Working Paper

SOCIAL, ECONOMICAL AND FINANCIAL CONSEQUENCES OF FINANCIAL EXCLUSION

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The aim of this paper is to analyse and draw conclusion on the string line and contrasts regarding social, economical and financial consequences of financial exclusion within EU member sates.

1 Review of the literature on social, economical and financial consequences of financial exclusion in EU member states

1.1. Disparity of data and literature among EU member states

While the problem of financial exclusion has been identified in the majority of European member states studied within the present research project (eleven countries out of fourteen), literature on social, economical and financial consequences of financial exclusion has only been produced in four of them, namely United Kingdom, France, Ireland and Belgium.

The following table compares the 14 European countries studied in terms of prevalence of a financial exclusion problem, level of financial exclusion, existence and importance of the public debate around the issue and the existence or lack of data regarding financial exclusion consequences.

Country	Financially excluded (1)	Problem of financial exclusion (2)	Debate on financial exclusion (2)	Literature/data on consequences (2)
Netherlands	1	no	no	no
Belgium	1	yes	yes	yes
France	2	yes	yes	yes
Austria	3	yes	yes	no
Germany	3	yes	limited	no
United Kingdom	6	yes	yes	yes
Spain	8	no	no	no
Irland	12	yes	yes	yes
Italy	16	yes	limited	yes
Slovakia	26	yes	no	no
Poland	40	yes	limited	no
Lithuania	41	yes	limited	no
Norway	Not available	no	no	no
Bulgaria	Not available	yes	limited	no

(1) Percentage of people with no transaction bank account, revolving credit or savings - Source: Eurobarometer 60.2 for Netherlands, Belgium, France, Austria, Germany, United Kingdom, Spain, Ireland and Italy; Eurobarometer 2003.5 for Slovakia, Poland and Lithuania ; Base: All adults aged 18 or over
(2) Source: Based on the experts answers in country reports stage one realised within the present study

By looking at those different variables, three different groups of countries can be identified.

The first group gathers countries that are not facing a problem of financial exclusion (Spain, Norway and Netherlands). Those countries have a low level of financially excluded people (people with no transaction bank account, revolving credit or savings); there is no current debate on financial exclusion nor data or literature regarding consequence of financial exclusion available.

The second group gathers the new member states (Lithuania, Poland, Slovakia and Bulgaria). These countries are facing a problem of financial exclusion and their prevailing levels of financially excluded people are the highest among EU member states studied (from 26 to 41%). However, there is currently no debate on the issue of financial exclusion or only a limited one in those countries, and no literature or data available on consequences of financial exclusion either.

The third group gathers the countries facing a problem of financial exclusion while having a low prevailing level of people financially excluded (United Kingdom, France, Ireland, Belgium Germany Austria and Italy) were a current debate on financial exclusion exist, even if sometimes limited to specific issues or involving only few parts.

All the existing data and literature regarding financial exclusion consequences is related to countries belonging of this last group, but not all of them are covered.

These following statements regarding literature existence and disparity can therefore be made:

- There is a big dearth of data regarding consequences of financial exclusion;
- The topic has only been studied in countries were the prevailing level of financial exclusion is low, but not in all of them;
- There is a current debate on financial exclusion in all countries were literature on consequences of financial exclusion has been produced.

1.2. *The link between prevailing level of financial exclusion and financial exclusion consequences severity*

(This section over crosses partly the financialisation point addressed in the working paper –"the ling between financial exclusion and overindebtedness")

The severity of the consequences of financial exclusion will depend to a large extend on the prevailing level of financial exclusion in a country (.

It is for example more problematic to rely on cash transactions in a country where almost everyone else has a bank account (like countries identified in group one and three) than it is in one where a significant proportion of the population lacks one (countries identified in group two).

In Norway and the Netherlands, financialisation is very high but nearly all the population is financially included due to policies that have been introduced.

Financialisation is also very high in Austria, Belgium, France, Germany, Ireland and the UK but financial exclusion represents a more important issue over there despite the various policies implemented to address the problem of financial exclusion.

In countries like Spain, Italy or Lithuania but above all in Poland, Slovakia or Bulgaria, financialisation is less high and people who avoid using most financial services do not face the same socioeconomic consequences.

In Italy for example, cash transactions are still widely used and being unbanked is not equated with risking financial exclusion. According to the latest sample on Italian's households' financial behaviour, receiving one's wages or pension in cash is still preferred buy as much as 20.7% of income earners, but it is a decreasing figure as it was nearly 34%in 1995 (Anderloni and Carluccio, 2006). In Poland, not having a transaction bank account does not generate any problems to find and keep a job (Country report stage I M. Iwanitz Drodzdowska ; 2007).

