formal financial product because they believe they would be refused

eg. fear for debt

Financial inclusion/exclusion in the global context

- the Asian system offered universal participation in which the government performed a major role by directing credit at low but stable rates of return.
- European countries tended to offer a "range of functionally distinct institutions" that was tailored to meet diverse needs; some were scaled to cater to nation-wide demands while others were simply to meet local needs.
- The US used to have a system in which banks were local and segmented with near-universal participation
- Countries in Latin America used to have universal banking in urban areas and informal financial arrangements in rural areas.
- However, all these diverse models of banking which were unique to their environments are now being replaced by a homogeneous system as a result of financial globalization that caters to the upscale segment.

- As financial institutions focus on attracting desirable upscale customers by offering them low or zero fees for service, the poor customers are left with costly and limited services.
- Furthermore, the cross-subsidies between elite customers and other customers which allowed banks to offer small but similar financial services are being eliminated. Because banks now compete globally for elite customers, they no longer offer subsidies to lower-balance or riskier clientele.
- The end result of all these transitions is a larger number of households becoming unbanked ("those who are unable to establish or maintain bank accounts" (Dymski, 2005, p. 125) and an ever clearer division between the financially included and the financially excluded.

Financial exclusion in Europe

- Carbo et al. (2007) indicate,
- the widespread liberalization of the financial industry has drastically increased “intensification of bank competition”
- Liberalization policy has deregulated the banking and financial market, which create benefits to rich class
- That challenged the standard of justice in financial practices
- Carbo et al. (2007) observed that financial exclusion is “invariable experienced by the poorer members of society” even though they are in developed countries.
- The percentage of the adult population, in Europe, who do not have bank accounting, for example is stunning: 22.4 percent in Italy, 17.9 percent in Greece, 16.8 percent in Ireland, 16.7 percent in Portugal, 13.5 percent in Austria and 10.5 percent in the UK. Between 14% and 18% in the Czech Republic, Ireland, Latvia, Lithuania, Poland and Slovakia

Consequences of financial exclusion

- The lack of access or not having a bank account makes it difficult for the poor
  - to receive income and to make payment,
  - to receive credit that they really need to help them navigate the financial crises
  - It also reduces saving habits, financial literacy and management skills
- As a result, the poor resort to alternatives to the traditional financial institutions such as
  - money-lenders
  - payday loans
  - pawnshops that charge very high rates.
  - inability to obtain insurance coverage.

Different approaches to combat the problem of financial exclusion

- These approaches have travelled under such different names as
  - social investment programs
  - micro-finance programs
  - community finance, and
  - community development
- the government of the UK stimulates local enterprises and reduce dependency on state support through: promoting community development and finance programs (CDFI) to provide credit to poor communities, and grant-funding community

Assignment 01

- Group activity

1. Interview 5 to 10 poor people in your area and analyze the characteristics of their poverty
2. Introduce a suitable social entrepreneurship model/s to irradicate their poverty

(marks 30)

Results should be presented in the class using a PowerPoint presentation. Everybody has to contribute to the project and present the outcomes

Presentation will be on 27th April