Financial Inclusion Disparities in the European Union

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Abstract: - The European Union is a leader when it comes to various inclusion indicators. At first glance, this would suggest that the EU enjoys a high level of financial inclusion. The analysis we performed reveals that the EU-level averages often hide extremes. While Western European countries have a very high level of financial inclusion, when we look at the countries in Eastern Europe, we can even talk about a financial exclusion of the population. The study relies on three sets of indicators, related to the use, geographical access, and digitalization of financial services. On a positive note, inclusion indicators have improved over the analyzed period. However, this improvement took place at different paces for the Member States and, as a result, disparities not only persisted, but even deepened in many cases.

Key-Words: - financial inclusion, financial integration, disparities, European Union, financial services access, digitalization

JEL Classification: - G20, G21, G50, G53

1 Introduction

Few studies to date have explicitly addressed the issue of financial inclusion in the Member States of the European Union, primarily because statistical data, or rather the lack thereof, have not allowed for the development of complex analyses. Perhaps the most comprehensive approach in this regard is the study conducted under the auspices of the World Bank by Demirguc-Kunt and Klapper (2012), a large-scale survey that provides us with a sufficiently clear perspective on the level of global financial inclusion.

The European Union in general, and the euro area in particular, lead the rankings in terms of various inclusion indicators. At first glance, these rankings would suggest that the EU enjoys a high level of financial inclusion. The analysis we perform in this article reveals, however, that the averages at Union level often hide extremes. While Western European countries have a very high level of financial inclusion, in Eastern Europe - usually in the countries that joined after 2004 - we can talk about financial exclusion, as the extent to which the population participates and benefits from financial services is much lower. The need for financial inclusion has been recognized and reaffirmed by the EU authorities several times. We mention here the project of the capital markets union (European Commission, 2015), which aims at facilitating the access of enterprises and of the population to financial services. Although at declarative level the European Commission has spoken out in support of market development and financial inclusion, concrete actions are lagging behind, against the background of the lengthy decision-making process and of the recent turmoil caused by the pandemic crisis.

The analysis of financial inclusion in the EU Member States targeted three sets of indicators:

i) Financial services use: current accounts, deposits, contracted loans, credit cards, wages received in current accounts or in cash from the private sector, payments from public authorities in current accounts or in cash.

ii) Geographical access to financial services: number of ATMs per 100,000 adults, number of commercial bank branches per 100,000 adults.

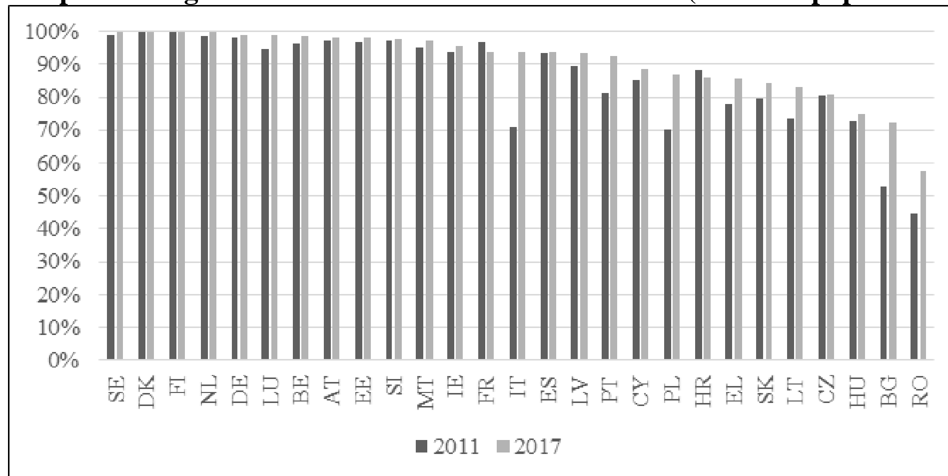
iii) Digitalization of financial services: the use of a debit or credit card for online purchases, online payments made in the previous year.

Inclusion indicators have improved during the analyzed period, therefore there is a positive trend at Union level in terms of financial inclusion of the population. However, this improvement has taken place at different paces in the different Member States and, as a result, not only that disparities persisted, but in many cases they even deepened. These disparities make the case for the necessity that national authorities develop and implement inclusive policies comprising concrete measures. Moreover, the success of such policies would be enhanced by the active involvement of the Union authorities and the timely resumption of the Commission's action plans for the development of the Member States' financial markets.

