

# report

## FINANCIAL INTEGRATION AND INCLUSIVE DEVELOPMENT

A View from the Mediterranean Countries



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A View from the Mediterranean Countries

Banco de España, Madrid

On 13 December 2019, the Banco de España and the European Institute of the Mediterranean (IEMed), with the support of the Organisation for Economic Co-Operation and Development (OECD), organised the 5<sup>th</sup> Conference of Mediterranean Central Banks at the headquarters of the Banco de España in Madrid, Spain. The event, under the title “Financial Integration and Inclusive Development: a View from the Mediterranean Countries”, brought together the Central Bank Governors of Spain, Tunisia, Portugal, Morocco, and Libya, as well as the Vice-Governor of the Bank of Italy and the Vice-President of the European Central Bank, with the aim to contribute to the mutual understanding, exchange, and cooperation between Mediterranean Central Banks.



The Governor of Banco de España, Pablo Hernández de Cos, opening the conference.

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The Governors, together with experts from the OECD, think tanks, the academia, and the public and private financial sectors debated the challenges related to financial integration and inclusive development in the region. Particularly, speakers paid great attention to issues such as the lack of financial inclusion and education, examining the opportunities brought by digitalisation and innovative technologies to boost financial literacy and access to basic services. They also discussed the potential contribution of migration policies to sustainable development in the Euro-Mediterranean area.

## Opening Remarks

Pablo Hernández de Cos, Governor of Banco de España, Isidro González, Deputy Secretary General of the Union for the Mediterranean (UfM), and Senén Florensa, President of the Executive Committee of the IEMed, inaugurated the conference highlighting the importance of boosting financial integration and inclusive development as means to reach shared prosperity in the Mediterranean region. While security issues, political instability, migration, and inequalities persist at the regional level, Mediterranean economies face also global trends such as climate change and a new wave of protectionism. The combination of these threats makes mutual understanding and cooperation more necessary than ever.

In face of the emergence of disrupting new service providers taking advantage of new technologies, the conventional financial landscape now belongs to the past. For instance, “Tech Giants” or “GAFA” like Google, Facebook or Amazon have become important financial actors, already offering loans and providing credit cards. They plan to move even further with the offer of bank accounts and the creation of global and virtual crypto-currencies. This new landscape calls for new policies and regulations to accompany these transformations through adapted regulations and policies to safeguard the stability of the financial sector and the rights of the consumer. On the other hand, the role of the financial sector is deemed crucial in catalysing the new opportunities provided by digitalisation to expand access to basic financial services.



Isidro González, Deputy Secretary General of the Union for the Mediterranean, delivering opening remarks

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The panel therefore invited the Governors, experts, and practitioners to discuss the challenges related to financial integration in the region, with the aim to suggest policies to enhance financial stability, financial education, foster regional cooperation, and capture the potential of technological innovation and migration to contribute to inclusive development in the Mediterranean region.

### **Central banks, financial inclusion and digitalisation: harnessing technology for inclusive growth**

Financial inclusion is widely recognized as one of the main pillars of the global development agenda. Indeed, ensuring that individuals and businesses have access to useful and affordable financial services meeting their needs (payments, savings, credits, insurance) is crucial to enable the poorest and most vulnerable to step out of poverty, empower people to make the right financial decisions, and eventually drive economic growth and social stability. While in developing economies, financial inclusion is on the rise, the level of access to and use of financial services in MENA countries is still among the lowest worldwide. The lack of financial inclusion remains one of the main factors behind the lack of inclusive growth in Southern and Eastern Mediterranean countries. Against this background, Governors of the Central Banks of Spain, Tunisia, Morocco, Portugal, and Libya were invited to debate whether and under which conditions developments associated with digitalisation can contribute to achieving a higher degree of financial inclusion in Mediterranean economies.

The lack of reliable means, high transactional costs, the lack of infrastructures and physical access are often highlighted as some of the most important factors explaining poor indicators of financial inclusion in Southern Mediterranean countries. In light of these obstacles, the emergence of fintech solutions (online banking, mobile payments, e-wallets, card processing, e-commerce, etc.) opens up promising perspectives for reducing financial exclusion.

Indeed, having a smartphone or simply a connection to the internet now considerably expands the possibilities to access a variety of financial services. It is particularly relevant at a time when, according to the World Bank, two-thirds of the adult population without access to banks do have a mobile phone. The reduction of costs associated with the traditional banking sector and the access to financial services in rural and remote areas are just two concrete application fields where fintech can help overcome barriers preventing the unbanked from accessing financial services. Moreover, digital wallet solutions have emerged with multiple functionalities and specific proposals for international remittances.

