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FINANCIAL EXCLUSION AS BARRIER TO SOCIO-ECONOMIC DEVELOPMENT OF THE BALTIC SEA REGION

Introduction

All over the world there are households which, due to many reasons, are not able to use services offered by banks and other financial institutions. These are households whose members are being excluded from the financial services market, and consequently from the contemporary society. Therefore, financial exclusion is often referred to as a plague of the 21st century.

The problem of financial exclusion has been given little attention both in practice as well as in specialist literature, although it afflicts not only poorer countries or world regions, such as Latin America, Africa or Asia. In fact, it is becoming more common in highly-developed countries of Europe and North America as a result of immigration of poorer people and consolidating processes in the financial sector, with frequent closures of less profitable branches of smaller banks and other financial institutions situated in smaller towns and on city outskirts.

Financial exclusion comprises a set of difficulties which some people face whilst accessing basic financial services. This means that financial institutions do not allow some of their present or would-be clients to access their basic banking offer such as bank accounts and other related products or basic insurance. People who have been excluded from the financial services market are not only denied access to credits, loans, or payment cards, but are also turned down by bank tellers on account of insufficient amount of funds they want to withdraw or deposit. A milder variant of exclusion consists in charging bigger fees and commissions from people who are not commercially attractive for a financial institution. Such a policy is meant to discourage people who do not fit a desired customer segment from using financial services.

People who have been excluded from the financial services market cannot settle their financial commitments (rent, electricity, etc.) through their bank account, thus being forced to use less convenient and more expensive cash payments. Without being able to take a bank credit, they resort to loans granted at a usurious interest rate by non-banking institutions or various financial agents whose operation is frequently illegal. People who do not have their own bank accounts also encounter problems connected with finding work or receiving welfare benefits. Moreover, they are in a worse position when it comes to planning their expenses. Thus, financial exclusion is closely related to social ostracism.

The aim of the paper is to determine the scale and the level of the phenomenon of financial exclusion (with a special focus on the Baltic Sea countries) as one of significant barriers to socio-economic development of contemporary

economies. This paper is also an attempt at defining reasons behind the phenomenon and at identifying groups which are most prone to financial exclusion.

1. Financial exclusion – theoretical background

The term financial exclusion was first coined in 1993 by geographers who were concerned about limited physical access to banking services as a result of bank branch closures (Leyshon and Thrift, 1993). Throughout the 90s there was also a growing body of research relating to difficulties faced by some sections of societies in gaining access to modern payment instruments and other banking services, to consumer credit and to insurance. There was also concern about some people lacking savings of any kind. It was in 1999 that the term financial exclusion seems first to have been used in a broader sense to refer to people who have constrained access to mainstream financial services (Kempson and Whyley, 1999). Since then, a number of commentators have added their views of how financial exclusion should be defined.

Research to date in the field of financial exclusion has been wide and diffuse. Much of it has been concerned with defining and documenting the nature, causes and consequences of financial exclusion, together with actual and proposed solutions: Donovan and Palmer (1999), Financial Services Authority (2000), and Sinclair (2001). Several specialist streams of research have emanated from this broad field. These include geographic and other 'space locations' (like social and economic) of financial exclusion: Leyshon and Thrift (1995), Dymski and Li (2002) and Fuller and Jonas (2002); the role of bank strategies: Alexander and Pollard (2000), Argent and Rolley (2000) and Boyce (2001); the future of mutuality: Rossiter (1997) and Waite (2001); the genesis, evolution and efficiency of specialist financial institutions, like credit unions: Fuller (1998), Hayton (2001) and McKillop et al. (2002); and finance for small businesses in deprived communities: Bank of England (2000 a & b).

1.1. Notion and characteristic of financial exclusion

The term 'financial exclusion' has a broad range of both implicit and explicit definitions. Research carried out and discussions held among experts within the present research project leads us to propose the following definition: financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong.

There is also a widespread recognition that financial exclusion forms part of a much wider social exclusion, faced by some groups who lack access to quality essential services such as jobs, housing, education or health care. Difficulties accessing appropriate financial services. Beside the fact that use of financial services makes more and more part of a standard life, the way to access and use those services may be more and more over demanding on various aspects as geographical, technical, cultural, educational, or about guarantee and risk analysis criteria. This leads to a large range of access and use difficulties that are deeply related to each country's market structure (Anderloni, 2003).

Financial products will be considered ‘appropriate’ when their provision, structure and costs do not lead the customer to encounter access and/or use difficulties. These difficulties are caused simultaneously by the characteristics of the products and the way they are sold (supply side) and the situation and the financial capability of the customer (demand side). The analysis of each structure (both demand and supply sides) may, for each country, highlight the way supply meet demand, and how appropriate it is (Carbo et al., 2004).

