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CENTER FOR STRATEGY AND INNOVATION POLICY

POLICY BRIEF

APRIL 2021

FINANCIAL INCLUSION AND HOUSEHOLD INCOME IN CAMBODIA

The desirable effects of financial services on household income and budget constraint are confirmed; however, a greater effort into financial literacy, particularly for women, is required to further enhance the roles of financial inclusion in improving low-income households' livelihoods.

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FINANCIAL INCLUSION — access to and use of services offered by financial institutions – can play an important role in economic development and serve as a policy tool for achieving the Sustainable Development Goals (SDGs). The intended effects of financial deepening on economic growth, income inequality and poverty alleviation have been evidenced in many empirical studies.

Alongside the financial inclusion's developmental outcomes, financial literacy – the ability to understand financial topics – has been seen as a tool to enhance people's effective use of financial services and reinforce the favourable socio-economic effects of financial inclusion. Seng (2018) argued that the borrowers' limited financial knowledge is a main constraint on the pro-poor development of microfinance in Cambodia. Then, the strategy to improve poverty-stricken households' earnings via financial inclusion should not overlook the financial literacy.

Over the past two decades, Cambodia has achieved remarkably the development of financial services, particularly microfinance, which contributes to the socio-economic development of the country. In spite of the potential of financial inclusion to produce developmental outcomes, there is a concern about the mechanism underlying its desirable effects on household income, requiring more conclusive evidence for policy consideration.

This policy brief paper provides emprical evidence of the effects the financial inclusion has on household income by taking the financial literacy into account, and then recommends possible ways to reinforce the roles of financial inclusion in enhancing badly-off households' livelihoods in Cambodia.

SUMMARY OF FINANCIAL INCLUSION IN CAMBODIA's BANKING SECTOR

From 1997 to 2011, the sector played a leading role in Cambodia's economy, especially in the rural communities (Bylander, 2015). The government has made efforts to promote the sector's growth, aiming at enhancing the socio-economic development and poverty reduction (Seng, 2017 & 2018). Cambodia's banking sector started with microfinance in the early 1990s, emerging from not-for-profit microcredit projects supported by international donors and nongovernmental organisations (NGOs). Microfinance was developed to support job creation for demobilised soldiers and fill in the financing gap. As of the end of 2019, there were 46 commercial banks, 16 specialised banks, 7 microfinance deposit institutions (MDIs), 75 MFIs, 248 rural credit institutions, and 15 leasing companies (*National Bank of Cambodia [NBC]*, 2019).

Cambodia's financial inclusion has been promoted with a focus on improving access to credit and saving accounts, payment instruments, and payment

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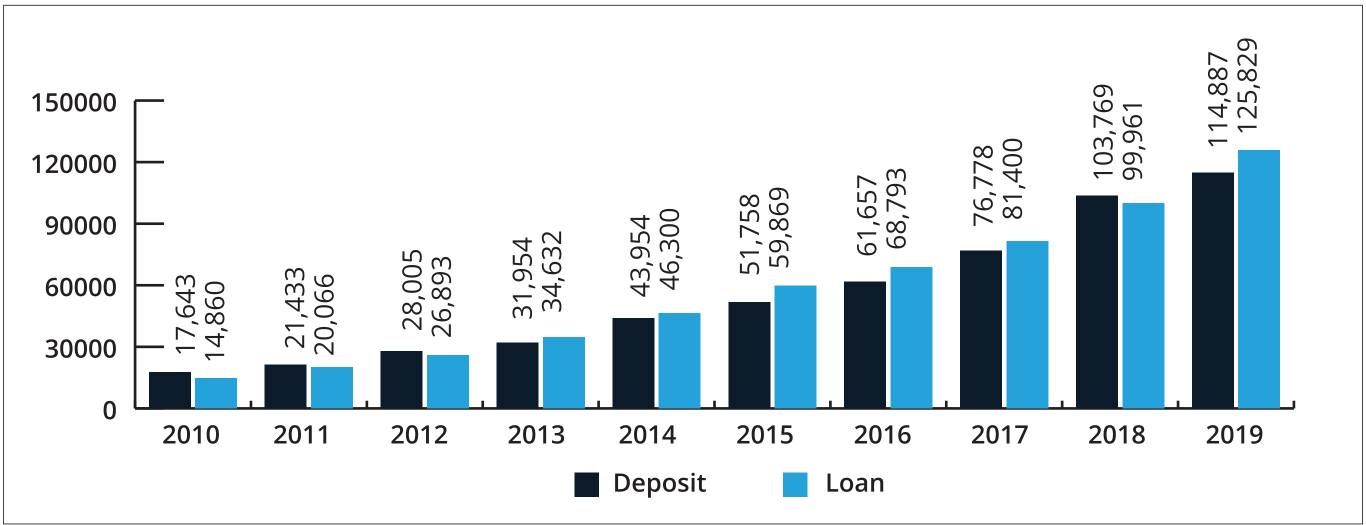
Figure 1. Total Deposit and Loan in Banking 2010–2019 (Billion Riels)