2 Financial services use

A current account is a basic service, often complementary to other types of financial services. Existing data show that current account facilities are easily accessible in the European Union, especially if we consider the average of 91% of the population over 15 holding such a financial instrument at EU level in 2017 (up from 86 % in 2011). As mentioned above, the averages do not accurately reflect the actual situation of the Member States, and the graphical representation below indicates very sharp discrepancies between developed and emerging markets (Graph 1). In Sweden, Denmark, Finland, or the Netherlands, 100% of the surveyed population had a current account open with a financial institution in 2017. A relatively recent analysis by the European Central Bank (Esselink and Hernández, 2017) states that more than 93% of the Eurozone population owned or had access to a bank account in 2016, which reflects, at first glance, a very good access of the population to primary financial services. However, we note lower percentages in the countries of belonging to the Southern part of the Eurozone (e.g. Greece, Slovakia) and in the Baltic States (Latvia, Lithuania). Hungary, Bulgaria and Romania occupy the last three places. Although the countries of Central and Eastern Europe show a low penetration of financial services on their markets, for some of them we notice a significant increase in these percentages between 2011 and 2017: Romania from 45% to 58%, Bulgaria from 53% to 72%, Poland from 70% to 87%. This high growth rate can be explained by the fact that these countries have emerging, unsaturated, and rapidly expanding markets in terms of financial services. High growth rates are generally specific to emerging economies and reflect their underdevelopment and the so-called "catching-up" effect in relation to developed markets, which are advancing at a much slower pace.

Graph 1. People holding an account with a financial institution (% of the population aged 15+)



Source: author's representation based on World Bank– Global Findex Database

If discrepancies exist in the case of demand deposits, which *sine-qua-non* are a support tool for other financial services, they become much more obvious if we analyze the situation of term deposits. Savings deposited with financial institutions give us an even clearer picture of the development of the financial markets in question. A small percentage of the population holding a deposit shows one of the following:

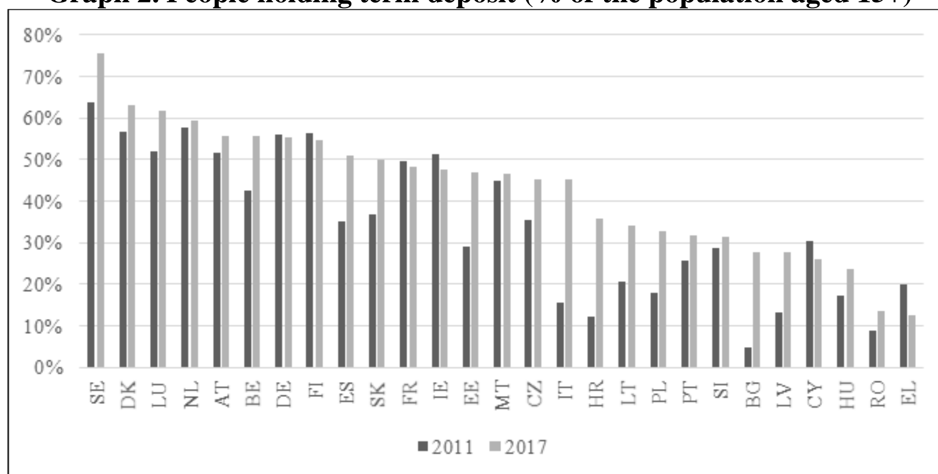
(i) the population does not make savings and only relies on subsistence income,
(ii) the population does not trust financial institutions,
(iii) the population does not have access to financial institutions,
(iv) deposits are not attractive, because of the low interest rates offered.

Each of these possible explanations suggests that financial intermediation is weak in these markets. We take into account the fact that the main purpose of banks is, or should be, to channel deposited financial resources back into the economy. The lack of these resources has negative effects on the supply of loans and on the financing of production activities.

Among the countries where the highest percentages of the population deposits savings in banks are Sweden (75% in 2017), Denmark (63% in 2017), Luxembourg (62% in 2017) and the Netherlands (59% in 2017) - Graph 2. At the other end, countries such as Poland, Hungary and Bulgaria have comparable levels in 2017, between 33% and 24%. The worryingly low percentage of the Romanian population depositing savings with banks puts into question the country's degree of economic development, especially considering the fact that enterprises mainly rely on bank loans for financing. On a positive note, deposits are on the rise, from only 9% of the population over the age of 15% in 2011.

Greece occupies the last place, with a declining percentage in 2017 compared to 2011. We recall that through the systemic risk management package, the Greek authorities temporarily banned not only the liquidation of term deposits, but also cash withdrawals from demand deposits. Subsequently, for a long time, very strict daily limits were imposed on the amounts withdrawn, in order to maintain liquidity in the banking system. In general, the instability of the Greek financial system, but especially these measures meant to restrict the population's access to its own resources, significantly affected the confidence in financial services.

