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A Systemic Literature on Financial Inclusion and Economic Growth: Challenges and Research Direction

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Abstract

The main objective of this research works is to examine the impact of financial inclusion (FI) on the economic growth(EG). Financial inclusion states access, usage and availability of the financial product and service to the entire population without discrimination to the society. Last few decades, the policy maker shifted from the financial development toward the FI to enhance the EG both the developed and developing countries. So this research highlighted and whether FI service enhance the countries growth. For this research purpose the research works selected from the both developed and underdeveloped countries to check the literature on the relationship among the FI and EG. The research work found that FI has positive and significantly influence on the EG of the both developed and developing countries.

Keywords- Financial Inclusion, Economic Growth, and SLR

Introduction

Over the course of the past few decades, there has been a rise in the level of interest in the topic of economic development on the part of researchers as well as policymakers in both developed and developing nations. Two of the most recent studies were carried out by the research teams of Spyromitros and Panagiotidis (2022) and Abate and Abate (1996), respectively. (2022). (2022). Since Solow and Swan established the neoclassical growth model in 1956 and endogenous growth models in the 1970s, this phenomenon has been observed in the majority of the countries that are located in the Sub-Saharan African region. (Abessolo, 1998; Basu et al., 2005; Ndambiri et al., 2012) and UEMOA. (Ndambiri et al., 2012). (Romer, 1986; Lucas, 1988; Barro, 1990). (Abessolo, 1998). (Combey, 2017; Dedewanou, 2016). The vast majority of people who live in developing nations in Africa and Asia do not make use of the goods and services that are made available by financial organizations, and a significant number of these people do not even have bank accounts to store their money in. Financial exclusion can be caused by a number of factors, including a low income, a lack of knowledge about money, a lack of the appropriate paperwork, a bank that is located in a faraway location, or complicated financial products and services. (Oji, 2015). Since the year 2000, financial inclusion (FI) has become an increasingly important topic all over the world, particularly in countries where the economy is still in the process of developing. When the globe Bank Group and fourteen other partners presented their Universal Financial Access by 2020 (UFA2020) strategy in 2015, they showed how they planned to increase the number of people all over the globe who have access to financial services. UFA2020 stands for the Universal Financial Access by the Year 2020.

According to Bank (2015), the phrase "financial inclusion" refers to a scenario in which individuals and businesses have access to financially useful goods and services that are also reasonably priced and that satisfy their requirements for transactions, payments, savings, credit, and insurance in a manner that is both transparent and updatable. In this scenario, individuals and businesses are able to meet their needs for transactions, payments, savings, credit, and insurance in a manner that is both updatable and transparent. According to Kama and Adigun (2013), approximately 54 percent of the population of the globe does not have access to the necessary banking services. According to the information provided by Agbelusi, the World Bank estimates that two billion individuals do not have access to official financial services. (2018). This statement was made in a fashion that was very similar to what was described in the previous paragraph. As a direct result of this fact, the objective of FI is to make basic financial services, most notably microcredit, accessible to individuals with lesser incomes. This is done with the intention of assisting these individuals and groups in the expansion of their respective businesses. While developed economies like the United Kingdom, Sweden, and France have made explicit legal and policy statements to encourage activities (mostly by banks) that ensure continued growth and long-term financial stability, developing economies like Nigeria have taken the opposite strategy. Developed economies like the United Kingdom, Sweden, and France have encouraged activities (mostly by banks) that ensure continued growth and long-term financial stability. Activities (mostly by banks) that ensure continued economic growth and long-term financial stability have been encouraged in developed economies such as the United Kingdom, Sweden, and France. Activities (primarily banking) that guarantee sustained economic development and long-term financial stability have been encouraged in developed countries such as the United Kingdom, Sweden, and France, amongst others, including the United States. These countries include the United Kingdom, Sweden, and France. Countries that already have manufacturing sectors that are highly developed, such as the United Kingdom (UK), Sweden (SE), France (FR), and others, have asserted that these assertions are legitimate. These countries include the United Kingdom (UK), Sweden (SE), and France (FR).

In classical economic theories, factors of production and economic growth that were considered essential included labor, capital, and entrepreneurial activity. In these theories, the importance of finance was completely disregarded, and it was believed that the market was flawless, with no transaction costs for financial services. This gives the impression that the significance of having a robust financial system was given less consideration. As a direct result of this, there haven't been many attempts made to determine the connection between EG and business. However, modern economic theories have placed a greater emphasis on the significance of finance and a financial system as an instrument for the purpose of fostering circumstances that are favorable for EG.

