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Digital Financial Inclusion and the Informal Sector: A Review Study

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Abstract

Digital financial inclusion (DFI) has emerged as a critical tool for promoting economic growth, reducing poverty, and fostering inclusive development. The informal sector, which constitutes a significant portion of the global economy, often remains excluded from formal financial systems. This paper reviews the existing literature on digital financial inclusion and its impact on the informal sector. It explores the barriers to financial inclusion, the role of digital technologies in bridging the gap, and the potential benefits and challenges associated with DFI in the informal sector. The study concludes with policy recommendations to enhance digital financial inclusion for informal sector participants.

1. Introduction

The informal sector, characterized by unregistered businesses, casual labor, and lack of formal contracts, plays a crucial role in the economies of many developing countries. According to the International Labour Organization (ILO), the informal sector accounts for over 60% of global employment and contributes significantly to GDP in many low- and middle-income countries (ILO, 2018). Despite its economic importance, the informal sector often faces significant barriers to accessing formal financial services, such as credit, savings, insurance, and payment systems. This exclusion limits the sector's potential for growth and perpetuates poverty and inequality. Digital financial inclusion (DFI) refers to the use of digital technologies to provide affordable and accessible financial services to underserved populations. DFI has the potential to bridge the gap between the informal sector and formal financial systems, enabling informal sector participants to access financial services that were previously out of reach. This paper reviews the existing literature on DFI and its impact on the informal sector, focusing on the barriers to inclusion, the role of digital technologies, and the potential benefits and challenges associated with DFI.

2. Barriers to Financial Inclusion in the Informal Sector

Lack of Formal Identification

One of the primary barriers to financial inclusion for informal sector participants is the lack of formal identification. Many informal workers and businesses operate without official registration or documentation, making it difficult for them to open bank accounts or access credit. According to the World Bank, approximately 1 billion people worldwide lack formal identification, with a significant proportion of these individuals working in the informal