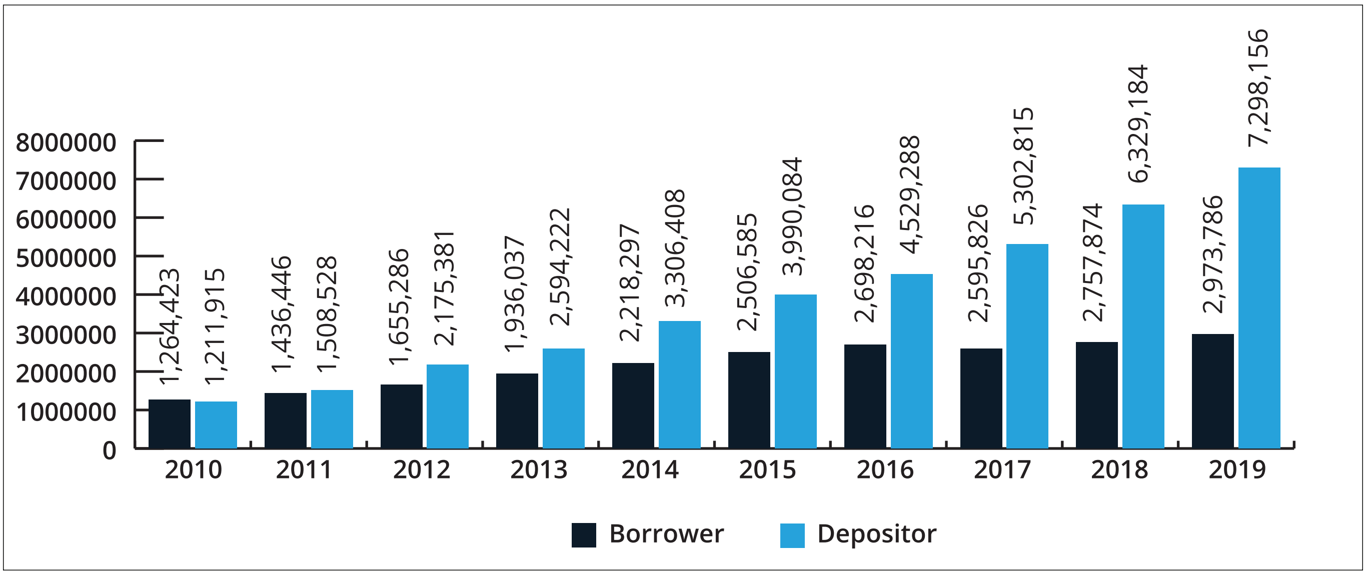


Source: National Bank of Cambodia (2019).

services. According to the Financial Stability Review published by the NBC in 2019, the credit to businesses as a percentage of gross domestic product (GDP) increased from approximately 29% in 2012 to 58.30% in 2018, while the credit to individuals grew from approximately 15.50% in 2012 to 56.50% in 2018. However, the credit to businesses as a percentage of the total had an downward trend, declining from 62% in 2012 to 45% in 2018, while the credit to individuals had an increasing trend from approximately 38% in 2012 to 55% in 2018.