Further developments on intermediation markets are also providing for improvements in the financing of microenterprises or of those usually struggling to access finance services.

However, the governors identified a series of risks associated with the emergence of fintech and which could hamper its contribution to financial inclusion if not properly addressed. In addition to risks related to money laundering, fraud and cyber criminality, fintech is also exposed to cybersecurity threats or lack of transparency on data privacy that may well weaken its appeal to unbanked potential users. Indeed, the lack of trust rooted in the perception of potential cybersecurity gaps or misuse of sensitive personal data is not likely to prompt economic actors to step out of the informal sector which, in Southern and Eastern Mediterranean countries, constitutes a large part of the economy.



Governors Saddek Omar Ali Elkaber (Central Bank of Libya), Abdellatif Jouahri (Bank Al-Maghrib), Marouane El Abassi (Central Bank of Tunisia), Carlos da Silva Costa (Banco de Portugal) and Deputy Governor Luigi Federico Signorini (Bank of Italy) discussing challenges of financial integration.

This is why the gaps in the legal, regulatory and supervisory frameworks should be addressed. Overall, Governors of Central Banks evoked the need to improve regulation and oversight of fintech in order to guarantee the consumers' rights and security, as well as transparency. But they acknowledged as well the difficulty to keep the pace with a very dynamic and innovative sector. Consequently, they recommended that Central Banks and financial authorities in general should

approach and engage with innovators of the fintech sector to rapidly adapt to new products and consumption habits on one hand, and to understand the potential of fintech to provide solutions to the challenge of financial inclusions on the other hand.

While fintech is likely to help fighting financial exclusion, it might also turn out to be a double-edged sword. In fact, fintech is supposed to make financial services available to a greater number of consumers, especially to the vulnerable segments of the population. Yet, it could also favour situations of over-indebtedness and abuses providing cheap, flexible, convenient and immediate but also untransparent and unsuitable financial services prone to push poor households into the debt trap.

Therefore, the basic prerequisite through which financial inclusion could be achieved thanks to the contribution of fintech is financial education. According to the Governors of Central Banks, the true challenge lies indeed in the fight against the widespread financial illiteracy in countries of the South and East of the Mediterranean. To that end, they recalled that they have taken steps to tackle this issue. For instance, the Al-Magrib Bank designed a national strategy for financial inclusion in Morocco including the creation of a national foundation for financial education placed under its authority and cooperating with the Ministry of Education and trade unions.

The risk to create a digital divide is also inherent in the development of fintech. One cannot deny that financial technology carries the risk to leave behind those of the financially excluded who are also digitally illiterate, especially among older generations.

Cooperation is not an option but an obligation to mitigate the risks associated with fintech and unleash its potential to decisively contribute to a greater financial inclusion. Central Banks of the Southern and Eastern Mediterranean countries have already understood it: they have set up dedicated committees in the framework of regional organisations such as the Union for the Arab Maghreb and the Arab Monetary Fund to promote cooperation for a better adaptation to the challenges of financial technology innovations.

### Central banks, financial integration and capital flows

Since the 1997 Asian financial crisis, the increase in international financial markets interconnectedness has resulted in a doubling of the cross-border positions as a share of global GDP. The global financial integration has had both positive and negative effects: improving each economy's capacity to absorb idiosyncratic shocks, it has however increased the possibility to be affected by international spillover effects. Macroeconomic policies in advanced economies can indeed lead to globally synchronized fluctuations in highly volatile capital flows and asset prices (global financial cycles), having significant repercussions on the financial stability of emerging economies as well as on their monetary policy autonomy.

As it was argued, monetary policy is a delicate matter for the euro area and its Mediterranean neighbours. The eurozone is not immune to international spillovers, especially given the influence of the US monetary policy as a driver of the global financial cycle. However, with the euro as the second most important currency in the world, the European Central Bank's (ECB) policies can also be a primary source of international spillovers. Following the 2008 Great Recession, unconventional monetary policies and other ECB's accommodating measures can affect international markets through two main channels: the so-called portfolio rebalancing channel of asset purchase programmes and international banking channel.

The latter appears particularly relevant for emerging economies. Southern Mediterranean economies, usually characterised by stricter capital controls and a lower degree of openness, have recently experienced an increase in the need for external financing. As a result, Euro-denominated loans have fuelled local national accounts' deficits exposing the economies to eurozone fluctuations.

With regard to the current situation in emerging and Southern Mediterranean economies, speakers agreed that there is still a lack of appetite for emerging markets. Because of push factors and lack of confidence in the full recovery of the world economy, we can expect that net private capital flows in the region will remain low, with foreign direct investments currently at around 1% of GDP.



