Social Inclusion and Poverty Reduction Unit of
the Government of the Republic of Serbia

FINANCIAL INCLUSION IN SERBIA
An Analysis of Status, Barriers, Benefits and Opportunities

Summary

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STUDY:
FINANCIAL INCLUSION IN SERBIA:
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"Banks should be Robin Hood!"
a quote from a focus group

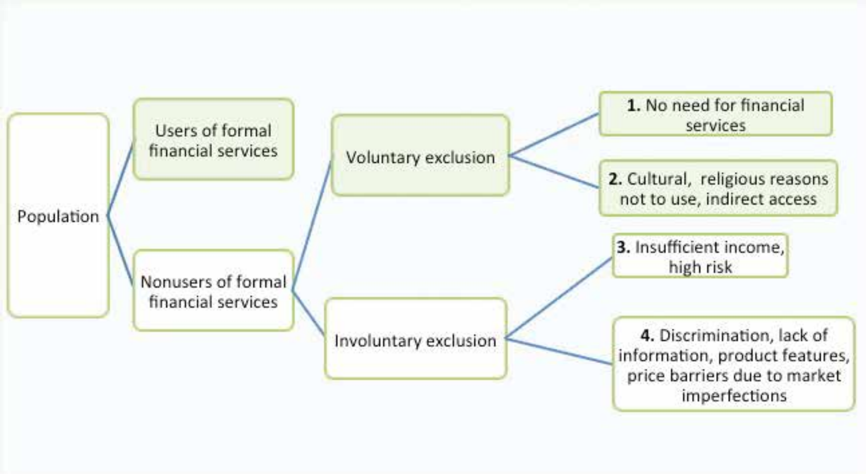
Executive Summary

In the most general terms, financial inclusion is defined as the proportion of individuals using financial services (savings, credit etc.). As the topic has not received sufficient attention in Serbia, the available sources include the results of only a few researches carried out and papers. Hence, this analysis aims, first, to ascertain the status of financial inclusion in Serbia by reviewing and comparing the existing surveys and researches, then to verify the available data and gain a deeper insight into individuals' views of financial inclusion by means of focus groups, and, finally, to propose measures to enhance financial inclusion in Serbia on the basis of the established data and a review of international literature and practice. The analysis thus lays the foundations for and provides an introduction to further research and policy implementation with a view to improving financial inclusion in Serbia.

The financially excluded are a highly heterogeneous group and their shared features are usually the most common causes of exclusion, such as unemployment, poverty, low, uncertain or irregular income, disability, isolation or remoteness from major centres (European Foundation for Financial Exclusion, 2013). However, it should be noted that exclusion can be voluntary or involuntary (Figure 1). Some well-to-do individuals choose to refrain from using financial services; however, this paper is concerned primarily with those who are vulnerable and the barriers to their inclusion in the financial system to the extent needed.

Financial exclusion as such must be viewed as part of wider social exclusion faced by individuals with no or hampered access to the labour market, basic social, health care and education services, etc. Likewise, financial exclusion must be set in the context of the development level of the financial system and financial services available (and, by implication, also comprehensible and adequate) to members of a society. Financial exclusion is thus defined as a relative concept, informed by the society's development level and the financial services development level in the given society.

Figure 1. Individuals may be financially excluded voluntarily or as a result of a barrier (involuntarily)



Source: World Bank. (2014a). *Global Financial Development Report 2014*, Washington DC.

Owing to its impact on higher economic growth and poverty reduction, financial inclusion is among the global issues currently in the focus of attention of decision makers, social policy makers and researchers worldwide. Financial inclusion is addressed by the World Bank's recently published **Global Financial Development Report 2014**, as a result of growing awareness of its importance for increasing and distributing benefits of socio-economic development. The **Bill & Melinda Gates Foundation** funded a survey that covered more than 150,000 people in 148 countries whose combined populations account for over 97% of the global population. Last year, the G20 finance ministers and central bank governors commended the launch of the **Financial Inclusion Support Framework**. The **Maya Declaration,** signed by numerous countries, also calls for the alignment of global efforts to include the 2.5 billion people without bank accounts in the financial system. **Within the European Union (EU)**, further development of the single market for financial services is crucial for EU growth and competitiveness; consequently, the **Single Market Acts I and II** have been adopted and, with a view to enhancing financial inclusion, a **Proposal for a Directive on bank accounts at the EU level** has been developed. In a time when many governments worldwide commit to increasing financial inclusion in their countries, and research increasingly points to its benefits to society, Serbia should not take a passive stance on this matter.