Figure 1 shows that the total amount of deposits at banks and MDIs increased remarkably from approximately 17,643 billion riels (US$4.41 billion) in 2010 to 114,887 billion riels (US$28.72 billion) in 2019, while the total amount of loans offered by banks, MDIs and MFIs also grew from approximately 14,860 billion riels (US$3.72 billion) in 2010 to 125,829 billion riels (US$31.46 billion) in 2019.[1] Of note, from 2013 to 2017, the amount of deposits each year was smaller than that of loans. This trend suggests that deposit and loan growth is likely getting more extensive and inclusive. The inclusiveness is equally underpinned by Figure 2, showing that the number of borrowers increased from approximately 1,264,423 in 2010 to 2,973,786 in 2019 and the number of depositors increased from approximately 1,211,915 in 2010 to 7,298,156 in 2019.

Figure 2. Number of Borrowers and Depositors 2010–2019 (Number of borrowers & depositors)



Source: National Bank of Cambodia (2019).

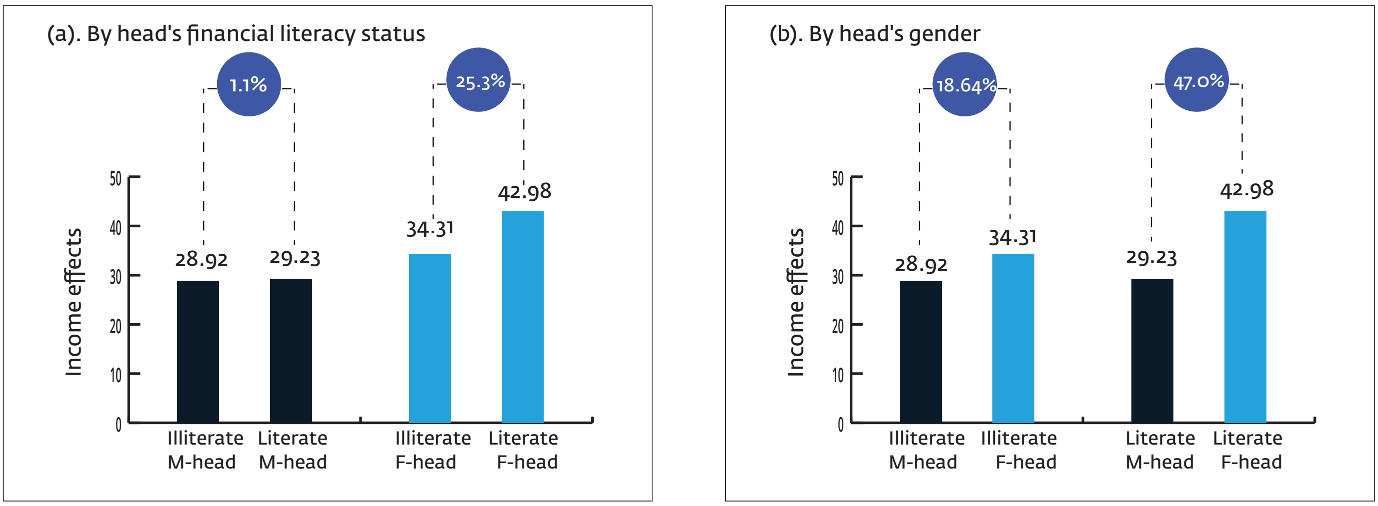
[1] The amount is converted into US dollars at the exchange rate of US$1 =4000 riels.