Abdellatif Jouahri, Governor of Bank Al-Maghrib, during the second session

Against this backdrop, participants of the session shared their analysis on the possible policy responses to tame the impact of negative monetary and financial spillovers, from the perspective of both the originating and impacted countries in the Euro-Mediterranean region.

Though it was acknowledged that the European Central Bank can hardly internalise the spillovers of its policies to the South of the Mediterranean due to its eurozone-focused mandate, it can limit their negative effects through transparency and clear communication unveiling policy intentions and decisions.

On the side of the countries affected by adverse spillovers, such as Southern and Eastern Mediterranean countries, it was argued that, in order to build resilience to external shocks, they should focus their efforts on building strong economic fundamentals and sound policy frameworks and institutions. For instance, policymakers should promote policies and economic reforms leading to sustainable public finances, attractive business environments, effective regulation and oversight of the financial sector, and a better monitoring of

amplifiers of financial spillovers such as the national accounts' exposure to foreign exchange debt. The negative effects of financial and monetary negative spillovers can also be mitigated by exchange rate flexibility, though it was acknowledged that it cannot be a panacea.

Finally, speakers stressed the need for enhanced cooperation at a multilateral level. According to them, the Eurosystem and its Southern and Eastern Mediterranean neighbours should promote transparency, dialogue and mutual knowledge of the different regional monetary policies. This would be possible through, for instance, the creation of a regional platform for the exchange of views, which would help prevent and better respond to financial spillovers.

The participants also mentioned the OECD Code of Liberalisation of Capital Movements (CLCM) as a crucial tool for international cooperation. Because unilateral approaches to capital controls can only create negative spillovers and invite countermeasures, cooperation is of utmost importance in an interconnected global financial system. In this regard, the OECD Code, a set of norms and a multilateral platform for discussion created in 1961, aims at promoting openness and transparency of the capital account for an international system of orderly capital flows. The CLCM, nowadays' only multilateral legal framework on the matter, was recently revisited in 2019 to adapt to the new context characterised by financial integration and capital flow volatility. It should be considered as an important leverage tool to help domestic reform agendas for more financial stability.

### Boosting financial education to tackle social inequalities

As previously stated, financial illiteracy is one of the main determinants of financial exclusion. At a time when households are expected to take greater personal responsibility for their own financial welfare, financial services are proliferating and becoming increasingly complex. Yet, recent OECD financial literacy surveys have highlighted that many people lack even the most basic financial knowledge and are ill-prepared to take financial decisions. As a consequence, financial illiteracy leads to situations of poor saving and excessive spending, over-indebtedness, bad investment decisions, bankruptcy, and other financial harmful habits deepening socioeconomic inequalities and exclusion. At a macroeconomic level, financial illiteracy ends up being particularly detrimental to financial stability as a whole. On the contrary, positive and well-informed financial behaviours support the achievement of broader economic and social outcomes by strengthening consumers' resilience to major financial shocks and long-term financial outlook.

In the Mediterranean region, where financial exclusion is an important development issue, countries are becoming increasingly aware of the need to tackle financial illiteracy to enhance financial inclusion, socioeconomic empowerment, financial stability, and inclusive growth. Many central banks and other public authorities in the region are committing themselves to improve financial literacy through widespread financial education provision. Experts from think tanks, Central Banks, the private banking sector, and the OECD explored the challenges they face and the opportunities and best practices to ensure that financial education initiatives lead to an improvement in people's financial well-being in the countries of the region.

According to the OECD, boosting financial literacy across a nation is best achieved through the definition and implementation of a National Strategy for Financial Education. In order to prepare such a strategy, it is crucial to establish the current level of financial literacy of a population, evaluate its needs, with the aim to identify priorities and target groups. Following the guidance from the OECD, the strategies must also establish effective and sustainable institutional

and governing arrangements with explicit mandates on financial education and clear codes of conduct regarding the involvement of the private sector. Indeed, with regard to this latter issue, it can appear interesting to involve the private financial sector to take advantage of its resources, expertise and to help extend the reach of financial education delivery. However, in order to ensure that no conflict of interests arises from this type of collaboration, experts suggested to partner with banking industry associations rather than individual banking institutions, or to adopt codes of conduct excluding marketing departments or practices from the implementation of financial education projects.

Participants also stressed the need to methodically monitor and measure results of the provision of financial education as well as the overall national strategy. They pointed out the lack of existing data resulting from the evaluation of these strategies and which would be essential to develop effective financial education policies. This is why they called for the inclusion of common evaluation frameworks within the national strategies for financial education. Core competencies frameworks on financial literacy should also be included in order to identify targets against which measuring progress.