Graph 2. People holding term deposit (% of the population aged 15+)

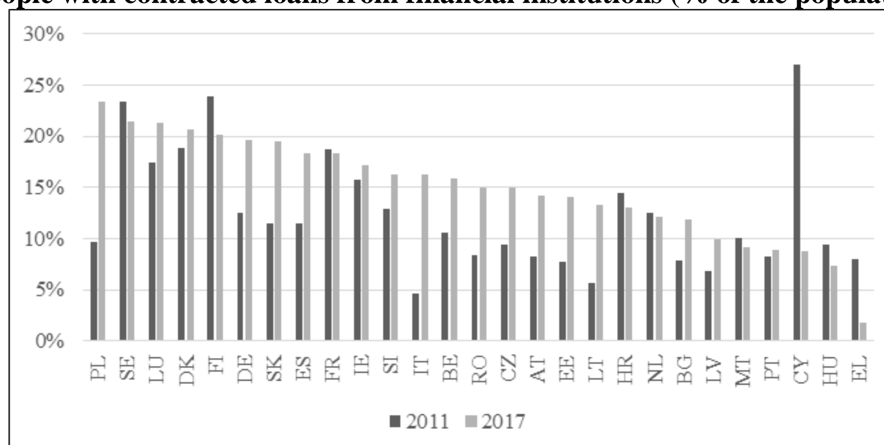


Source: author's representation based on World Bank– Global Findex Database

Perhaps the most relevant aspect of financial inclusion is the access to finance. In terms of loans contracted by the population, the ranking is heterogeneous, and the differences between 2011 and 2017 are wide. This time we find Poland on the first place. In Poland, an obvious leap occurred between the two years we analyzed, from 10% in 2011 to 23% in 2017. Also, Romania is in the middle of the ranking, surpassing countries such as Austria or the Netherlands. Sweden (21%), Luxembourg (21%), Denmark (21%) or Finland (20%) are once again at the forefront of the hierarchy. The percentage of the population that accessed a loan in 2017 varies from 23% in Poland to 2% in Greece – Graph 3.

According to Gómez Urquijo (2015), discrepancies in terms of contracted loans do not necessarily reflect people's access to financial services. They can be correlated with the countries' culture. Specifically, some countries, especially those in Central and Eastern Europe, perceive long-term indebtedness negatively and regard it strictly as a last resort financing source.

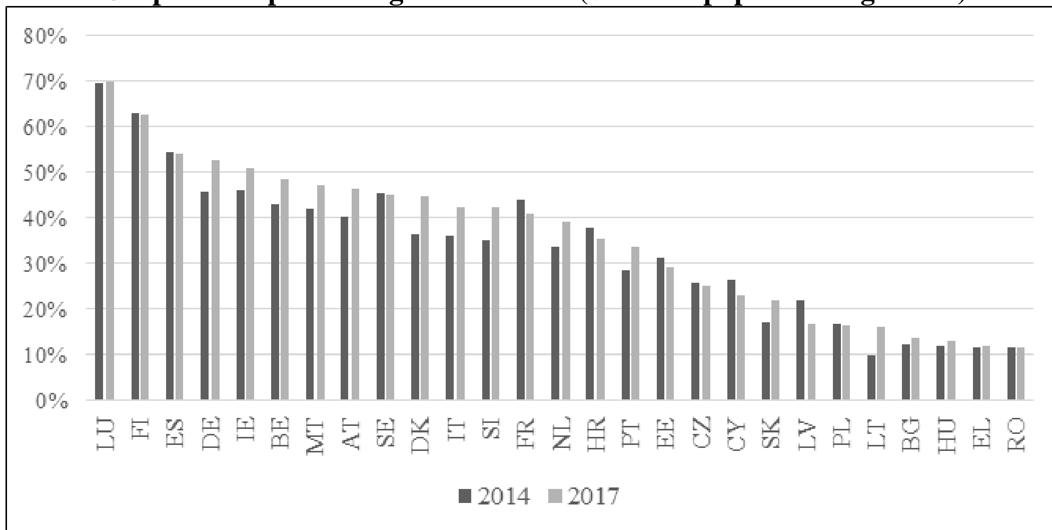
Graph 3. People with contracted loans from financial institutions (% of the population aged 15+)



Source: author's representation based on World Bank– Global Findex Database

Credit cards are also a popular financial instrument, but relatively more sophisticated than demand deposits. As expected, a smaller part of the population resorted to such services that allow credit purchases. The percentages vary, in 2017, from 70% in Luxembourg to only 12% in Romania (Graph 4). Credit cards have started to become more attractive as banks have eased access conditions and interest rates on purchases have fallen. On the emerging markets, financial institutions are taking extensive steps to popularize these tools by collaborating with online stores and offering preferential conditions to new customers who choose the alternative of a credit card. The extremely low percentages in Romania, Greece, Hungary, Bulgaria and Lithuania, but also the minimal evolution between 2014 and 2017 may indicate the reluctance of the population and even the lack of confidence in credit instruments. This lack of trust is even recognized by the World Bank (2019) as the main reason for the voluntary exclusion from the use of financial services.