This inclusiveness explains rural people's easier access to financial services, which in turn stimulates income-generating activities. The rural credit offered by MFIs contributes to the expansion of cultivated land, upholding agricultural production and then improving living standards in the rural communities (Eliste & Zorya, 2015). The extension of MFI services was estimated to benefit approximately 3,878,618 Cambodians (CMA, 2014). Arguably, it provides needy households with better access to financial services. Still, high credit costs and financial illiteracy limit access to financial services, in particular for those living in rural areas.

FINANCIAL INCLUSION AND HOUSEHOLD INCOME

Figure 3 presents the effects of financial inclusion on household income per capita, which were estimated by Seng (2020). The effects are distinguished by household heads' gender and financial literacy, with Panel A illustrating the effects by financial literacy status in each gender group and Panel B demonstrating the effects by gender in each financial literacy status group. Panel A suggests that households headed by financially-illiterate men, once taking up financial services, are likely to enjoy an increase in per capita income by 28,920 riels (US$7.23)/month, while those headed by financially-literate men are likely to enjoy 29,230 riels (US$7.50)/month of income growth. That is the increase in per capita income of the financial service users headed by financially-literate men is 1.10% higher than that of those headed by financially-illiterate men. More significantly, the users headed by financially-illiterate women are likely to enjoy an increase in per capita income by 34,310 riels (US$8.60)/month, while those headed by financially-literate women are likely to achieve the growth in per capita income by 42,980 riels (US$11)/month, or 25.30% greater than that of those headed by financially-illiterate women. The results suggest that, regardless of the heads' gender, the financial service users headed by financially-literate persons are likely to enjoy a larger increase in household income per capita than those headed by financially- illiterate ones.

Figure 3. Effects of Financial Inclusion on Household Income per Capita (000 Riels/Month)



Notes: M-head is male head; and F-head is female head.
Source: Adopted from Seng (2020). Household income per capita is the monthly income in thousand riels. The details on the estimated conditional expected income per capita can be found in Seng (2020).

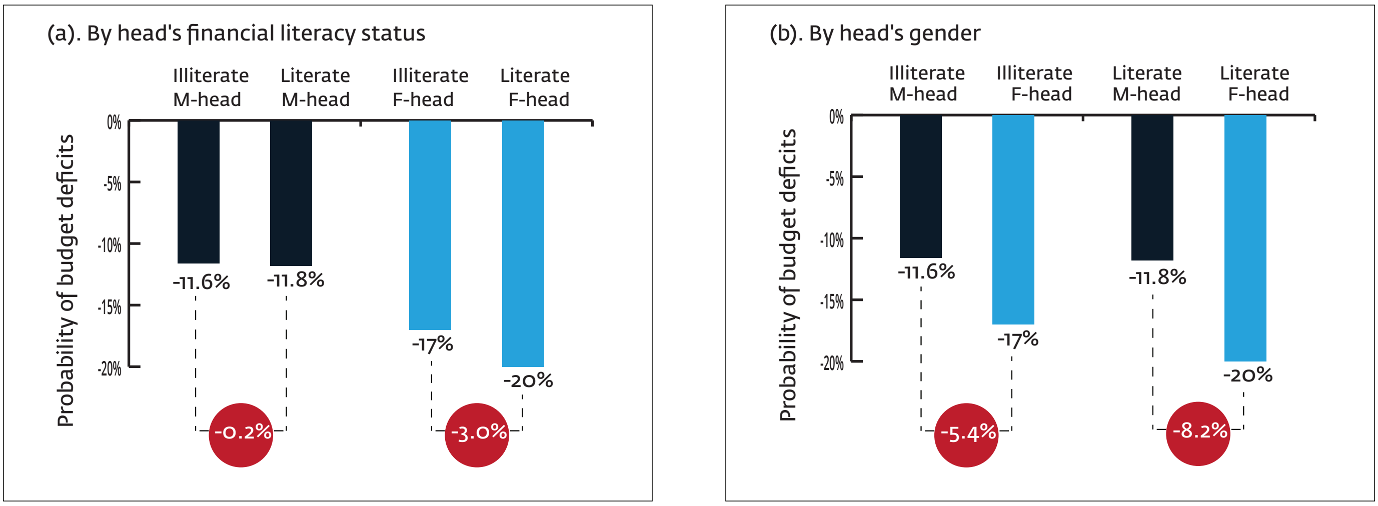
In other words, Panel B shows that the income growth of the financial service users headed by financially-illiterate women (34,310 riels (US$8.60)/month) are likely to be 18.64% higher than that of those headed by financially-illiterate men (28,920 riels (US$7.23)/month). Furthermore, the increased income of the users headed by financially-literate women (42,980 riels (US$11)/month) are likely to be 47% higher than that of those headed by financially-literate men (29,230 riels (US$7.50)/month). Therefore, regardless of financial literacy, the female-headed users are very likely to achieve a larger increase in per capita income than the male-headed users.