But in all of these countries, financialisation is growing. The more a country is financialised, the more people who have no access to financial products face difficulties and will suffer from important financial, economical and social consequences.

1.3. Review of existing data available in EU members states regarding consequences of financial exclusion

According to the national experts' country reports, data regarding consequences of financial exclusion has been produced in United Kingdom, France, Ireland, and Belgium. We will list them below according to the type of financial exclusion they refer to: transaction banking, credit or savings exclusion.

1.3.1. UNITED KINGDOM

The first point made in the United Kingdom country report is that, as there is decrease in the proportion of people without a bank account, savings or access to credit in the country, the consequences for those who do not have these basic financial services become more serious.

In relation to **transaction banking** exclusion**,** the main issues are cost and inconvenience as the outlets for paying in cash have all but disappeared.

Payment of bills without a bank account is time consuming and more expensive as many utility companies offer discounts to people who pay by direct debit, which are not available to people who pay in other ways (BMRB 2006).

Kempson and Whyley (1998) found that (ten years ago) paying gas bills in cash cost up to €65 a year more than those paying by direct debt; pre-payment meter customers also paid higher tariffs so that their annual gas bills cost up to €120 more a year.

Calculations made by the NGO Save the Children in 2007 showed that operating a cash budget can cost as much as €1,500 a year (Save the Children/Family Welfare Association, 2007).

Moreover, the unbaked face the problem of cashing third party cheques and have to support the cost of having to use alternative cash checking companies (Kempson & Whyley 1998; 1999a);

Accepting a job can be more difficult as most employers insist on paying wages electronically into an account (Kempson & Whyley 1999a) (Treasury Select Committee 2006b);

Getting access to other financial products (insurance, credit) may depend on being able to pay by direct debit and not having a bank account also reduces credit scores (Kempson and Whyley 1998; 1999a);

Finally, unbanked are unable to make cash savings by buying products and services on the Internet (Leyshon et al 1998).

The level of total **credit** exclusion in the UK is low compared with other EU countries but for the people affected the only option in times of need is illegal lenders (Ellison A, Collard S & Forster R 2006).

Such lenders do not issue credit agreements and apply default charges that can be extortionate and arbitrary. Consequently many borrowers can never settle their loan in full. In the worst cases, failure to pay can mean customers being forced to deal drugs or into prostitution on behalf of the lender (Ellison *et al.,* 2006).

A much wider problem, however, relates to people using the sub-prime credit market, where terms and conditions are inferior to those in the prime market and costs are higher (Collard and Kempson, 2005) (Treasury Select Committee 2006a) (Kempson et al 2000).

Self-evidently people who lack **savings** have no way to deal with income shocks or emergencies other than borrowing (Kempson and Whyley 1999a) (Kempson et al 2000).

Secondly, people who save informally (that is not in a bank account) do not benefit from the interest rates and tax advantages that people with savings accounts enjoy (Kempson et al, 2005).

Finally savings kept in cash at home are vulnerable to theft (Kempson 1998; Whyley et al 1998).

1.3.2. FRANCE

Access and use difficulties regarding **transaction banking** encountered by some clients generate extra-costs that can be hard to support for people with a low income.

In France, the fact that cheque is free of charges led to make its use nearly compulsory for many kind of payments. The use of cash to pay important amounts has become stigmatizing. Not having access to a check book implies to use much more costly payment means (Brunet et al., 2004).

In the same way, since a very large majority of the population ha access to a bank account led the French state, for cost and security reasons, to make the social benefit payments only by bank transfer on a bank account.

Difficulties of use, like to respect banking rules generate extra costs that can pile up very rapidly (Gueneau, 2000). Moreover, extra cost generated by multiplicity of banking charges can lead people to adopt "survival management" behaviour (Gloukoviezoff 2004). The first effect of it is the destruction of their savings and the feeling of security that goes with it. The second effect is the need to establish a priority within payments, bills with immediate consequences if they are not paid being therefore paid before health and insurances costs despite potential consequences (Dourgnon et al., 2001).

This type of behaviour can have indirect financial consequences, as it will sometimes induce negative moral judgement from bank officers or social workers, leading to a much severe judgement of the person's demand or situation. (Ébermeyer et al., 2003).

Banking exclusion can also lead to difficulties to rent an apartment or a house (Gloukoviezoff 2004).