The basic financial services in Serbia comprise **savings, transactions, loans and insurance.** The first step to financial inclusion usually entails opening an account and using transaction services; one usually starts saving later, and finally purchases insurance.

Figure 2. Supply of basic financial services in Serbia

The Serbian financial ecosystem comprises consumers who use these services, main financial service providers – commercial banks, Serbian Post, Western Union, the central bank – the regulator and consumer associations. All of the abovementioned services are offered by banks. Bank branch offices are widely present in Serbia; however, they are missing in many smaller communities as their presence would not be profitable. Serbian Post offers cash and cashless transaction services. It plays a significant role in increasing financial inclusion, in particular in rural areas, among the elderly and undereducated. The National Bank of Serbia (NBS) manages the monetary policy, regulates banks' operations and protects the users of financial services. In addition, the NBS implements activities aimed at increasing financial inclusion, in particular through financial education for citizens. An important role is also played by private civic associations, which fulfill an important function in consumer protection, information and education, as well as dissemination of new ideas for solving their problems.

According to a World Bank research, the highest risk of financial exclusion in Serbia is faced by **youth and those with low educational attainment**, **the rural population and the poorest 40% of the population face "medium"**

risk, while those with higher education, the richest 60% and the urban population fare considerably better. By the criterion of the percentage of citizens with bank accounts (62%), Serbia comes close to the regional average, but lags behind developed countries, where the figure is nearly 100%. A positive aspect is that women are equal to men, and in this respect, Serbia is among the most successful countries in the region. By the criterion of obtaining credit from a financial institution, women in Serbia are even at an advantage compared to men.

Figure 3. Financial Ecosystem in Serbia

The financial infrastructure is underdeveloped in Serbia. The number of branch offices per 100 thousand people is the smallest in the region, only Bosnia and Herzegovina has a smaller number of ATMs per 100 thousand people.

In Serbia, electronic payment is used far less than in developed countries; however, in comparison with countries in the region, electronic transactions are more widespread than in Bulgaria, Montenegro and Bosnia and Herzegovina. This mode of payment has potential to develop fast.

As regards borrowing from and savings in financial institutions, vulnerable groups borrow to a lower extent compared to the regional average. Youth are particularly vulnerable.

In order to identify problems and individual views through direct communication, focus groups were organised for the purposes of this research in Sremska Mitrovica, Novi Pazar and Kraljevo. The financially excluded are often characterised by more than one of the aforementioned features; e.g. youth who are at the same time unemployed and poor, which constitutes "multidimensional vulnerability". Therefore, in order to obtain as much information as possible, in designing focus groups, in addition to the four vulnerable groups (the poor, the undereducated, rural population and youth), the Roma, persons with disabilities, the unemployed, seasonal and informal workers were also included, as well as Muslims, to assess the possible impact of religious affiliation. A vast majority of respondents who had current accounts in banks did not use them at all owing to high maintenance charges and irregular income. Bank accounts were mainly used only by those who were employed and used them to receive their wages/ salaries. To pay utility bills, they mainly used Serbian Post. The use of payment cards was negligible. Few respondents had any savings, but none kept their savings in banks; the most frequently cited reasons were bank charges and distrust. They needed to borrow, mainly for unforeseen expenditures, but none of the focus group participants took loans from banks; instead, they borrowed from friends or relatives. Over 80% of the respondents used the Internet and all had mobile telephones; hence, the high prevalence of new technologies among vulnerable groups represents substantial potential for increasing financial inclusion in Serbia. The level of financial literacy and skills was very low. No differences by religious affiliation were observed.

Table 1. Vulnerability degree of groups by indicators of financial inclusion

	Debit cards	Electronic payment	Accounts in fin. inst.	Savings in fin. inst.	Loan from fin. inst.
Urban	non-vulnerable	non-vulnerable	non-vulnerable	vulnerable	non-vulnerable
Richer 60%	non-vulnerable	non-vulnerable	non-vulnerable	vulnerable	non-vulnerable
More educated	non-vulnerable	non-vulnerable	non-vulnerable	vulnerable	non-vulnerable
Rural	non-vulnerable	moderately vulnerable	moderately vulnerable	vulnerable	moderately vulnerable
Poorer 40%	non-vulnerable	moderately vulnerable	moderately vulnerable	vulnerable	moderately vulnerable
Less educated	non-vulnerable	vulnerable	vulnerable	vulnerable	moderately vulnerable
Youth (15–24)	vulnerable	vulnerable	vulnerable	vulnerable	vulnerable

1 vulnerable — moderately vulnerable — non-vulnerable 3

Source: World Bank, 2011.

