Spotlight 1.1

Financial inclusion and financial resilience

Financial resilience is an important aspect of financial inclusion*—that is, when one has access to the appropriate financial tools (such as bank accounts, savings, credit, and digital payments) that can be used safely in a well-regulated environment to meet one's needs.* Financial resilience *refers to the ability of people and firms to recover from adverse economic shocks, such as job loss or unanticipated expenses, without suffering a decline in living standards.*

Before the pandemic, only half of the adult population of emerging economies said they could come up with emergency funds within the next month.[1] The shares were smaller for women (45 percent) and poorer adults (34 percent). Among adults in emerging economies who said they could access emergency funds, a third said they would come up with the money by picking up extra shifts at work or by borrowing from their employer—options that may be impossible or undesirable during a crisis like COVID-19 (coronavirus).

COVID-19 underscored the importance of strengthening financial resilience. The crisis disproportionately hit micro-, small, and medium enterprises (MSMEs) and vulnerable groups, who typically have meager cash buffers. These vulnerable groups are overrepresented in sectors that suffered the most from the crisis.[2] Job and income losses driven by lockdowns and mobility restrictions were deeply felt by individuals and entrepreneurs, depleting already limited savings and assets.[3] The World Bank predicted that poverty would worsen in low-income countries and that about 100 million people would fall into poverty in 2021.[4]

Access to financial services is essential for resilience and economic recovery. Digital payments, savings, credit, and insurance allow businesses and individuals to manage risk, smooth expenses, and invest. Evidence shows that households and businesses that have access to such financial services are better able to withstand adverse financial shocks than those that do not.[5] Mobile money helps people manage economic shocks by making it easier to borrow money in an emergency from a wider geographic and social network of family and friends.[6] Research from Kenya found that mobile money services allowed families to become less poor in the long term.[7] Savings accounts boost financial resilience by providing a buffer against unexpected expenses.[8] Mobile credit can boost

financial resilience as well, to the extent that borrowing can help address the immediate impact of a shock, although these products also raise consumer protection concerns.[9] Lack of access to credit, on the other hand, can reduce resilience; in India, a reduction in microfinance was associated with significant decreases in wages, income, and consumption.[10]

One study found that sustained credit flows in the United States during periods of stringent financial constraints can boost small firms' resilience by shielding their sales and employment.[11] A review of the literature suggests that MSMEs in Organisation for Economic Co-operation and Development countries with access to credit are more likely to survive as employers and creators of economic value.[12] And, as revealed in an analysis of the early impacts of COVID-19, a decline in output is less common among firms in low- and middle-income countries that had better access to finance before the pandemic (although firms with stronger fundamentals might have better access to credit).[13] Financial inclusion also helps governments deliver services cheaper and faster.[14] As the COVID-19 crisis erupted in 2019, countries with higher rates of financial inclusion were able to leverage that infrastructure to rapidly roll out government support, as evidenced by the experiences of China, Colombia, and India.[15]

In recent years, millions of adults have gained access to accounts and other tools that help build financial resilience—but exclusion remains widespread. Worldwide, over 1 billion adults lack access to a transaction account. Lower-income adults in emerging economies access credit and savings largely through informal channels, with very limited access to insurance. For example, access to crop insurance is practically nonexistent among small farmers, despite widespread risk in the agriculture sector.[16] At least 41 percent (130 million) of formal MSMEs in emerging economies lack access to credit, which is viewed as a top obstacle to business survival and growth.[17]

Because MSMEs and the informal sector are the largest source of employment and livelihoods in emerging economies, their resilience is at the core of any economic recovery effort.[18] Access to credit, in particular, is central to the ability of businesses to manage working capital and investment needs. Low-income households and businesses typically do not have enough discretionary savings or insurance coverage to carry them through an adverse income shock. Instead, they often rely on credit instruments to help smooth consumption and safeguard business continuity. Research from Africa and the United States confirms that access to short-term credit can help consumers smooth consumption in the face of idiosyncratic shocks. This research offers evidence that credit—if delivered responsibly—*can* be an important tool in ensuring the resilience of households with limited ways to manage risk.[19] It is less clear that credit can play a significant role in helping MSMEs and lower-income people cope with the impacts of large systemic shocks. Borrowing as a resilience strategy relies on a timely recovery that restores the income needed to repay debts.