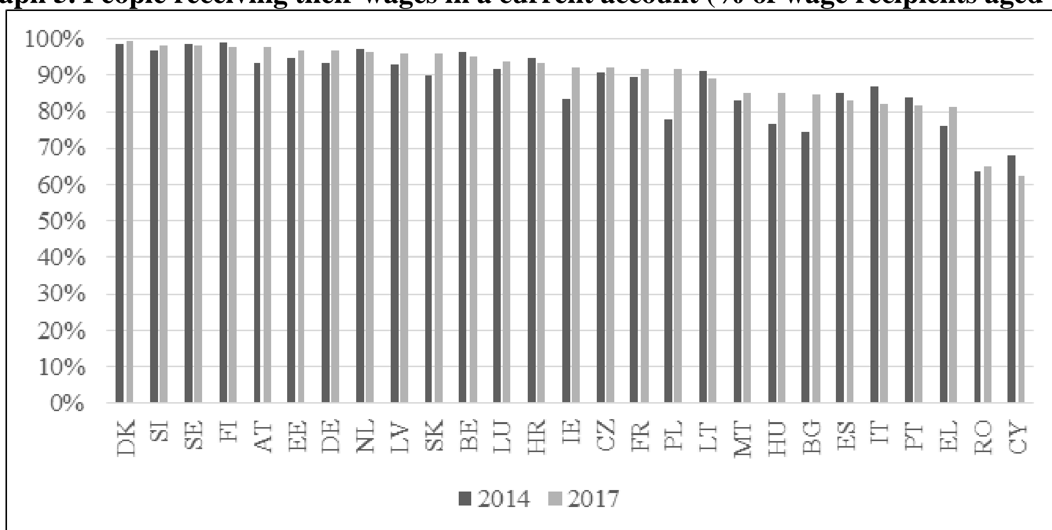
Graph 4. People owning a credit card (% of the population aged 15+)



Source: author's representation based on World Bank– Global Findex Database

In 2017, high percentages of the employed population received salaries in a current account – Graph 5. The fact that in recent years, private companies abandoned cash payments and conditioned the payment of wages on the holding of a banking account could be a possible explanation for the high values.
The percentage of people who received their salary in a current account in 2017 varies between 99% in Denmark and 62% in Cyprus. We also notice very high percentages in Slovenia (98%), Sweden (98%), or Finland (98%). Romania is once again at the bottom of the ranking with only 65%, preceded by Cyprus with 62%.

Graph 5. People receiving their wages in a current account (% of wage recipients aged 15+)

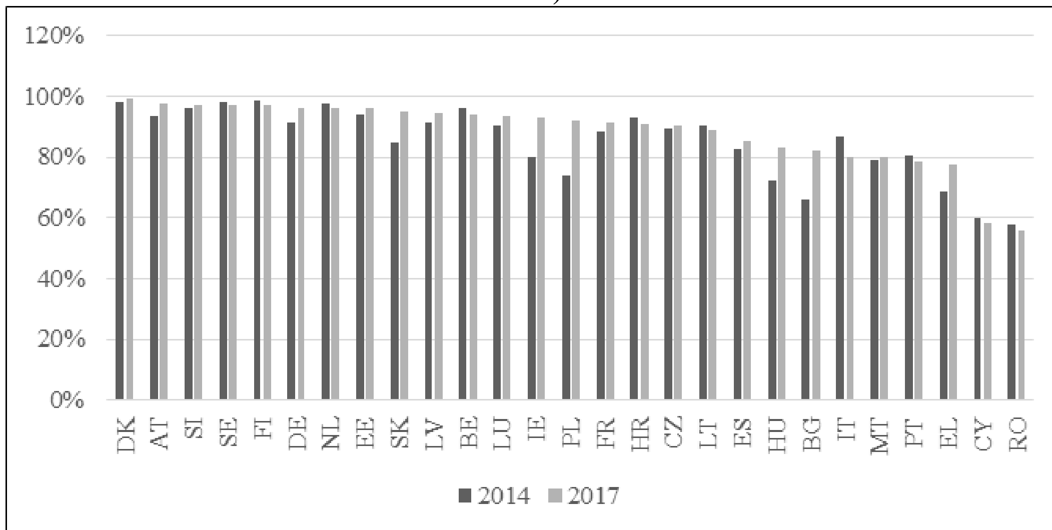


Source: author's representation based on World Bank– Global Findex Database

Graph 5 gives us an overview of the wages received in bank accounts. However, the data reveal sharp discrepancies between public and private systems. As we can see in Graph 6, most of the wages received in bank

accounts are in the private system. According to these data, the private system contributes to a greater extent to the financial inclusion of the population in the Member States. At the top of the hierarchy in 2017 are countries such as Denmark (99%), Austria, Slovenia, or Sweden, all of them with 97% of the employed population receiving wages from private companies through a financial institution. The last three countries from this point of view are Greece (77%), Cyprus (58%) and Romania (56%).