Among the countries which have developed a national strategy for financial education in the Southern shore of the Mediterranean, Morocco is an example to follow. Identifying a low level of financial literacy and use of financial services, as well as great inequalities among its population, the Central Bank of the country, Bank Al-Maghrib, took the initiative to create the *Fondation marocaine pour l'Education financière* (FMEF) in 2013. This Foundation aims at strengthening and safeguarding the financial capabilities of the population to contribute to its financial well-being. In charge of implementing the national strategy of financial education, the FMEF partners with a broad range of actors from the public and private sectors (ministries, trade unions, regulators, banks and insurances, NGOs and associations), and mainly targets the youth, women, rural populations and SMEs in order to reduce social inequalities.

Continuing the discussion of the first session, the panel put the issue of digitalisation of financial services back on the table: as previously mentioned, it entails risks that call for new and strengthened financial literacy competencies while providing new tools for the delivery of more effective financial education programmes. Consequently, the panel highlighted the need to include digitalisation in financial education programmes, both to develop competencies for proper use of the fintech, and to deliver financial education through digital tools to reach a much larger audience.

Finally, policy-makers should cooperate at the international level, contributing and learning from global and regional projects, exchange of best practices and encourage links with public and private stakeholders, in order to keep designing improved evidence-based policies with the right delivery methods.

It is also important to acknowledge that, in order to increase the financial welfare of individuals and households, public authorities should also support and implement sound human and socioeconomic development programmes for marginalised segments of the society in parallel with financial education initiatives.

## Migration in the Mediterranean area: an assessment of policies and finance in the light of the Sustainable Development Goals

The 2030 Agenda for Sustainable Development recognizes for the first time the contribution of migration policies to sustainable development and better lives. Indeed, migration is a cross-cutting issue that has close relationships with many, if not all, of the SDGs. 11 out of 17 goals contain targets and indicators that are relevant to migration or mobility, especially SDG 1 “No poverty”, SDG 8 “Decent Work and Economic Growth”, and SDG 10 “Reduced inequalities”, for which migrant workers play an important role as stressed by the speakers of this session.



Migrants make an important contribution to development both in countries of origin and in destination countries. The most tangible outcomes of migration are the remittances that migrants send back to their relatives in origin countries. Participants highlighted that the importance of the flows of remittances have exceeded the foreign direct investments flows to low and middle-income countries. As a matter of fact, a speaker stressed that, inflows from Egyptian workers abroad make a major portion of Egypt's GDP (currently just above 10%) and have sustained the national economy, especially when tourism dropped as a source of foreign exchange. In this

regard, remittances are mainly contributing to poverty alleviation and inequality reduction and are essentially spent on consumption but also on education and healthcare. However, participants of the session pointed out the high cost of transferring remittances through official channels (banking system) and encourage Central Banks to take up this issue.

In destination countries, migrants play a decisive role in mitigating the negative impacts of demographic changes on the labour market. Indeed, a speaker mentioned that, in Europe, immigrants represented 92% of the increase in the labour force over the past decade. As Europe is now living demographic changes, the ageing of its population in Europe and its socioeconomic consequences with perspectives of population decline by 2030, skilled migrants are called upon to fill gaps in the labour market.

Against this background, experts were invited to assess the migration policies implemented by the EU over the last years. They noted a shift of narrative in 2011 when migration ceased to be treated as a horizontal socioeconomic issue to become a humanitarian one. However, the current policies are the product of another shift which took place in 2015 with the securitization of EU migration policies, pushed by the promoters of identity politics. Consequently, legal migration has been increasingly disappearing in all the references of the EU agenda on migration. This has given way to restrictive migration policies, illustrated by major and increased funding primarily directed towards border management in the proposals for the European multiannual financial framework (2021-2027). However, all participants agreed that focusing on management of migration and the prevention of irregular flows was a myopic vision missing out a large opportunity.

Indeed, the numbers provided by the panellists dismissed the idea that the EU is a besieged fortress. A speaker stressed that the potential flows of migrants from Southern Mediterranean countries is relatively low, while adding that the bulk of the total flows remains largely South-South. For

instance, it was mentioned that, between 2004 and 2014, 40.000 Tunisians on average migrated to the EU, while most of Tunisian migrants settled in Libya. Therefore, they insisted that, despite the current trends in EU politics, there was no need to sound alarms.