Much of the exclusion appears to arise from a failure of the mainstream commercial providers to supply a range of products that are appropriate to the needs of all sections of society. ‘Mainstream providers’ may be considered as non stigmatizing providers regarding to the national reference. Related to the market structure of each country, a particular type of providers may appear as mainstream in one and as ‘alternative’ in another one (e.g. saving banks are mainstream in France or Spain, but not in the United Kingdom). ‘Alternative’ may refer to organizations paying special attention to marginal segments, often operating as not-for-profit organizations and acting in compliance with rules and regulations or other providers which exploit the marginal market segments and often act on the borderline of legality (Solomon et al., 2010).

Financial exclusion is deeply interrelated with social exclusion: if the latter almost automatically leads to the first, financial exclusion belongs to a process that reinforces the risk to face social exclusion. Being objectively excluded or having a subjective feeling of being excluded can begin or be reinforced by access or use difficulties in financial practices. The perfect financial inclusion may therefore be described by the capacity to access and use appropriate financial services proposed by mainstream providers. Meanwhile, there may be an adequate ‘second best choice’ to get appropriate services proposed by alternative providers that comply with rules and regulations and do not exploit low income people. At least, an authenticated ‘social/open minded’ provider may give a sufficiently safe/positive image to enable excluded people to try once again finan-

cial services, which could then be the first step towards financial inclusion with mainstream financial providers (Schiffman & Kanuk, 2010).

1.2. Who is exclude from financial sector

There is a debate about who is excluded from financial sector. In this are there is an important distinction to draw between access and usage of financial services. First of all, in the context of banking we need to consider how to categorize people who do have transaction banking facilities with an account but choose not to use them. As we note above, such people are often considered to be marginally banked (Anderloni and Carluccio, 2006; BMRB, 2006; Barr, 2004; Corr, 2006; Kempson, 2006; Solomon et al., 2010).

Then there is the issue of people who could gain access to specific services, but choose not to do so. This applies especially to consumer credit and insurance, but it can also be the case for savings and banking transactions too. Here an important distinction is often made between those who choose freely not to use a particular service (such as people who have a fundamental objection to using credit) and those who are deterred from doing so because they believe the features of the products or services make them inappropriate to their needs or the costs puts them beyond their reach.

Next, there is the issue of people facing use difficulties because they accessed to inappropriate financial products. These difficulties are caused simultaneously by the characteristics of the products and the way they are sold (supply side) as well as the situation and the financial capability of the customer (demand side). These difficulties can happen with a current bank account which becomes overdrawn as people are not used to manage money electronically. It can also happen with a loan that is sold with insufficient advice and with technical terms that are incomprehensible to anyone who is poorly informed, or with exorbitant charges for someone with a low income. Inappropriate access (e.g. use difficulties) to credit could result in the borrower having less disposable income and sometimes over-indebtedness (Gloukoviezoff, 2008).

Finally, there is a problem whether financial exclusion (and banking and credit exclusion) should be assessed at the individual or household/family level (Anderloni and Caluccio, 2006; BMRB, 2006; Gloukoviezoff, 2004; Kempson and Whyley, 1999). Each has its limitations. If the assessment is made at the individual level, people appear to be financially excluded even though their partner may make extensive use of financial services and they would easily get them in their own right. In addition, a decision has to be made about the age range of individuals to be covered. In most countries there is a legal age limit below which credit facilities cannot

be granted. As a consequence many studies have looked at adults aged 18 or over, although others cover people from the age of 16 or 15.

On the other hand, assessing access at the family level (that is the head of household and their partner if they have one) we have a clearer idea of the proportion of the population with no ready access, even through a partner, but underestimate the proportion of people at risk of being financially excluded if they experienced the break-up of their family. It also underestimates the number of people who are affected. For this reason the United Kingdom Government, in its monitoring, estimates the number of adults living in family units without access to banking (Financial Inclusion Taskforce, 2006a, 2006b).

Assessing access at the household level (that is considering all adults living in a household) compounds these problems still further as there is much less stability of households than of family units. Moreover, household level analysis does not provide estimates of the financial exclusion faced by young adults still living at home.

1.3. Financial exclusions according to type of services

The World Bank (1995) indicates four key group of services to which all in society should have access: transaction banking, savings, credit and insurance.

The access to banking (transaction banking services in particular) is seen as a universal need in most developed and cashless societies. The lack of access or use of this financial provision has such bad effects that social inclusion is effectively damaged because:

- it is the most popular/generalized financial provision, lack stigmatizes,
- it is a key to access other financial services (credit/savings), lack disturbs market access and gives opportunity to unfair provisions to grow and may consequently increase risk of poverty,
- it becomes more difficult and expensive for people who can only pay in cash, lack increases risk of being stolen and risk of poverty,
- it leads to time consuming and somehow annoying procedures, lack reinforce exclusion.

The types of transactions that can be linked to an account are:

- receiving regular (electronic) payment of funds such as wages, pensions or social assistance,
- converting cheques or vouchers into cash,
- storing money safely until it needs to be withdrawn,
- paying for goods and services other than in cash,
- paying bills electronically,

- making remittances.