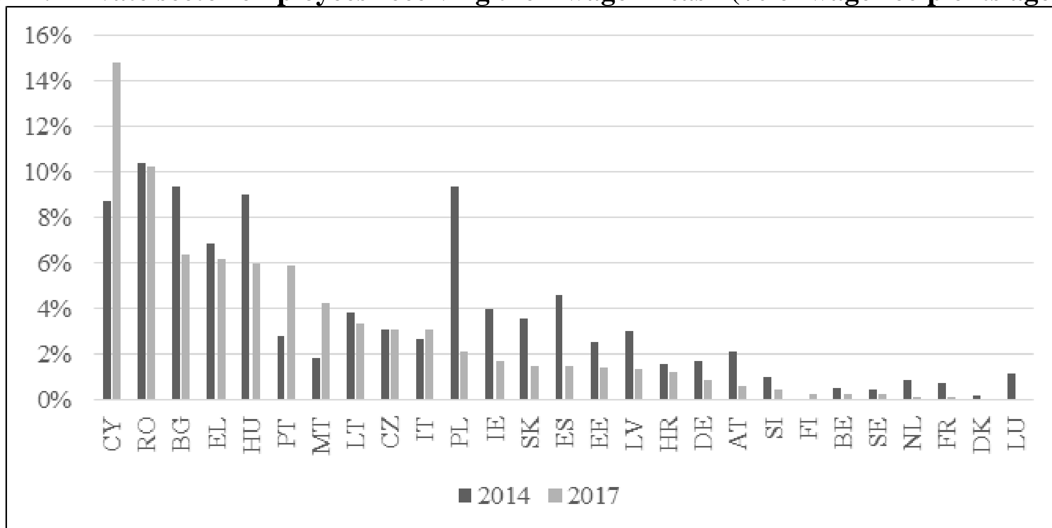
Graph 6. Private sector employees receiving their wage in a current account (% of wage recipients aged 15+)



Source: author's representation based on World Bank– Global Findex Database

Data on the payment of cash wages in the private sector show a reversed hierarchy. This time, on the first positions we find the countries with a strong cash payment culture: Cyprus (15% in 2017), Romania (10% in 2017), Bulgaria (6% in 2017). The percentages for Luxembourg, Denmark, France or the Netherlands are equal or very close to 0% - Graph 7. It is easy to see that transfers to current accounts are generally preferred to cash payments, and we recall again that a large proportion of private companies - especially multinational companies - have conditioned the payment on the holding of a bank account. This may be the reason why Central and Eastern European countries still have relatively small percentages of cash payments.

Graph 7. Private sector employees receiving their wage in cash (% of wage recipients aged 15+)

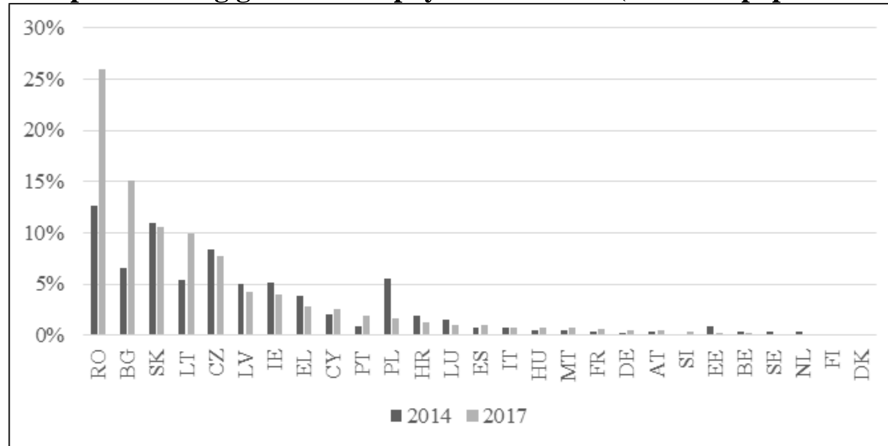


Source: author's representation based on World Bank– Global Findex Database

Payments made by governments through bank transfers, instead of cash payments, indicate the degree of participation of the authorities in the financial inclusion of the population. From the data analyzed up to this point, we infer that access to a current account should not be a barrier for financial inclusion. Therefore, in some Member States - especially in Central and Eastern Europe - the authorities prefer not to use bank intermediation when making payments to the public. Graph 8 confirms the discrepancies mentioned above. The percentage of

people who received cash payments from state authorities varies between 26% in Romania to 0% in Denmark. In Romania's case, we notice a doubling of the percentage in 2017 compared to 2014, most likely due to the social policy measures adopted and to the public expenditures made in this regard. Bulgaria and Slovakia occupy the next two places in the ranking of government cash payments, with 15% and 11% respectively in 2017. According to the data, in countries such as Denmark, Finland, the Netherlands or Belgium, the authorities prefer to make payments in current accounts.