Vulnerable citizens, even when they aspire to financial inclusion, face various barriers that preclude it. For a poor individual, the problem lies in the high charges for financial services, which are often set based on the well-to-do population, which represents the main source of profit to service providers. If there are no banks in one's place of residence, the costs and time required to travel to the nearest branch office pose a barrier. Further, if services are available, the vulnerable often lack information on the services offered, and even when they do receive information, they are mainly insufficiently financially literate to select the most suitable product. For the vulnerable in Serbia, an additional barrier is distrust of the financial system, which is not surprising in view of the experience of 1990s, when citizens' savings were "frozen" or seized.

Many researches worldwide have shown multiple benefits of increasing financial inclusion to the economy. It is necessary for Serbia to raise the level of education needed for new jobs if its citizens' standard of living is to be improved and inequality among them reduced. If vulnerable citizens do not save in banks and do not take out loans to fund their schooling, investment in education decreases, thus exacerbating inequality and decreasing economic growth. Individuals who have knowledge and business ideas, but no bank accounts, cannot apply for business loans; financial exclusion thus hampers the emergence of new small enterprises in the market. Higher competition among banks and financial inclusion accelerate economic growth and labour demand, in particular that at the bottom end of the income scale, which results in higher inclusive growth.

Conclusions

As any state intervention in the economy has **distortion effects**, positive consequences should be carefully weighed against negative ones to ensure that the overall impact of the measures is beneficial. State activity should be undertaken in cases of "market error", but the goal must not entail increasing financial inclusion at all costs. Irresponsible insistence on financial inclusion could lead to over-indebtedness, and it is the most vulnerable individuals that would fall victim.

For the above reasons, **the introduction of free-of-charge basic bank accounts** aimed at increasing financial inclusion **is not recommendable**. Such measure would not yield long-term effects, as these accounts would soon become inactive, while banks would incur costs and face organisational problems. If the state assumed the costs, the issue of abuse and oversight would arise. This is a good example of a measure that appears simple and efficient at first glance, yet, essentially, has an adverse impact on the market, imposes costs and yields no long-term results.

The main potential for increasing financial inclusion in Serbia lies in the use of new technologies. A high proportion of focus groups participants (selected as representatives of various vulnerable groups) have mobile phones, which implies that financial inclusion could be increased by using new technology solutions. Increased use of mobile banking, payment cards and electronic payment has multiple positive effects: the use of cash would be reduced, thus lowering various costs to both individuals and banks; the state would collect higher tax revenues as transactions would be more transparent; in such environment, banks' costs of opening branch offices in small communities and increasing the supply of lending and saving services would be lower, which would further enhance financial inclusion. Impact on economic growth would inevitably ensue.

The role of Post was neglected in earlier research and decision makers were, consequently, unaware of its actual significance. In comparison with developing countries, **Serbian Post has the second highest capacity to increase financial inclusion.** This potential could best be exploited through cooperation with banks.

After the G20 initiative and the adoption of the Maya Declaration, an environment of international synergy was created, enabling countries to seek technical assistance and join the global process of increasing financial inclusion; thus, about 60 countries are currently implementing their national **financial inclusion strategies.** Serbia needs such a strategy as well; however, it will be feasible only with clear political support and cooperation with the private sector. Goals must be measurable, and the success of the strategy should be monitored by analysing regularly collected data.

Financial inclusion cannot be increased by activities undertaken by the state if its citizens are financially illiterate, nor can the state protect them from abuse in the market. Therefore, **activities aimed at raising financial literacy** are essential in Serbia. However, to identify the modality of training that will ensure citizens are capable of choosing the right products for themselves and protect themselves against possible abuse is not a straightforward task. Research has shown that activities targeting the general population and involving the usual financial literacy training are not efficient. The training model should, therefore, be adapted to an acceptable form, and programmes should target the parts of the population that would benefit most.