Rather, the panellists highlighted the need for the EU to offer more legal pathways for labour migration. In this regard, the mobility partnerships signed by the EU with Morocco (2013), Tunisia (2014) and Jordan (2014), aimed at facilitating mobility but discouraging irregular migration, were a first step in that direction. However, the negotiations proved difficult and their results fell short of the expectations of the Southern Neighbourhood partners. Participants also considered unsustainable to continue to derogate migration management to the EU while it has little concrete incentives (especially visas) to offer to partners countries. Moreover, the latter's concerns regarding the brain drain phenomenon were not addressed in the cases of Morocco and



Pablo Hernández de Cos, Governor of Banco de España, and Carlos da Silva Costa, Governor of Banco de Portugal

Tunisia. On the contrary, the EU-Jordan Mobility Partnership specifically referred to the need to prevent and manage the “brain drain” phenomenon, notably through the promotion of circular migration, a concept relatively appealing for both the EU and its Southern Neighbours.

In this regard, a participant suggested to upgrade these partnerships in the form of skills mobility partnership which can help improve skills matching and fill the gap between low skilled (seasonal) and high

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skilled legal migration channels that the EU is currently experiencing. It was thought as a mutually benefiting way to share the burden in terms of skills development, increase the recognition of these skills, while meeting the needs in terms of supply and demand.

Panellists also called for enhanced political dialogues on the issue of migration in the Mediterranean region that would be less unilateral while adopting an integrated approach between migration and related issues such as trade and labour market. They urged to replace the developmental approach at the centre of the EU migration policies. In this regard, the EU Trust Fund for Africa (2015) has been a major innovation of the EU in this field, with a focus on addressing the root causes of irregular migrations. However, a speaker regretted that it has not changed the nature of cooperation, mainly unilateral, but only its scale and procedures.

## Closing and Conclusions

The 5<sup>th</sup> Conference of Mediterranean Central Banks entitled “Financial integration and inclusive development: a view from the Mediterranean countries” provided an opportunity to analyse the challenges related to financial inclusion, education and integration, and their contribution to sustainable development goals, including inclusive growth and reduced inequalities. Best policies and practices, opportunities for dialogue and cooperation, and national successful experiences were highlighted by the participants throughout the conference with the aim to develop knowledge of the regional challenges and expand the range of policy tools to tackle them.

During the first session, Governors of Central Banks discussed the emergence of fintech solutions which offer promising perspectives for reducing financial exclusion (mainly through enhanced access and low cost). They stressed the risks and obstacles preventing digital technologies to become major tools to enable a greater financial inclusion in Mediterranean countries. Among them, they cited the lack of trust in fintech as a result of a lack of safeguards and transparency related to the use of personal data and emphasized the need to improve regulation and oversight of these innovations to guarantee the consumers’ rights.

The lack of financial literacy was identified as the main factor which could hamper the contribution of fintech to financial inclusion. Session 3 was dedicated to this issue, highlighting the importance of financial education in tackling social inequalities and fostering inclusive growth. Best practices such as the design of national strategies for financial education, ways through which partner with private financial entities were explored with experts sharing important policy recommendations. While financial education is the prerequisite for a good and effective use of fintech innovations, the contribution of digitalisation to financial education delivery was in turn acknowledged by the participants. They called for more cooperation among public and private financial stakeholders and with the fintech sector to work together to harness the potential of digitalisation for inclusive growth.

Financial integration has brought unquestionable benefits to our Mediterranean economies (efficient capital allocation, better governance, higher growth and investment). However, volatile capital flows, and spillovers from monetary policy actions and global shocks accompanying this increasing financially interconnected world are highly challenging for Central Banks. However, participants gave valuable insights on these policy challenges, advocating for building strong economic fundamentals, sound policy frameworks and above all for an enhanced multilateral cooperation that would promote transparency, dialogue and mutual knowledge of the different monetary policies in the region. In that sense, the OECD Code of Liberalisation of Capital Movements is an important tool for cooperation and achieving domestic reforms for financial stability.

Finally, the contribution of migration to sustainable development should be widely acknowledged. This calls for a review of migration policies focusing mainly on border management and for more legal pathways facilitating labour migration in the region. Participants advocated the promotion of skills mobility partnerships and circular migration as mutually beneficial ways to tackle the issue from a developmental approach. The contribution of migration to sustainable development should also be maximised lowering the cost of transfer of remittances.



Senén Florensa, President of the Executive Committee of the IEMed, during the closing session.

This new edition hosted by Banco de España in Madrid proved once again the utility and the relevance of such a rendez-vous gathering Governors of Mediterranean Central Banks, as well as experts from the OECD, think tanks and practitioners. It demonstrated that actors are eager to engage in fruitful exchange of views and dialogue which are contributing to a better understanding between financial Euro-Mediterranean partners for the development, prosperity and well-being of the people of the Mediterranean region.