Graph 8. People receiving government payments in cash (% of the population aged 15+)



Source: author's representation based on World Bank– Global Findex Database

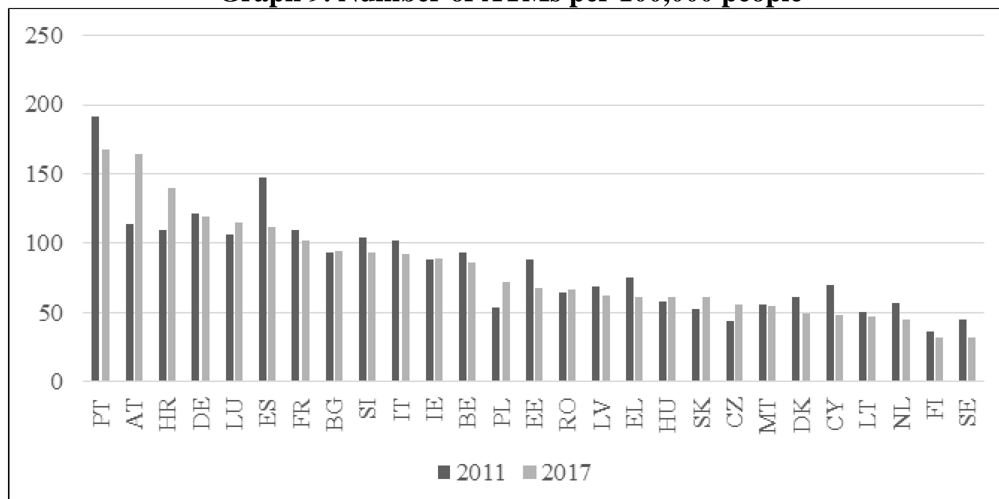
3 Geographical access to financial services

Geographical access to financial services is perhaps the most relevant aspect of financial inclusion. It is easy to understand that inclusion cannot be achieved without the proper financial infrastructure. In this sense, our analysis focuses on two indicators: the number of ATMs and the number of bank branches per 100,000 people, respectively.

The number of ATMs per 100,000 inhabitants varies in 2017 between 167 in Portugal and 32 in Sweden (Graph 9). It is interesting to note that the number of ATMs is not always correlated with the level of economic development. We can see that the density of ATMs is much lower in countries with developed capital markets such as Sweden, Finland, or the Netherlands. These percentages are not surprising, given that financial services in these countries are highly digitalized. We recall that ATM infrastructure allows cash withdrawal, and the need for cash is higher in emerging countries. However, the ranking is not homogeneous, as we also find developed countries with a high density of ATMs. For example, Austria had 165 ATMs per 100,000 inhabitants in 2017. Incidentally, Austria is also host to many of the headquarters of the European Union banks.

We notice that Romania is in the middle of the ranking, with a density of 66 ATMs. It should be noted that although the density seems optimal at national level, ATMs are usually concentrated in urban areas and are almost completely absent in rural areas.

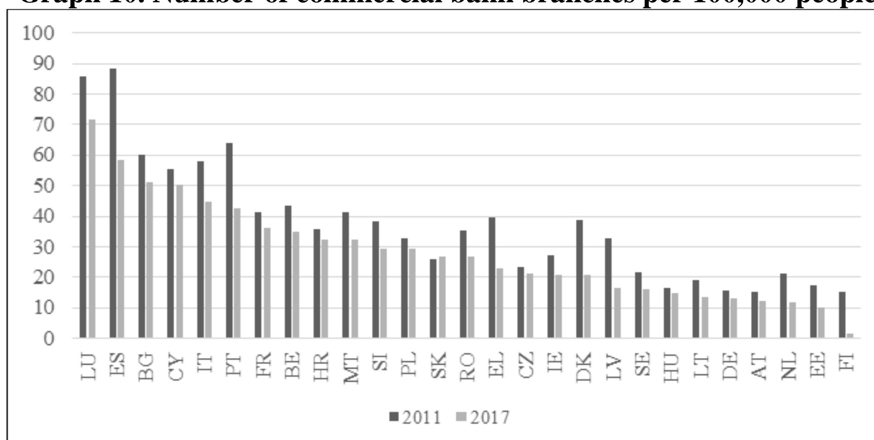
Graph 9. Number of ATMs per 100,000 people



Source: author's representation based on IMF - Financial Access Survey

The density of bank branches per 100,000 people varies significantly, from 71 in Luxembourg to 1.4 in Finland (for 2017) – Graph 10. At the same time, we notice a general downward trend in terms of the number of bank branches between 2011 and 2017. The progress made in recent years in terms of digitalization of financial services has rendered a considerable number of physical banking units redundant. We notice this phenomenon of accelerated digitization in the countries with the lowest figures: Finland (1.4 banks), Estonia (10 banks), the Netherlands (11 banks), Austria (12 banks), Germany (12 banks) and Lithuania (13 banks). Finland has no more than 1.4 banks per 100,000 people, although it is a country with a very high level of financial inclusion. This example illustrates that from a certain degree of development onwards, the physical financial infrastructure is no longer a determining factor for financial inclusion. The presence of banks and the interaction with their officers are more relevant in emerging economies, especially in predominantly rural areas where the population does not have access to online services or does not have the necessary knowledge for this access. Bulgaria, for example, has a fairly high density of banks (51 per 100,000 people in 2017). In the same period, Romania had 26 banks per 100,000 people.