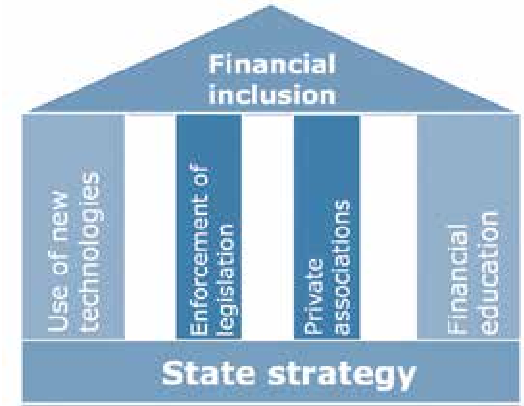
Private associations have played a positive role in the protection of and provision of information to financial service consumers. Through direct communication with citizens, private associations quickly receive information on problems, on the basis of which they launch initiatives or exert pressure through the media. This is extremely useful, as these associations fulfil the information, advisory and oversight functions with relatively low resources.

Recommendations

1. **Active measures on the part of the state are necessary to promote the development of electronic and mobile banking with a view to minimising the use of cash and increasing financial inclusion.** Introducing charges for cash withdrawals or deposits, as well as lowering the charges for electronic transactions would encourage citizens to reduce the use of cash. Lower charges compared to classic banks would make services more acceptable to the poorer population.

2. **Improving financial inclusion requires a state strategy.** To be successful, it requires support at the highest political level and the involvement of the private sector, which will be interested only if the strategy is well suited to the market. New products should be adapted to the poorer population, and the NBS would be required to participate in strategy development and implementation in order to sustain financial system stability and protect consumers against abuse and over-indebtedness.

Figure 4. Financial inclusion strategy pillars



3. **Among developing countries, Serbian Post has the second highest capacity to increase financial inclusion. Cooperation between Serbian Post and mobile banks would be a catalyst for financial inclusion of vulnerable groups. Installing ATMs in Serbian Post outlets** would enhance the functionality of mobile banking and facilitate the use of payment cards, especially in rural areas. In addition, cooperation between Serbian Post and commercial banks would reduce bank branch offices' operational costs, which could increase their territorial coverage.

4. **It is very important to improve citizens' financial literacy and information level.** Training programmes should primarily target vulnerable groups, as this will maximise their results. Further, the quality of mathematics instruction in schools should be improved, as it improves financial literacy indirectly, yet efficiently.

5. **It is essential to improve the legislation and procedures to increase competition among banks and make financial services easier to use, while some existing rules must be enforced more efficiently.**

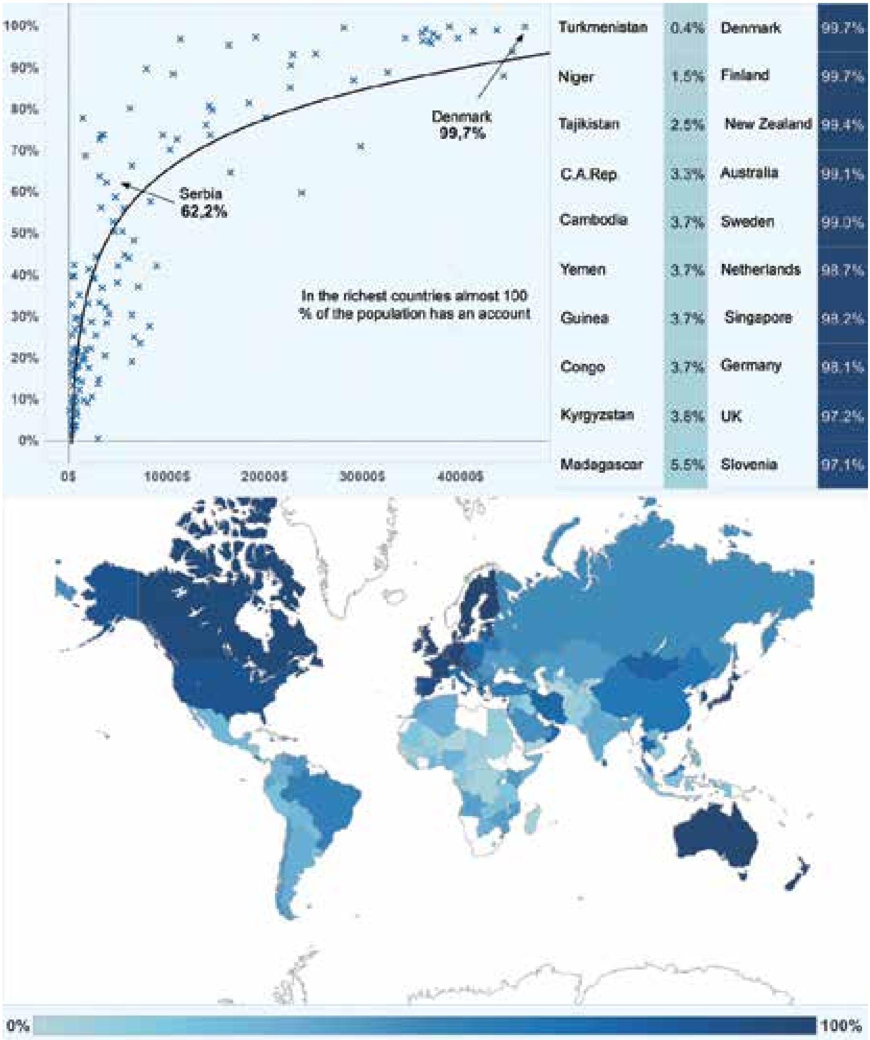
6. **The effective annual interest rate should be limited to 36%.** Such limitation would prevent abuse such as excessive interest rates or usury, which arises as a result of consumers' inadequate training and information levels. Vulnerable groups - citizens with low education attainment and lower income – are the most frequent victims of excessive interest rates.