These results imply that the households headed by financially-literate women are likely to reap the greatest benefit from using the financial services. Then, enhancing financial inclusion together with financial literacy for women is one of the best ways to help needy households increase their earnings.

FINANCIAL INCLUSION AND HOUSEHOLD BUDGET CONSTRAINT

Figure 4 presents the effects of financial inclusion on household budget deficits (i.e., spending > earnings), which were estimated by Seng (2020). The effects are differentiated by household heads' gender and financial literacy, with Panel A reporting the effects by financial literacy status in each gender group and Panel B presenting the effects by gender in each financial literacy status group. Panel A illustrates that the financial service users headed by financially-illiterate men are likely to reduce the likelihood of running household budget deficits by 11.60%, while those headed by financially-literate men are likely to reduce the probability by 11.80%. These results demonstrate that the budget-deficits-reducing effects on households headed by financially-literate men are 0.20% greater than those on households headed by financially-illiterate men. More significantly, the financial service users headed by financially-illiterate women are likely to reduce the probability by 17%, while those headed by financially-literate women are likely to reduce the likelihood by 20%, revealing that the reduced probability of budget deficits achieved by the latter is 3% larger

Figure 4. Effects of Financial Inclusion on Household Budget Deficits



Notes: M-head is male head; and F-head is female head.
Source: Adopted from Seng (2020). The details on the estimated probability of household deficits can be found in Seng (2020).

than that of the former. The results show that, regardless of the heads' gender, the users headed by financially-literate persons are likely to reduce the probability of running household budget deficits at a greater level than those headed by financially- illiterate ones.

Panel B indicates that the probability of reduction in budget-deficits achieved by the financial service users headed by financially-illiterate women are likely to be 5.40% larger than that of those headed by financially-illiterate men. Furthermore, the budget-deficits-reducing likelihood of the users headed by financially-literate women are likely to be 8.20% greater than that of those headed by financially-literate men. The results suggest that, irrespective of financial literacy, the female-headed users of financial services are very likely to perform much better than the male-headed users in terms of reducing household budget constraint.

These results imply that the financial service users headed by financially-literate women are more likely to reduce the probability of household budget deficits at the greatest level, confirming that the budget-constraint-relaxing effects of financial inclusion are greater for the users headed by financially -literate women. The financial literacy can help financial service users prepare household budget and financial plan, manage financial activities more effectively, and mitigate the risk of household budget deficits, that, in turn, reinforce the income effects of financial inclusion.

POLICY CONSIDERATION

This policy brief paper provides the argument that the financial inclusion produces the intended effects on household income in Cambodia, with the effects being likely greater for the household users of financial services headed by women, in particular financially-literate women. Thus, it is imperative for the government to consider the following policy priorities:

First, promoting women's access to financial services at lower costs by promoting the adoption of fin-tech platforms, reducing operational costs of financial institutions, and developing a mechanism to reduce financing constraints faced by financial institutions. *Second*, providing incentives to financial institutions to incorporate credit with extension services, in particular borrower's management of loans. *Third*, integrating financial education into the general secondary school system and vocational training, with a focus on personal finance topics such as budgeting, money management, and financial planning.

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