The problem related to savings is completely different. The access to a simple deposit account does not seem globally to bring many problems. In addition, a lack of access or use may bring inconvenience in day to day life, but cannot be related to social exclusion. Nevertheless, some social problems have been identified related to savings account:

- lack of identification document (relevant for transaction banking too),
- lack of any significant advantage bring by a deposit account (due to costs, fees and/or complexity of the procedures/contracts).

In addition, we have to consider that the lack of deposit is more often a consequence than a cause of social problems, as in the following cases:

- lack of money to save (low income, low pension etc.);
- lack of habit to save money in bank;
- unwilling to deal with banks because of negative past experience or prejudice.

Credit is a main financial tool to enable access to goods or expenditures that oversize the monthly budget such as equipment goods (e.g. diverse vehicles, housing, furniture, renting guarantee etc.). It may play a significant role to smooth consumption and to protect against income shocks. Consumer credit pilot-project experiences proposed by not-for profit providers underline the positive social impact an appropriate small credit can bring for usually ‘credit excluded’ household: increase on mobility, access to training and improving the quality of the housing (improve health and self-esteem) which can lead to higher future income and wider general welfare. The lack of access or use of this financial provision may impact social inclusion in various ways:

- because some type of credit (e.g. overdraft facilities / credit cards) are already so much used in some EU region, lack may stigmatize,
- because lack of access to some goods impact access to the minimum national standard of living, lack of appropriate credit may stigmatize and reduce welfare level and self-esteem,
- because lack of access to appropriate credit may lead to reimbursement difficulties, it may increase household budget disequilibrium for long period of time and, finally, it may lead to over-indebtedness. Indeed, over-indebtedness may lead to financial and social exclusion.

A good understanding of the structure of national market supply is once again particularly relevant to measure the way demand is met, and the way it is appropriately met. The existence of interest rate ceiling, sub-prime market or equivalent, illegal lenders, non for profit or social providers, mainstream providers with high Corporate Social Responsibility (CSR) standard may influence

deeply the situation from a country to another. Problems of use, for credit, are mainly relying on the quality of the risk analysis (creditworthiness and credibility) realized in the pre-contractual phase, on the main characteristics of the contract: cost, guarantee, duration and clarity and on the possibility to adapt to unforeseen events that borrowers can encounter once the loan is granted. Concerning credit matters, problems of access or use are more difficult to define and contain, because of their multidimensional aspects: various products, various providers, various laws, various demands and various methodologies (credit score). Moreover, the need for someone to have an appropriate credit has to be balanced with the reasonable need for banks to avoid too high risks. For all these reasons, building a precise scale from a fully excluded to a perfectly and appropriately served client is difficult.

Nowadays some kinds of insurance are essential in the organization of modern societies and, some of them, are therefore mandatory (for example those for the use of motor vehicles, or to carry on some kind of jobs). However, there is no clear definition of which types of insurance are considered essential so that anyone who lacks them might be considered financially excluded. Furthermore, the insurance tool for retirement purpose is of growing importance, due to the well-known difficulties of the state welfare systems. Since this matter requires a complete study on its own, it has been decided to not go deeper into the subject in this paper.

1.4. Degrees of financial exclusion

The World Bank distinguishes between those who are 'formally served' that is those who have access to financial services from a bank and / or other formal providers and those who are 'financially served' who also include people who use informal providers. In contrast to the other work described above, the term 'financially excluded' is only used to describe those who have no access at all (World Bank, 2005). We have decided to consider only the formal sector which includes only the legal providers as the illegal sector is clearly not to be encouraged. The following details the degrees of financial exclusion per category studied: transaction bank accounts, credit and savings.

Regarding the bank transactions account, there are three levels of exclusion:

- 'unbanked' who are generally people with no bank at all,
- 'marginally' banked who are people with a deposit account that has no electronic payment facilities and no payment card or cheque book. It can also be people who do have these facilities but make little or no use of them,

- 'fully banked' are people that have access to a wide range of transaction banking services that are appropriate to their needs and socio-economic status (Anderloni and Carluccio, 2006).

For the credit category, we have identified five main levels:

- credit excluded,
- inappropriately served by alternative lenders,
- inappropriately served by mainstream lenders,
- appropriately served by alternative lenders,
- appropriately served by mainstream lenders (Devlin, 2005).

Finally, concerning the savings category, being excluded is slightly different here, in the sense that it is not lack of access or usage that determines the exclusion, but the mere fact of the concerned person actually being able to save or not. As we will see there are many ways to save from the unofficial home savings, to the savings account with a credit union, to the savings account with a mainstream bank account.

2. Financial exclusion in the Baltic Sea region

The main source that has been used to assess levels of financial exclusion in the Baltic Sea region is the Eurobarometer Survey (Anderloni and Carluccio, 2006; Nieri, 2006; Corr, 2006). To date, however, use of the Eurobarometer data has been restricted to looking at access to specific products only (*banking*: Anderloni and Carluccio, 2006; Corr, 2006; *credit:* Nieri, 2006; *life insurance*: Corr, 2006).