Literature review

King and Levine (1993) investigated the connection between economic expansion and increased income. Entrepreneurs who bring fresh ideas and original products to the market receive assistance from financial organizations, which contributes to the expansion of the economy. (EG). Entrepreneurs have been found in countries with a low or low-middle income, but these individuals either do not have access to financial resources or must negotiate difficult or complicated circumstances in order to gain access to them. Some people take advantage of informal lending facilities, which puts them at risk of being taken advantage of. (Onaolapo, 2015). According to Rajan and Zingales (1996), the primary function of the financial sector is to reallocate money from those with more capital to those with less capital. This is the case because the financial sector exists. It's possible that finance is all that's needed to enable the pursuit of investment possibilities, which can then contribute to long-term growth.

Dixit and Ghosh (2013) conducted research on the use of FI as a tool for inclusive development in Indian regions. Through the production of resources and the mobilization of those resources, FI makes a significant contribution to development. FI (through the use of financial services) helps to distribute resources, particularly to people who do not have straightforward access to them. King and Levine conducted research on the connection between progress in economics and increased financial sophistication. (1993). We took the long-term average of these three measures of economic progress: (i) real per capita GDP growth; (ii) real per capita capital stock growth; and (iii) overall productivity growth. The level of financial depth, represented by the letter FI, is determined by a company's liquid obligations. They used secondary information for 77 different countries from the years 1960 to 1989. The findings of the research indicate that there is a correlation that is statistically significant and favorable between total output growth, real per capita capital stock growth, real per capita GDP growth, and real per capita GDP growth.

Estrada et al. (2010) conducted research to investigate the ways in which the expansion of the financial sector influenced the actual increase of GDP per person in developing Asia. Panel information on the economic situations of 125 developing Asian nations were collected from 1987 to 2008. It has been discovered that the expansion of the banking sector is beneficial to the development of the real GDP per person. This was discovered through empirical research. A greater positive impact on development is caused by financial profundity rather than by financial structure. It has been discovered that the efficiency with which investments are managed has a direct bearing on the rate of growth in production. There is not a significant distinction between the links between money and economic growth in developing countries and newly emerging economies. The hypothesis that there is a connection between financial wealth and economic expansion, as well as the existing corpus of research, are consistent with the findings of this study. The expansion of the financial industry and an increase in transparency regarding monetary matters are both beneficial to growth and have a positive impact on it.

After the financial crisis has passed, the level of economic openness in developing Asian countries has a greater impact on economic expansion than it did in the past. This holds true after a certain amount of time has passed after the catastrophe. Prochniak and Wasiak (2017) investigated the effect that the expansion and stability of the financial sector had on EG in 28 countries from the European Union (EU) and 34 economies from the OECD. It is generally accepted, at least in principle, that increased production is positively correlated with both the expansion and stability of the financial sector. This research used data from 1993 all the way up until 2013. It makes use of a variety of characteristics that are analogous to the financial industry, each of which has an individual influence on the process of development. The GMM estimation technique developed by Blundell and Bonds reveals that the creation and expansion of credit is a significant factor in determining the rate of growth in output. Domestic credit and GDP growth have a negative correlation, particularly in EU countries that have emerged from the financial crisis; this finding suggests that carrying an excessive amount of debt does not encourage economic development.

Another variable from the financial sector that was used in the research that had an inverse relationship with GDP growth was the percentage of total gross loans that were considered to be nonperforming loans. The third variable is the bank capital to asset ratio, which has a positive correlation with GDP growth in OECD nations but a negative correlation in EU nations, suggesting a spurious correlation. This variable has a positive correlation in OECD nations because of its positive correlation with GDP growth in EU nations. The next variable, market capitalization, reveals a fascinating relationship between output growth that is both positive and negative. This relationship is interesting because it can go either way. The rate of output growth is guaranteed to slow down in the long run if the degree of development of the capital market is excessively high. This is the case in nations that have financial markets that operate efficiently. The expansion of capital markets, on the other hand, is one factor that contributes to faster output growth in nations where capital markets are still in their early stages of development. According to the findings of the model, there is an inverse correlation between inflation and the amount of money spent by the government on consumption, while there is a positive correlation between investment, trade openness, and EG.

Developments in the financial sector, such as lowered interest rates on loans and expanded availability of credit, encourage greater levels of investment and the creation of new avenues for profitable activity, which in turn stimulate economic growth. Investors come out ahead when the economy grows because this triggers a change in the production function toward higher levels. It is necessary to have a developed and well-established domestic financial industry in order to increase the amount of money that is sent from abroad. The steady-state level of production and capital stock both rise as a consequence of increased remittances and the development of the financial sector.

Unbreen and Nawaz (2014), the long-term steady-state rate of production growth and capital accumulation is increased when remittances and financial development are present. They extended the growth model for open economies developed by Ramsay Cass Koopmans by incorporating remittances and financial development in the banking sector. They came to the conclusion that the initial phase of economic growth is accompanied by an increase in consumption as well as net production. This may give the impression of a trade deficit, but in the long run, it results in a trade surplus. They came to the conclusion that an advanced financial sector coupled with an increase in contributions has a direct impact on the economy of EG.