Graph 10. Number of commercial bank branches per 100,000 people



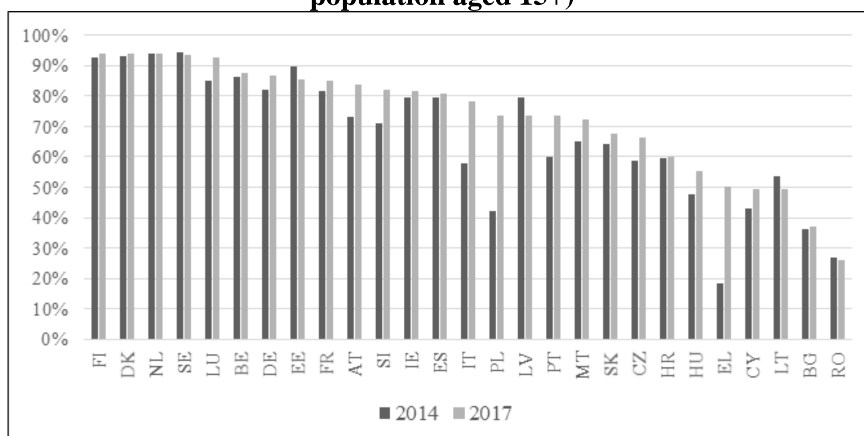
Source: author's representation based on IMF - Financial Access Survey

4 Digitalization of financial services

It is important to point out that purchases using electronic payments contribute to the reduction of tax evasion (OECD, 2017). In light of this, we note that Romania and Bulgaria are the countries with the lowest rates of electronic payments use, while also being countries where poor state revenue collection has already become an acute structural problem. In Romania, only 26% of the population over the age of 15 made purchases using solely electronic payments (37% in Bulgaria, 49% in Lithuania). We also notice that the same respondents have current accounts in a higher proportion, but we deduce that a good part of them choose not to use them to make payments.

Countries such as Finland, Denmark, the Netherlands and Sweden are again first in terms of electronic payments (all with 94% in 2017) – Graph 11. Poland and Greece stand out among the rest of the Member States, with a significant shift between the two periods - electronic payments doubled between 2011 and 2017.

Graph 11. People who used a debit or credit card to make a purchase in the past year (% of the population aged 15+)



Source: author's representation based on World Bank– Global Findex Database

The percentage of people who made online payments varies between 98% in Denmark and 33% in Romania. The first places are occupied by Denmark, Finland, Sweden, the Netherlands and Luxembourg, while the last places are occupied by Romania, Bulgaria, Greece, Hungary and Cyprus. There may be several explanations why respondents, although holding accounts, choose not to use them to make online payments. Possible reasons include:

(i) lack of funds (accounts exist but have no funds);

(ii) lack of trust in financial institutions (funds exist, but are withdrawn as soon as they are received, with subsequent payments made in cash);

(iii) lack of trust in online merchants (consumers prefer cash on delivery over digital payment in advance, as a guarantee of delivery of the product under the established conditions).

These may indeed be influenced by local culture, but as we will find out in the next section, the lack of transparency of banks in Central and Eastern European countries is one of the main reasons why the population does not use financial services.