Although Eurobarometer 2012 surveys individuals aged 15 or over, our analysis is restricted to people aged over 18 as this is the legal age of access to some types of product (including a transaction bank account with an overdraft and unsecured credit). It asks about the holding of a range of financial products, including transaction accounts (with a cheque book and/or a payment card facility), deposit accounts (which pay interest, but have no payment card or chequebook) and other savings products including life assurance policies, stocks/shares, collective investments (unit trusts) and bonds. The forms of credit covered include overdrafts, credit and charge cards and loans for car purchase and other purposes.

It is important to note that the Eurobarometer data is useful to draft a broad picture and to be able to draw very rough international comparisons, but that is it not 100% accurate information. Indeed, experts have underlined that the questions are sometimes interpreted differently from one country to another, and as the study shows, comparisons with national data sometimes show quite important gaps, which could not only be due to samples issues. To summarize, it is one of the best data available for the moment, but it can still be improved in the future.

2.1. Level and diversification of financial exclusion in the Baltic Sea region

The analysis of data from Eurobarometer shows that 28 per cent of adults aged 18 of adults in the this region had no bank account at all. We describe these people as *'unbanked'*. A further 6 per cent in the Baltic Sea states had only a deposit account with no payment card or cheque book – these we have called '*marginally banked'*. Generally, adults were less likely to hold revolving credit than savings. In all 58 per cent of Baltic Sea adults had no access to revolving credit (credit card or overdraft) whilst 43 per cent respectively did not have a savings product. Putting this together, we find that around 20 per cent of all adults in the EU countries had none of these three types of financial product and might, consequently, be considered '*financially excluded*'.

Levels of financial exclusion varied widely, ranging from one per cent or less in Denmark, to 40 per cent in Poland and 48 per cent in Latvia. Indeed, the countries with large proportions of adults who are financially excluded feature among those with the highest proportions of people excluded from each of the three types of financial services we have studied in detail: banking, unsecured credit and savings.

Moreover, there was a broad a correlation between levels of financial exclusion and the levels of affluence (measured by the GDP per capita) and inequality (Gini coefficient), which is consistent with other research (Kempson, 2006). Where affluence was high and income inequality was low, levels of financial exclusion tended also to be low.

The Eurobarometer analysis shows wide variation in exclusion from transaction banking services across the Baltic Sea countries – ranging from 7 per cent of individuals in Germany to 65 per cent in Latvia and Lithuania (65 per cent). It should be noted, however, that in Estonia, a high proportion of individuals had a deposit account even though they lacked a transaction account, so the proportion lacking an account of any kind was a good deal lower.

Using the Eurobarometer data it is possible to compute two variables to measure the level of exclusion from unsecured credit. The first is the proportion of people with no credit in the form of an overdraft, credit card or loan; the second is a narrower definition – of access to mainstream revolving credit facilities (overdrafts and credit cards). Both measures, however, tend to provide an overestimate of credit exclusion as they will include people who are opposed to borrowing and so decline such facilities or they simply did not need them. Importantly, the extent of this will vary from country to country, depending on the prevailing attitude towards borrowing. It should also be noted that there are three

quite distinct types of credit card in Europe, and also that the Eurobarometer survey puts charge cards together with credit cards even though they do not offer extended credit. Secondly, the Eurobarometer survey excludes some forms of credit that are quite prevalent in some countries – including goods bought on credit through mail order catalogues and, in Poland, a form of credit known as hire purchase. Despite these concerns about the Eurobarometer data, it does offer at least some insight into levels of access to credit across the Baltic Sea countries. These should, however, be kept in mind when interpreting the findings of the analysis.

Across the Baltic Sea countries 58 per cent of adults aged 18 or over did not have any revolving credit facilities. Again there was wide variation across countries. The proportion of people with no revolving credit was lowest in Denmark (18 per cent) and Sweden (33 per cent). The highest proportions were found in Lithuania (86 per cent), Estonia and Latvia (80 per cent).

As we saw earlier, around 43 per cent of Baltic Sea countries had no savings account at the time of Eurobarometer survey. Once again there were wide variations across individual countries. Sweden was the country with the highest incidence of saving account-holding – only 7 per cent of adults lacked a savings account. At the other extreme, countries in the Baltic Sea where a large proportion of the population did not have a savings account included Latvia (76) and Estonia (67).

Table 1. Levels of financial exclusion in the Baltic Sea region (in%)

Country	Unbanked	Marginally banked	No revolving credit	No savings	Financially excluded
Denmark	5	7	18	15	1
Estonia	27	8	80	67	16
Finland	11	6	48	34	6
Germany	5	2	46	21	3
Latvia	62	3	80	76	48
Lithuania	53	12	86	61	41
Poland	56	2	73	60	40
Sweden	8	9	33	7	2

Sources: Eurobarometer (2012).