Finally, not having access or not knowing how to use properly bank services can also, depending on history, status and life experience of people facing it, have an impact on self esteem and lead to (self)-isolation and depravation of social connections and social relationships with friends or family (Gloukoviezoff 2004).

1.3.3. IRELAND

In Ireland, It is becoming increasingly necessary to have a **transaction bank account** with direct debit facilities to pay for a number of services and products. Payment of certain bills in cash can be more expensive (Corr 2006).

Cashing third party cheques in banks can be a problem, and using alternative cash checking companies is costly. Some supermarkets are only willing to cash cheques if a portion of its value is spent in the store (Corr 2006).

It can also be more difficult to get rented accommodation or a job without a bank account (Corr 2006). Almost all employers now insist on paying people directly into bank accounts (Herbert and Hopwood-Road, 2006: 5) and some individuals have had difficulties in maintaining employment or training due to their failure to open an account for salary payments (NTMABS, 2006).

Denial of **credit** from mainstream financial institutions is the main push factor towards moneylenders (Byrne et al., 2005; Daly and Walsh, 1988; Quinn and McCann, 1997; Quinn and NiGhabhann, 2004, Corr.2006).

These institutions generally lend at high interest rates that can cause further financial strain and unmanageable levels of debt for low-income households (Herbert and Hopwood-Road, 2006).

In research carried out in the south of Ireland, Byrne *et al.* (2005) found that 60% of those who were borrowing from only moneylenders were paying out over 20% of their income every week on loans. They concluded that moneylending was not only a 'serious drain on the household economy' but also 'on the local economy of poorer communities across Ireland' as a 'significant percentage of state transfers into communities is quickly drained out in high interest payments to moneylending companies' (Byrne *et al.*, 2005: 23).

1.3.4. BELGIUM

The most frequent consequences of access difficulties to a **transaction bank account** in Belgium are administrative, psychological, renting and professional life difficulties (Bayot, 2001).

Access difficulties to transaction bank account can also cause financial problems, like the difficulty of cheque cashing, the impossibility of locative guarantee constitution, problems of gas and electricity payments and budget management problems.

Daily life problems have also been observed, like payment difficulties in shop, time loss due to bank bureau changes, need for budgeting, survival sometimes, problems of security and thefts.

Finally, access difficulties to a transaction bank account also sometimes generates social and integration problems within the family or the couple, or feelings of social exclusion and mistrust, leading sometimes to loss of self esteem.

2 The different dimensions of consequences of financial exclusion

This preliminary review allows identifying three dimensions financial exclusion consequences on the people affected.

Firstly, financial exclusion can generate **financial consequences** by affecting directly or indirectly the way in which the individuals can raise, allocate, and use their monetary resources.

Secondly, a wider dimension of financial exclusion can be identified as **socio-economical consequences.** Financial consequences do belong to this wider dimension of financial exclusion consequences.

These consequences are affecting individuals' patterns of consumption, the way they participate to economic activities or access to social welfare and the distribution of incomes and wealth. They impact the way in which people behave both in terms of purchase decisions and the way in which they choose to spend their time, as well as their overall quality of life.

Finally, a last dimension can be identified as the **social consequences** generated by financial exclusion.

These are the consequences affecting the various links that are binding the individuals: link to you corresponding to self esteem, links binding to the society and links binding to community and/or relationships with other individual or groups.

A single financial exclusion situation can of course generate at the same time financial, socio-economical and social consequences for the person facing it.

The different dimensions of financial exclusion consequences identified in the country reports are listed summarised below regarding each one of the keys areas of essential financial services: transaction banking, credit and savings.

2.1. Transaction banking

For transaction banking, a further distinction can sometimes be made between access difficulties and use difficulties consequences.

Financial consequences

Access difficulties

People with no bank account at all face difficulties dealing with cheques made out in their name by a third party. Often they have to pay to have the cheque cashed and in some countries there are networks of cheque cashing companies whose main purpose is to offer this service (Anderloni and Carluccio 2006; Hogarth and O'Donnell 1999, Kempson and Whyley, 1998; Kempson et al, 2000).

Lacking a transaction bank account with payment facilities can make payment of bills costly – particularly when such accounts are the norm and outlets for paying in cash are closed (BMRB, 2006; Corr 2006; Kempson and Whyley, 1998; Kempson et al, 2000).

Moreover, the cost of banking services bought separately is generally higher than those accessed within a stable relationship with the bank. Consequently, occasional payments of utility bills, payment of taxes, bank transfers to third persons, cashing cheques and money orders at the banking counter are more expensive for those who are not customers of the bank. Therefore there are relevant negative economic consequences of dealing occasionally with banks, not only of using alternative financial services providers.