7. **Consultative cooperation and information sharing between the state and private institutions should be promoted.** Organisation of events by state institution and joint media activity are desirable.

8. **Social assistance beneficiaries should be provided with the possibility of receiving state cash benefits to a basic bank account with special terms.**

How and to what extent citizens use financial services is no longer a topic of interest only to economic researchers, as increasing financial inclusion has become a global agenda aimed at reducing poverty and inequality and accelerating economic growth. Serbia's future strategy for increasing financial inclusion should be based primarily on the use of new technologies and raising citizens' financial literacy and skills levels. The key barriers to strategy implementation will be the people factor and the passivity of the existing institutions; it is, therefore, essential to raise decision-makers' awareness of financial inclusion. With more state activity, Serbia has capacity to approach the financial inclusion level of developed countries relatively fast.

Selected charts and figures

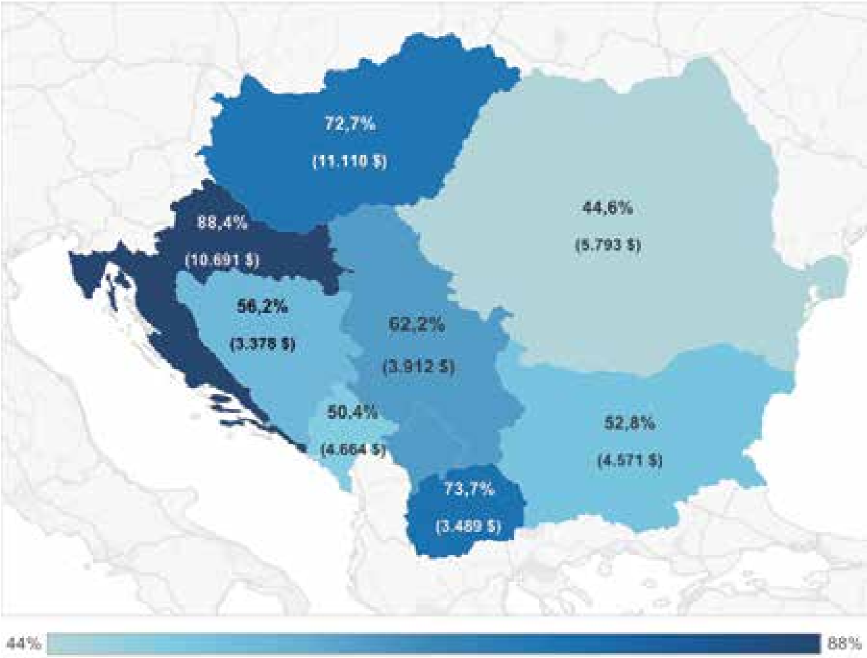


Turkmenistan	0.4%	Denmark	99.7%
Niger	1.5%	Finland	99.7%
Tajikistan	2.5%	New Zealand	99.4%
C.A.Rep	3.3%	Australia	99.1%
Cambodia	3.7%	Sweden	99.0%
Yemen	3.7%	Netherlands	98.7%
Guinea	3.7%	Singapore	98.2%
Congo	3.7%	Germany	98.1%
Kyrgyzstan	3.8%	UK	97.2%
Madagascar	5.5%	Slovenia	97.1%

World map by the percentage of the population over 15 years of age with accounts in financial institutions