To sum up, we have grouped the Baltic Sea countries according to their levels of financial exclusion. These were as follows:

- low level of financial exclusion (i.e. those with levels of exclusion under three per cent) – Denmark and Sweden,
- medium-low level of financial exclusion (between three and eight per cent) – Germany and Finland,

- medium-high level of financial exclusion (between 12 and 28 per cent) – Estonia,
- high level of financial exclusion (34 per cent and above) – Poland, Lithuania and Latvia.

2.2. Consumer typology according to financial exclusion in Baltic Sea region

Financial exclusion affects some groups of people more than others and, on the whole, similar types of people are disproportionately affected regardless of the prevailing level of exclusion in their country. These are people living on low incomes; and consequently those who are unemployed, lone parents caring for children full-time and people who are unable to work through sickness or disability. In new member states, retired people also have high levels of financial exclusion (Anderloni, 2003; Anderloni and Carluccio, 2006; Bank of Italy 2004, BMRB, 2006).

There is also evidence that financial exclusion is linked to people's knowledge of and exposure to financial services and that this remains statistically significant and has a large effect even when other factors such as income and work status are controlled (Disneur et al., 2006; Gloukoviezoff, 2005)

There is a link with age, with younger and older people being most likely to be excluded. Single people are more likely to be excluded than those living with a partner. In both cases, however, the regression analysis showed that the effects were small even though they were statistically significant. This suggests that they mediate their effects through income and work status. Although women had slightly higher levels of financial exclusion than men, gender was not significant in the regression – again suggesting that gender effects may be attributed to work status and income, as people who are retired or looking after the home full-time are disproportionately women (Kempson, 2006; Kempson and Whyley, 1998).

It is important to note that it is not just economic circumstances and personal characteristics that affect the propensity to be financially excluded. There is evidence that financial exclusion is concentrated in certain communities. So living in a deprived area increases the likelihood of being financially excluded and so, too, does living in a rural area in new member states. This almost certainly reflects the paucity of financial service provision in such communities. At the same time, there is evidence that people have higher levels of financial exclusion if their friends and family are also excluded (IFF, 2006; Marketing Partners Ireland, 2006). This suggests that where operating in a cash economy is the

norm, there is much less of an incentive to use financial services and may also explain the geographical effects.

On the whole, the same types of people had an above-average likelihood of being financially excluded regardless of whether they lived in a country with higher or lower levels of financial exclusion. It is plausible that as one moves towards a low level of financial exclusion, some groups get left behind. In fact, all groups, regardless of their circumstances, benefit greatly as one moves from high to low levels of financial exclusion. Even so, some groups of people disproportionately experienced financial exclusion whether they lived in a country where overall levels were high or one where they were low. These were lone parents, young people (aged 18-25), students and people who were unemployed. In contrast, the disproportionate exclusion experienced in countries with high and medium-high levels of financial exclusion by women, single people without children, retired people, those aged over 65, people who left school at an early age and rural dwellers, disappeared in countries where the level of financial exclusion was low. The effect of income also reduced markedly, as did the effects of attitudes, although people who did not know whether one could expect financial institutions to give advice remained disproportionately affected in areas of low exclusion.

Table 2. Type of people likely to be financially excluded in Baltic Sea region

Characteristics	Group 1	Group 2	Average
1	2	3	4
Gender:			
Female	8	37	22.5
Male	5	30	17.5
Age:			
18-25	13	36	24.5
26-44	5	23	14
45-64	5	31	18
65+	8	56	32
Age left education:			
Up to 15	10	57	33.5
16-19	5	32	18.5
20+	2	16	9
Still studying	16	39	27.5
Work status:			
Self employed	3	17	10
Employed	3	13	8
Looking after home	13	52	32.5
Student	17	39	28
Unemployed	12	57	34.5
Retired / unable to work	7	48	27.5

Table 2 contd.

1	2	3	4
Family type:			
Lone parent	11	40	25.5
Couple with children	5	28	16.5
Single no children	9	42	25.5
Couple no children	5	30	17.5
Household income:			
Lowest income quartile	9	55	32
2nd lowest income quartile	5	37	21
2nd highest income quartile	4	20	12
Highest income quartile	2	14	8
Geographical area:			
Rural area or village	7	43	25
Small or middle sized town	7	30	18.5
Large town	6	25	15.5

Note:
Group A: Denmark, Germany, Finland, Sweden ('old' EU member states).
Group B: Estonia, Lithueania, Latvia, Poland ('new' EU member states).

Sources: Eurobarometer (2012).

Finally, previous research has also shown that migrants and people who are over indebted are also likely to be excluded. It was not, however, possible to include this in the regression analysis, although it is highly likely that both factors would have been statistically significant. Through qualitative research, however, migrants are an interesting group to focus on to improve their chances of financial inclusion. Indeed, they are a population whose financial needs evolve according to their migratory plan (Mintel, 2005; Test Achats, 2001).