Many utility companies offer discounted rates for people paying their bills electronically each month (BMRB, 2006; Corr, 2006; Kempson and Whyley, 1998; Kempson et al, 2000). People lacking a payment card (debit or credit card) are also unable to take advantage of the lower prices of goods and services bought in this way.

It is also difficult to take employment in countries where payment of wages is by electronic transfer into a bank account (Citizens Advice, 2006; Treasury Committee, 2006b).

Social consequences

Finally, not having access or not knowing how to use properly bank services can, depending on history, status and life experience of people facing it, have an impact on self esteem and lead to (self)-isolation and depravation of social connections and social relationships with friends or family (Gloukoviezoff 2004).

In some places, having to pay in cash generates the feeling that the money is not clean or has been stolen. People concerned by this situation can feel humiliated by it and loose their self-esteem (Gloukoviezoff 2004).

2.2. Credit

Financial consequences and socio-economical consequences

(This section over crosses the working paper on "alternative credit providers")

People unable to get credit from banks or other mainstream financial providers often have to use intermediaries or sub-prime lenders where the charges are higher and the terms and conditions may be inferior (Anderloni and Carluccio, 2006; Collard and Kempson, 2005; Corr, 2006; Kempson et al, 2000; Treasury Committee 2006a).

Customers of alternative financial services can face a number of negative consequences (as do customers of mainstream services).

Those who are totally "credit excluded" and who cannot gain access to any type of credit also face negative consequences. In Germany, those who cannot access credit have to depend on informal borrowing (Policis, 2007). However, Rogaly et al. (1999) stress that 'relational capital', accessed through networks of neighbours and kin is 'double-edged' as it can cause conflict with friends and family. Another strategy used by low-income consumers who are credit impaired in France and Germany is to delay utility bill payments in order to ‘inject flex into their budgets’ (Policis, 2007: 36). Consequently, consumers in France and Germany are more likely than those in the UK to lose utilities and housing because of non-repayment.

As already stated, the main disadvantage of sub-prime lending is the high costs involved.

Customers can fall into greater financial difficulties and over-indebtedness as a result of terms and conditions applied to some sub-prime products. For example, alternative financial service providers rarely carry out credit ratings and therefore, customers can be at greater risk of defaulting, given that the lender is unaware of their capacity to repay the loan. Some alternative financial providers (e.g. sub-prime lending companies; cheque-cashers) also apply extra fees for extending a loan or issue penalties for defaulting.

Evidently, the most negative consequences are experienced by those lending from illegal financial service providers. In Germany, Policis (2007) highlighted that one of the major risks associated with borrowing from illegal lenders arises when borrowers find themselves in financial difficulties with lenders likely to use violence and intimidation. In Slovakia, when customers do not fulfil their repayments, unlicensed lenders pass on the information to an outsourcing company who then use harsh methods to recoup payments.

3.3. Savings

Financial and socio-economical consequences

Without savings, people have no means of coping with even small financial shocks or unexpected expenses. and those who keep savings in cash do not benefit from interest payments (Kempson et al, 2005).

Those who keep savings in cash at home are vulnerable to theft (Kempson and Whyley 1999; Kempson et al, 2000)

3 Best practices having an impact on financial exclusion consequences

Even if no specific practise aiming to it has been identified in the country reports, negative social consequences of financial exclusion can surely be addressed through appropriate psychological support.

Moreover, for people suffering from credit exclusion leading them to access to inappropriate credit, negative financial and socio-economic consequences can be addressed by curative practices related to their overindebtedness situation.

These practices are out of the scope of the study and have therefore not been addressed.

The most appropriate way to have an impact on financial, socio-economic and social consequences of financial exclusion is indeed for the stakeholders (financial institutions, NGO's) to implement preventive practices leading to financial inclusion of the people concerned. For those we do refer to the study report conclusions both in terms of best practices and policy recommendations.

4 Policy recommendations

The main policy recommendation regarding social, socio-economical and financial consequences of financial exclusion is to fill in the gap regarding information available on the subject in most of the European Member states.

Research on the impact of financial exclusion on people facing it is essential to understand better the financial inclusion issue and its place and necessity within the wider frame of social inclusion policy of a country.

Moreover, that knowledge is essential to underline and justify the important role that financial institutions corporate social responsibility can play to ensure financial inclusion.

All stakeholders (researchers, NGO's, financial institutions and policy makers) should therefore aim to carry out or/and finance further research on the subject.

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