Sethi and Acharya (2018) examine how the rate of economic development has been affected by FI in both developed and developing countries. Panel data models such as country fixed effect regressions, random effect regressions, and time fixed effect regressions are some of the tools that are utilized in the process of achieving their objective. Sarma (2012) presents information regarding monetary matters for the years 2004–2010.As a consequence of this, they discover a reliable and effective connection between FI and EG in 31 countries all over the globe. Nguling'wa (2019) examines the impact that FI has on EG across the continent of Sub-Saharan Africa by focusing on a collection of 25 different countries. From 2009 until 2014, all nations were under observation for a total of six years. It investigates whether there is a connection between higher levels of FI and higher levels of economic development. The results of estimations of two-way models that contain both fixed effects and random effects can demonstrate how FI impacts EG.

Moore and Craigwell (2003) are in agreement with the traditional theory of finance, which states that the interest rate on a loan will increase as the size of the loan increases in order to represent the growing risk that is associated with the loan. Moore and Craigwell (2003) have found this to be the case. They found out that the interest rate is connected to the size of the loan and vice versa by using data from the Barbadian banking business that was collected at the company level. This information was used to make their discovery. The information was gathered from within the companies themselves.

They also show, by utilizing a fixed-effect panel model, that borrower characteristics best explain the differences in interest rates between loan sizes for domestic banks, whereas operational characteristics were the most significant component for foreign banks. This finding was reached by demonstrating that borrower characteristics best explain the differences. It is possible for economic activity and, as a consequence, economic development to decline in the event that information inequality exists. On the other hand, Yorulmaz (2016) creates a FI measure for EU member states and prospective states so that he can evaluate how FI is progressing in a variety of countries. This measure is beneficial not only to countries that are already members of the EU but also to countries that are working to enter the EU.

In line with the demand theory, he investigates the relationship between the FI index and a number of different macroeconomic indicators. In particular, he focuses on the unemployment rate. In particular, he is focused on the percentage of people who are employed. (such as GDP per capita, adult literacy rates, rural populations, unemployment rates, Gini coefficients, and the human development index). According to the findings, there is a correlation that is not only positive but also statistically significant between the FI index and human development on the one hand and revenue on the other. This correlation is positive because there is a link between the two.

Both from a theoretical and an observational stance, thinking about the connection between financial innovation and the expansion of entrepreneurial activity is a very interesting and worthwhile endeavor. When attempting to explain the connection that exists between these two entities, there are a few different hypotheses that could be considered. According to one of these hypotheses, the effect that FI will have on EG will either be positive or negative, depending on which scenario you choose to believe. Both Bagehot's theory of financial development, which he developed in 1873, and Keynes's theory of financial intermediation are sound frameworks for undertaking research. Bagehot's theory was developed in England, and Keynes's theory was developed in the United Kingdom (Diamond, 1984).

The theory of knowledge disparity is unique in being both false and unique in being the only theory in existence. (Akerlof, 1970). Several authors have argued that plentiful real-world data demonstrates the beneficial effects of FI on EG. (Kpodar & Et Andrianaivo, 2011; Wong, 2015; Kim et al., 2017; Sethi & Acharya, 2018). However, despite how rarely it occurs, occasionally people's activities have undesirable outcomes (Moore & Craigwell, 2003; Naceur & Et Samir, 2007; Pearce, 2011). Archana (2013) argues that big banks and MFIs are crucial to the expansion of the financial sector because they provide loans to individuals who are otherwise unable to access credit. As a result, there will be more startups, more employment, higher wages, a larger consumer base, and greater output.

This indicates that the less fortunate also contribute to EG. Right now, Financial Independence (FI) is gaining popularity all over the globe. Through the use of an inclusive financial system, people with lower incomes have access to a broad variety of financial services that are priced affordably.

Kunt and Klapper (2012) Connecting the various sectors of the economy and making it simpler for various government programs to function are two benefits of having an inclusive financial system. Banks play a significant role in this system. When everyone has access to the financial system, financial organizations will be able to lend money to new businesses looking to get their feet off the ground. Policymakers and financial institutions in both developing countries and developed countries are coming up with and putting into motion a wide variety of plans to support financial inclusion on both an individual level and on a global scale. These plans are being developed to promote financial inclusion(FI).