3. Causes of financial exclusion in Baltic Sea region

The earliest analysis of financial exclusion concluded that it involves those processes that serve to prevent certain social groups and individuals from gaining access to the financial system (Leyshon and Thrift, 1995). The authors contend that people with limited incomes and certain disadvantaged social groups represent too high a risk as customers for mainstream financial institutions, which then avoid geographical areas where these groups of the population live. In other words, financial exclusion was seen in terms of physical and geographical access. Since then, there has been a large body of research that has identified

a wide range of other factors that restrict access to and use of financial services or that renders them less appropriate.

A range of societal factors have been identified as having an impact on people's access to and use of financial services. These include liberalization of financial services markets, which has, in turn, led to an increase in the number and complexity of financial products and providers. While this has widened access, the confusion that arises makes it difficult for some people to engage with financial services (Anderloni and Carluccio, 2006; Atkinson et al., 2006; Kempson et al., 2000). Secondly, there are structural changes in labor markets, leading to greater 'flexibility' and growing job insecurity, which in some countries is accompanied by high levels of youth unemployment (Anderloni and Carluccio, 2006). Thirdly, tightening of money laundering rules in response to terrorist attacks means that many people may face difficulty in getting access to services (Anderloni and Carluccio, 2006; Kempson, 2000). Fourthly, social assistance programmes can play an important role – with both the level of payments and the method by which they are made having an effect on levels of financial exclusion. And for benefit receipt the rules may deter people from saving where that might reduce the level of assistance they would qualify for (Anderloni and Carluccio, 2006; Citizens Advice; 2006; Kempson and Whyley, 1999). Fifthly, financial exclusion is affected by demographic changes such as rising levels of divorce and the tendency for young people to leave home at an older age (Anderloni and Carluccio, 2006; Kempson et al., 2000). Finally, there is a link between levels of banking exclusion and levels of income inequality as measured by Gini coefficients (Kempson, 2006). Much of the previous research and analysis has, however, tended to concentrate on the reasons for exclusion in specific areas of financial services.

In the area of transaction banking a range of factors covering both supply and demand has been identified across a wide range of countries (Anderloni and Carluccio, 2006; Corr, 2006; Gloukoviezoff, 2005; Kempson, 2006).

On the supply side, banks refuse to open full transaction bank accounts for certain groups of people, such as those with a poor credit history, unstable patterns of employment or those who fail credit scoring systems because their characteristics mean they are assessed as a high risk. In some countries, there exists negative registers for payment failures and insolvency, although legal initiatives aim to reduce this too-stigmatising risk. People unable to satisfy identity requirements also find it difficult to open an account. This applies especially to migrants but can also affect a wider group of people who do not have the standard forms of identity required. This is a particular problem in countries that lack

identity cards, where banks rely on passports and driving licences instead. Moreover, the terms and conditions and charges associated with transaction bank accounts deter both access and use. This includes such things as minimum balances, monthly charges and charges per transaction – especially if the charges are regressive and disproportionately affect people on low incomes (Collard et al., 2001; Kempson and Whyley, 1998; Kempson, 2006).

On the demand side, people are deterred from accessing and using transaction banking services for a range of psychological and cultural reasons. These include elderly people who are part of a 'cash only' generation, migrants and also people on low incomes generally, who frequently see banking as only being appropriate for people who are better off than they are and fear losing control of their money if they cease to deal only in cash. In Italy, people are deterred from opening an account if it does not have an overdraft facility to ease access to money paid in. Delays in clearing cheques paid into an account mean that people cannot have instant access to any money paid in (Anderloni, 2003; Solomon, 2010).

Moving on to consumer credit, previous research has identified a range of similar factors – again relating to both supply and demand. Refusal by credit companies is a very significant reason across all countries, as a result of lack of information about an individual at credit reference bureaux, an adverse credit history or failing the score card operated by creditors as a consequence of lack of stable employment, low income and other personal characteristics (Corr, 2006; Ellison, Collard and Forster, 2006; Kempson and Whyley, 1999; Kempson et al., 2000; Nieri, 2006). Often just as significant is the fact that some people do not apply for credit as they think they will be turned down. (Nieri, 2006; Kempson and Whyley, 1999; Kempson et al., 2000). Also significant in limiting access to and use of unsecured credit is a fear of borrowing – and especially of using forms of credit such as overdrafts and credit cards where it is easy to lose control over spending (Kempson and Whyley, 1999; Kempson et al., 2000; Collard and Kempson, 2005). People who cannot easily gain access to unsecured credit are often deterred by the high cost and poor contractual terms obtained through intermediaries (Nieri, 2006) or in the sub-prime market (Collard and Kempson, 2005). Many people on low incomes need to borrow fairly small sums of money for a short period of time. They also prefer fixed term loans which they know they will repay. Most mainstream lenders have minimum amounts that they are prepared to lend as a fixed term loan which are way in excess of the requirements of such people (Carbo et al., 2005; Collard and Kempson, 2005; Corr, 2006). Finally, religion can act as a barrier to use – especially in Muslim populations (Collard et al, 2001; Collard and Kempson, 2005; Kempson et al., 2000).