5 Financial inclusion issues in Central and Eastern European countries

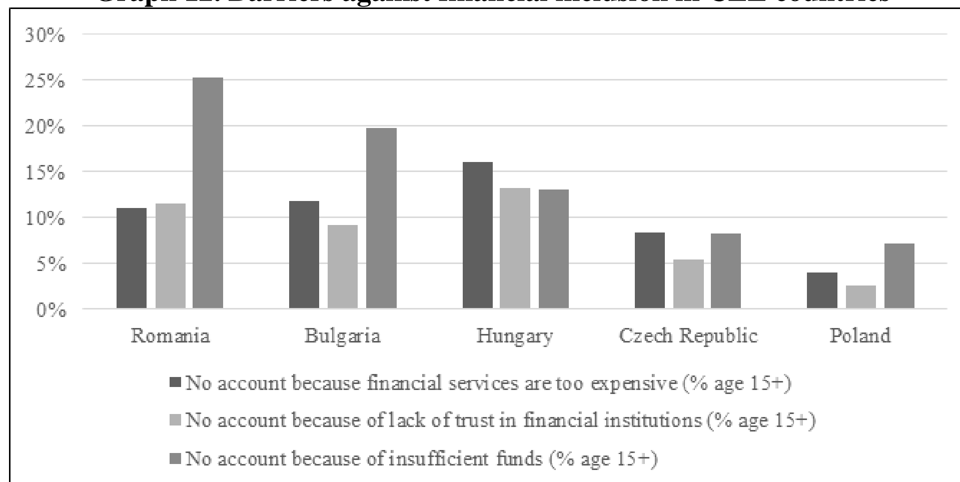
The analysis of the previous indicators revealed that there are sharp discrepancies in terms of financial inclusion between EU Member States. As we have seen, the physical financial infrastructure is not necessarily a determinant of financial inclusion. A high density of banking units or ATMs does not necessarily correspond to a more intensive use of financial services, just as having a bank account does not in all cases imply its actual use in transactions.

Countries such as Romania, Bulgaria, Hungary, the Czech Republic or Poland stand out, with a significantly lower level of financial inclusion than Western European countries. With the exception of Hungary, the main reason why respondents do not have a current account is that of insufficient resources – Graph 12. In these cases, we talk about an involuntary exclusion of the population from the use of services, and this is perhaps the most difficult obstacle for the development of financial markets. The justification given by the population signals the real problems that these economies face: very low living standards, especially in rural areas, and low income, often untaxed, on the verge of subsistence. The percentages of the population without an account due to the lack of necessary financial resources are as follows: Romania 25%, Bulgaria 20%, Hungary 13%, the Czech Republic 8%, Poland 7%.

Another reason why the population does not use these services is the lack of trust in financial institutions (Romania 11%, Hungary 13%, Bulgaria 9%, Czech Republic 5%, Poland 3%). According to Xu (2020) or van der Cruijsen et al. (2020), public confidence in financial institutions is a determining factor for the population's participation in the proper functioning of financial markets and, as a result, for, financial inclusion.

Last but not least, the cost of financial services is an important exclusion factor. Given that in these countries, a large part of the population foregoes financial services due to limited funds, it is easy to understand that any additional cost would discourage the population from initiating any connection with banks. This is also the reason why in recent years banks have reduced or waived administration costs or transaction fees. In any case, they are still an important barrier, especially for low-income people.

Graph 12. Barriers against financial inclusion in CEE countries



Source: author's representation based on World Bank– Global Findex Database

6 Conclusion

Increasing financial inclusion is a condition for the development of the European Union's capital markets. As we have seen in the previous sections of this article, not only that disparities between Member States have persisted in recent years, but they have even grown. The global financial crisis of 2008, the eurozone sovereign debt crisis and, more recently, the pandemic crisis generated by Covid-19 have brought to light a series of structural weaknesses of the internal financial markets. Addressing these shortcomings and reducing disparities first requires addressing their root causes.

In the emerging EU economies, the lack of public confidence in the banking systems has a strong impact on the financial inclusion process. As a result, in countries with lower financial inclusion, banks launched campaigns to promote financial instruments and reduced much of the administrative and trading costs. However, boosting public confidence is a long-term process that requires coordinated actions by national and European authorities. The European Commission (2008) recognizes the need to restore confidence in the banking systems, in order to stimulate lending and access to financial services for households and businesses, all the more so in the context of a global crisis. Also, according to the European Commission (2013), consumers must have access to basic financial services. For this purpose, banks should reduce or even eliminate administrative costs.

A project to facilitate access to financial services was implemented in 2015 (European Commission, 2015). Although at declarative level, the European Commission spoke out in support of market development and financial inclusion, concrete action is lagging behind, against the background of the lengthy decision-making process and the recent turmoil caused by the pandemic crisis. Moreover, fiscal consolidation and the tightening of lending conditions following the 2008 crisis have limited the access to finance for people and businesses. Gomez Urquijo (2014) reminds that disparities in terms of access to finance and lending restrictions limit economic growth, especially in emerging countries. Increasing the degree of financial inclusion at Member State level depends to a large extent on the integration of capital markets. Broadly speaking, the integration of these markets would involve:

- a more effective supervision of financial markets;
- the standardization of financing costs for governments, for the population and for businesses;
- the facilitation of cross-border access to finance;
- increased transparency and public confidence in banking systems.

It is important to emphasize that these objectives cannot be achieved without the existence of a Union body to coordinate and supervise the market integration process. Perhaps this could be the main reason why disparities have widened, although the Commission's plans have explicitly addressed this issue since before the global crisis of 2008. We emphasize the need for the national authorities to implement inclusive policies comprising concrete measures. Moreover, the success of such policies would be enhanced by the active involvement of the Union authorities and the timely resumption of the Commission's action plans for the development of the Member States' financial markets.

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