Since the year 2000, numerous nations' governments, banks, and financial authorities in other countries have taken measures to open up the financial system. This is due to the fact that EG benefits from having an open financial system. The Community Reinvestment Act was enacted in the United States in 1997, the loi contre l'exclusion was passed in France in 1998, and the Financial Inclusion Task Force was established in the United Kingdom. (2005). FI has the potential to assist developing nations in growing in a manner that is to everyone's advantage. People believe that financial services such as remittances, savings, and insurance are essential for economic growth and the reduction of poverty because these services are considered to restore balance to the financial system, make income and resources more evenly distributed, and contribute to inclusive growth. Consequently, people believe that these services are important for reducing poverty. (Dhillon and Mittal, 2016).

In the absence of an inclusive financial system, individuals with low incomes do not have the resources necessary to continue an education or become entrepreneurs, which stifles the growth of human capital. (Beck, Demirguc-Kunt, and Levine, 2007; and World Bank, 2008). In the same way, small and medium-sized businesses are forced to rely on the limited revenue generated by themselves in order to continue expanding. When there is a lack of lending infrastructure, access to funding is restricted, and when there is a lack of lending infrastructure, the development of an inclusive financial system is hampered. (Asia-Pacific Forum, 2016). Dixit and Ghosh (2013); Kamal et al. (2021;2022) conducted research on the use of FI as a method for achieving inclusive development in Indian states. FI contributes significantly to development by generating and mobilizing resources, which in turn helps growth significantly. The provision of financial services allows for the mobilization and distribution of resources in a manner that is disproportionately beneficial to individuals who do not have simple access to these resources.

The Financial Industry and Development in the Central African Economic and Monetary Community (CEMAC) Area was studied by Alter and Yontcheva (2015), who compared the region to others in Sub-Saharan Africa to determine its standing. (SSA). Inflation, a lack of access to credit information, and a greater cost-to-income ratio contribute to the fact that the CEMAC nations as a whole have a less developed and inclusive financial sector. Institutions, in addition to monetary policy, economic activity, industry, and so on, are vital to the economic growth of a nation.

Institutions include administrative organizations, financial organizations, and economic organizations. The growth of countries is greatly aided by the establishment of various institutions. King and Levine (1993) conducted research to investigate the connection between economic expansion and increased financial sophistication. The following three indicators of economic growth were combined over the course of the study: (i) real per capita GDP growth; (ii) real per capita capital stock growth; and (iii) total productivity growth. A measurement of a company's financial depth that is dependent on liquid liabilities is called FI.

Secondary statistics from 77 different countries were analyzed between the years 1960 and 1989. According to the findings of the research, there is a correlation that can be considered positive and is supported by statistical evidence between real per capita GDP growth, real per capita capital stock growth, total productivity growth, and FI. The primary purpose of the financial sector is to facilitate the movement of capital from entities that have an abundance of funds to entities that do not have sufficient funds. To ensure that finance continues to contribute to long-term growth, all that is necessary is the production of investment opportunities.

Financial development can effect growth in two ways: it can reduce the cost of capital and external financing. In an economy with a strong financial sector, firms that lack capital and are offered investment opportunities perform better. Financial development merely assists businesses in escaping the problem of internal funding. In nations with a developed financial sector, industries dependent on financing from outside the sector are more prevalent. It has been demonstrated that financial market imperfections influence investment and growth. (Rajan and Zingales 1996). When investigating the relationship between FI and EG, financial intermediary roles that allow reducing information asymmetry, thereby facilitating transactions and fostering EG, can also be considered.

According to Levine, Loayza, and Beck (2000), the increase in the number of financial intermediaries is beneficial to the expansion of the economy. They also assert that the reason various nations have varying degrees of economic development is due to the fact that their legal and bookkeeping systems are structured differently.

Using Mexico as a "natural experiment," Bruhn and Love (2014) investigated what transpired after an increased number of low-income individuals were granted loans and an increased number of commercial banks were established. It would appear that people's incomes rise, that they engage more money in unofficial businesses, and that the rate of unemployment falls when they have greater access to banking services.

Conclusion

The connections between FI and development remain inconclusive due to the contradictory findings in the literature. Despite numerous studies indicating that FI has a positive impact on economic development, some studies assert that it has a negative impact. On the basis of the availability of financial services, optimistic perspectives for FI on economic development include the expansion of bank branches, the reduction of financial barriers, and the contribution of the banking industry. To ensure economic sustainability resulting from FI, however, policymakers must play a role in expanding network branches, increasing the penetration of financial services, and removing all barriers to obtaining financial services. Those studies, on the other hand, that demonstrated a negative or feeble contribution of FI to development can be attributed to a weak financial system and a lack of financial system accessibility. To stimulate growth in a society and the nation as a whole, policymakers must promote the financial system's accessibility to a substantial portion of the population. Literature demonstrates, in general, that FI is a growth catalyst in a variety of dimensions, with a variety of methods used to evaluate this relationship. Nonetheless, some studies examined only a single variable to determine the effect of FI on development. Due to the multidimensional nature of the FI process, relying on a single variable to evaluate it will not yield accurate results.

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