In contrast to transaction banking and unsecured credit, there has been rather less investigation of the reasons why people lack savings accounts. Research in Poland has, however, shown that the explanation is not as simple as people not having sufficient money to save. Many people on low incomes do save but do so outside formal savings organizations, mainly in cash at home or through informal savings and loans schemes (Smyczek, 2001; Smyczek, 2007). There are a number of explanations for this. First, some people face the same difficulties providing proof of identity as we have noted for transaction bank accounts. Secondly, as we have seen above, clearing times for cheques deter people in Italy from opening accounts that do not allow instant access to the funds deposited (Anderloni, 2003). But, perhaps, more significantly, people do not put their savings into an account with a bank or other similar organization because they believe that a large minimum deposit is required or they feel that using such institutions is inappropriate if they have only small sums of money to save. Informal savings schemes are more accessible psychologically (Collard, 2001; Corr, 2006; Kempson, 1999; OLR, 2006). The number and complexity of savings products also acts as a deterrent (Citizens Advice, 2006). Finally, religious factors deter people from opening savings accounts just as they deter them from using credit (Collard et al., 2001; Kempson 1999).

Taking in consideration factors presenting above we can develop a group all the barriers which cause financial exclusion into three groups: societal, supply and demand factors. The classification also indicates whether they act to limit access or use, and also the type of financial services provision where they have their main effects. It should, however, be re-iterated, that not all these factors will necessarily apply in any one country. Moreover, the balance of their importance will also vary from country to country. It is also important to note that the reasons for financial exclusion are complex and these barriers do not often act in isolation. So any one individual may be prevented or deterred from using financial services for several reasons.

Generally, in the past, supply factors played a negative role (obstacles), recently sometimes new strategies of some innovative banks turned these factors positively in order to satisfy the specific needs of marginal segments. Listed demand factors generally play a negative role. Initiatives to improve financial capability and literacy as well as actions aimed to encourage to develop confidence in the banking system may reduce their negative impact.

Although the causes of financial exclusion are many and varied, a general tendency can still be detected. Indeed, and not so surprisingly, the most frequen-

tly evoked causes (at least by seven countries or more) seem to be, respectively, in each group of barrier, the following:

Societal factors:

- *Demographic changes technological gap*: the ageing population has difficulty in staying up-to-date with all the new ways of dealing with money.
- *Labor market changes*: more flexible meaning less stable incomes.
- *Income inequalities*: bring difficulties of access to financial services.

Supply factors

- *Risk assessment* procedures: generally they are becoming more and more tight and thus create financial exclusion.
- *Marketing* methods: they can be unclear and lead potential clients to abandon the request or to mistrust financial institutions and look for other alternatives.
- *Geographical access*: location of financial services providers are too far away from potential clients.
- *Product design*: the terms and conditions are not clear and target public is not defined.
- *Service delivery*: the financial service is delivered by inadequate means for the target public, e.g. Internet for older people.
- *Complexity of choice*: can be an education issue, too many products proposed, target public has trouble to choose.

Demand factors:

- *Belief* that bank accounts are *not for poor people or low self esteem*.
- *Concern about costs*: potential clients fear costs might be too high or lack information.
- *Fear of loss of financial control*: bank account feels intangible compared to cold cash, also some means are seen as ‘unsure’, i.e. Internet hacking;
- *Mistrust of providers*: fear of bankruptcy or lack of confidence with financial institutions.

Undeniably, societal, supply and demand factors can play a role in the exclusion or limited inclusion of individuals. Let’s take for example the risk assessment factor. The lack of permanent address and identification documents, the lack of an ‘official’ or stable job, not speaking the national language, and living in deprived economic circumstances may render it more difficult to have easy and fair access also to basic financial services.

This is clearly shown in credit scoring models, variables such as area of residence (i.e. postal code or also specific address), kind of job position, period of time in the same working place and of living at the same address are used in order to define the credit score. These models are mainly used for deciding whether to accept or to refuse a demand for unsecured loans and mortgages, but often represent a tool for customer segmentation and for identifying ‘undesirable’ customers.

To conclude, although societal factors were most commonly mentioned as the cause of financial exclusion, there are a number of failures of supply and demand that are clearly important. These almost certainly exist more widely than was reported but only come to light hen the situation is explored in detail. Such evidence only exists in a minority of countries.

4. Consequences of financial exclusion for socio--economic development of the Baltic Sea region

Two main dimensions of financial exclusion consequences under the umbrella of socioeconomic consequences on affected people can be determined. First, 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, social consequences can be generated by financial exclusion. These consequences are affecting individuals' patterns of consumption, the way they participate to economic activities or access 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.