The COVID-19 crisis was characterized by a large, rapid deployment of government initiatives aimed at helping residents and businesses weather the economic shock, including through extensive loan repayment moratoria, credit guarantees, and cash transfers.[20] As chapter 1 describes, however, the ability of governments to support these measures was time-bound and limited for lower-income countries, and programs often failed to reach all segments of the population. MSMEs, especially those operating informally, often did not receive commensurate support. As the broader recovery takes hold, however, the judicious use of credit could enable some enterprises and households to bridge cash-flow gaps. The residual uncertainty around the timing of localized recovery suggests that government guarantees could play a useful role. From a fiscal perspective, linking further expenditures to the actual realization of a negative outcome (such as yet another downturn in which credit guarantees are triggered) is less costly than blanket government support.

As the health crisis diminishes and consumer demand increases, credit for MSMEs and low-income households becomes an essential element of

the ability of businesses to invest in economic recovery. However, the ability of private sector lenders to lend has been reduced by weakening revenue and lenders' reduced visibility into the economic prospects and creditworthiness of borrowers. Economic shifts stemming from the pandemic have indeed rendered some borrowers less creditworthy, but the uncertainty has caused lenders to lose their appetite for risk, and lending even to creditworthy borrowers may be affected. As discussed in chapter 4, innovations that improve lenders' visibility into borrower viability and improve their ability to realize value from collateral can encourage safer lending. Carefully crafted guarantee programs could also bridge the gap between backward-looking risk aversion and future credit performance.

Notes

1. Demirgüç-Kunt et al. (2018). Respondents were asked if they could come up with the equivalent of 5 percent of the gross national income per capita, equal to approximately $3,000 in the United States.
2. OECD (2020); Vardoulakis (2020).
3. Gomes, Haliassos, and Ramadorai (2020).
4. Mahler et al. (2021).
5. Breza, Kanz, and Klapper (2020); Moore et al. (2019).
6. When hit with an agricultural shock, Kenyan households with no mobile money access suffered a 7 percent drop in the use of goods and services, while those who did have mobile money experienced no such drop on average (Jack and Suri 2014). In Tanzania, rainfall shocks resulted in 6 percent lower consumption on average, but mobile money users were able to maintain consumption due to improved risk-sharing (Riley 2018).
7. El-Zoghbi, Holle, and Soursourian (2019); Suri and Jack (2016).
8. In Chile, women who received free savings accounts reduced their reliance on debt and improved their ability to make ends meet during an economic emergency (Kast, Meier, and Pomeranz 2018). Women in Nepal who received free savings accounts with no withdrawal fees were better able to manage unexpected health expenses than those who did not receive accounts (Prina 2015).
9. Bharadwaj, Jack, and Suri (2019).
10. Breza and Kinnan (2021).
11. Chodorow-Reich (2014).
12. Bakhtiari et al. (2020).
13. Amin and Viganola (2021).
14. In a recent pilot in Albania, the World Bank estimated that digitalizing 75 percent of the current paper-based transactions could potentially achieve savings of about 0.4 percent of GDP. Lund, White, and Lamb (2017) estimate that emerging economies could save as much as 0.8–1.1 percent of GDP annually ($220–$320 billion) by digitalizing government payments alone, with benefits for both governments and recipients.
15. Agur, Peria, and Rochon (2020).
16. A Global Findex survey of economies in Sub-Saharan Africa found that, on average, one in three adults grows crops or raises livestock to produce their main household income, but only about 5 percent had purchased agricultural insurance in the previous five years. Yet roughly two-thirds of these adults faced a crop loss or significant loss of livestock in the last five years, and only a tiny share received any kind of financial payout to help deal with the loss (Klapper et al. 2019).
17. International Finance Corporation, MSME Finance Gap (database), SME Finance Forum, https://www.smefinanceforum.org/data-sites/msme-finance-gap.
18. Ayyagari, Beck, and Demirgüç-Kunt (2003).
19. Bharadwaj and Suri (2020); Collins et al. (2009); Karlan and Zinman (2010); Morse (2011).
20. Gentilini et al. (2020).

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