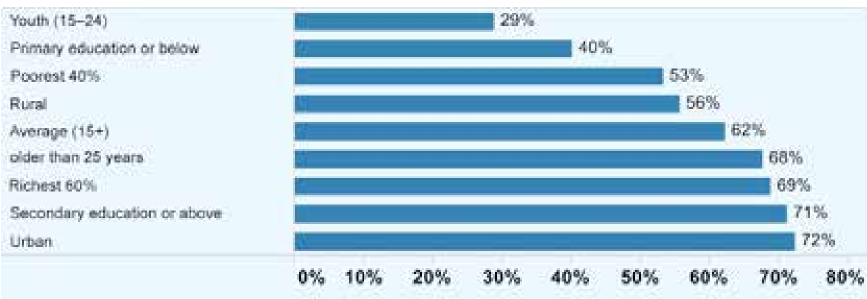
The figure shows the correlation of *per capita* GDP level and the percentage of account holders, and the table shows countries with the highest and lowest percentages.

Source: World Bank, 2011. (both figures are from 2011, and the *per capita* GDP is expressed in constant 2005 dollars)



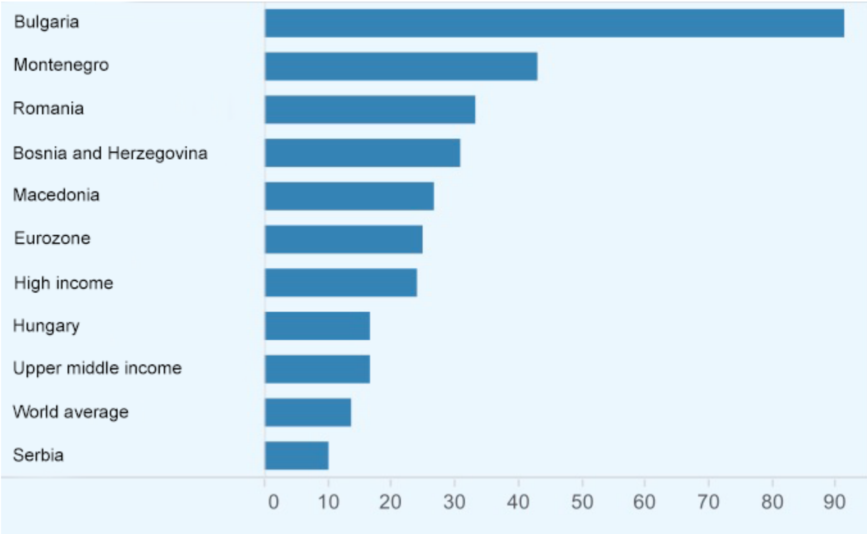
The percentage of the population over 15 years of age with accounts in financial institutions and the *per capita* GDP level in constant dollars by countries in the region

Source: World Bank, 2011.

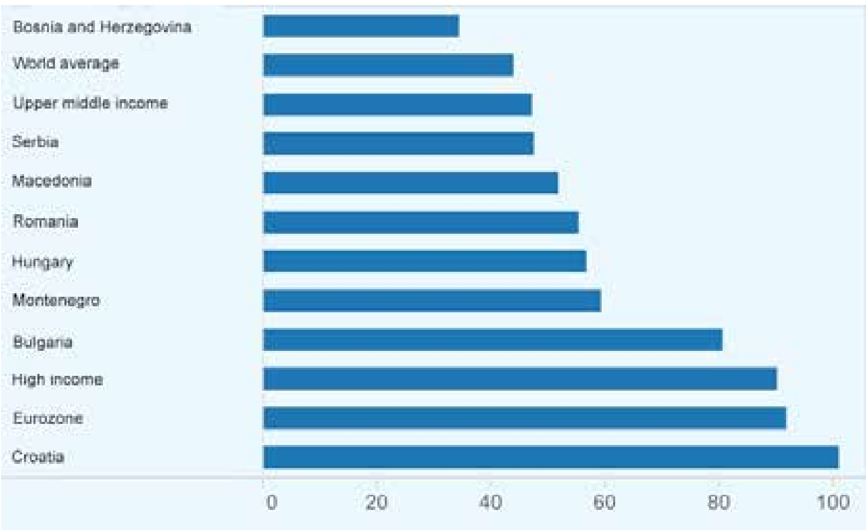


Account ownership by groups

Source: Svetska banka, 2011.



Number of bank branch offices per 100 thousand people
Source: World Bank, 2011.



Number of ATMs per 100 thousand adult citizens
Source: World Bank, 2011.