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 summarized below regarding each one of the keys areas of essential financial services: transaction banking, credit and savings.

For transaction banking, a further distinction can sometimes be made between access difficulties and use difficulties consequences. 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 commercial profit-oriented financial services providers (Smyczek, 2012).

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).

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).

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 commercial profit-oriented 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 Germany is to delay utility bill payments in order to 'inject flex into their budgets' (Policis, 2007, p. 36). Consequently, consumers in Germany are more likely than those in Sweden or Finland 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; chequecashers) 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 Poland, when customers do not fulfill their repayments, unlicensed lenders pass on the information to an outsourcing company who then use harsh methods to recoup payments.

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

Summarizing these analyzes it should be underline that financial exclusion is tightly linked to social exclusion. Different studies throughout this region demonstrate the importance of these links. Indeed, the access and use of basic a bank account and simple transactions are decisive to the integration of people in the Baltic Sea region society. There is also a widely made argument that access to banking is important for the economic development of a country (World Bank CGAP). Policy makers should consider financial exclusion issues in all courses of action regarding social exclusion or poverty.

The same certainty goes for the links between financial exclusion and over-indebtedness. Indeed, that the most important link is that over-indebtedness could be understood as a result of access and use difficulties. Similarly, it has been shown that access difficulties to bank accounts, means of payments or credit, can lead to use difficulties and vice versa. Nevertheless, it has to be clear that over-indebtedness is not always a result of access and use difficulties simultaneously: it could be a result of only one of them. Besides customers, it is necessary to consider the role of the state and other types of financial commitments (e.g. subscriptions) as part of the same process (Smyczek, 2012).

It is necessary to distinguish between unbanked people, marginally banked people or over-indebted people when looking for respective solutions. However, it would be damaging not to take into account that they are part of the same process as financial exclusion when examining global solutions (i.e. solutions which try to prevent access and use difficulties at the same time).

Finally, 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 Baltic Sea states. Research on the impact of financial exclusion on people facing it is essential to better understand the financial inclusion issue and its place and necessity within the wider frame of the 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, NGOs, financial institutions and policy makers) should therefore aim to carry out or/and finance further research on the subject.

Conclusions and direction for future research

The paper, from the author' perspective, both, contributes to the current literature related to financial exclusion and provides valuable insights for practitioners who consider financial services market development.

Financial exclusion is a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market, that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong. Given the growth in high-cost fringe banking services that target people who do not have access to mainstream financial services and the limited respect of consumers' rights and fair dealing rules by some alternative financial providers that exploit low-income people, it is important to consider the interplay between services and providers when assessing the access someone has.

While access is the first step towards financial inclusion it is important to have information about people's levels of usage of financial services too. As we shall see later, many people are deterred from using financial services by many of the same factors that may deny others access.

It is important to acknowledge that financial exclusion is not an absolute concept (excluded or not) but a relative one, rather like poverty, with degrees of exclusion. People vary in their extent of engagement with specific services (e.g. transaction banking where we have both the unbanked and the marginally banked). And they also vary in the number of types of financial products to which

they can gain access. It may be helpful in this context to use the term financially excluded for those who lack all products and marginally included for those who have limited access – just as poverty is often described either in terms of being in the lowest income deciles or quintile or, alternatively, of being below a threshold. Finally, sampling for surveys should be constructed in order to allow data to be analyzed at both individual and family level and should be explicit about the lowest age covered.

Analyzes show that levels of financial exclusion are lowest in the countries such as Denmark and Sweden where the standard of living is universally high. They are highest in countries like Latvia, Lithuania and Poland that have transition economies and low levels of gross domestic profit.

Financial exclusion affects some groups of people more than others and, on the whole, similar types of people are disproportionately affected regardless of the prevailing level of exclusion in their country. These are people living on low incomes; and consequently those who are unemployed, lone parents caring for children full-time and people who are unable to work through sickness or disability. In new member states, retired people also have high levels of financial exclusion. Regression analysis shows that these are the most significant factors statistically and have the largest effects.

There are three groups of causes of financial exclusion: societal, supply, and demand. It is on supply and demand reasons that we can better identify what could be done to avoid financial exclusion. Risk assessment, geographical access as well as product design and delivery are causes of financial exclusion that merit more attention in the public debate.

It is also possible to identify two main dimensions of financial exclusion consequences under the umbrella of socioeconomic consequences on affected people can be determined. First, 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, social consequences can be generated by financial exclusion.

It should be borne in mind that this research has some limitations, The key limitation of this study is connected with the choice of the Eurobaromenter as source of data. The Eurobarometer surveys provide a broad international comparison based on 'standard' functioning of markets and economies more than a perfectly accurate picture of the relative levels of financial exclusion across Baltic Sea region. Although many of the discrepancies with national surveys can be explained in terms of differences in sampling or the timing of surveys, it does seem that Eurobarometer may slightly over-state the levels of banking exclusion.

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