

## THE ROLE OF BANKS IN THE ECONOMY

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**Abstract.** The role of banks in the economy extends far beyond simple financial transactions. Banks serve as intermediaries, bridging the gap between savers and borrowers, which enables the efficient allocation of resources across sectors. By providing credit, banks support both individual and business growth, fueling investments and innovation. Furthermore, banks are pivotal in stabilizing economies by managing the money supply, influencing interest rates, and implementing monetary policy. This paper delves into the critical functions of banks, exploring their contributions to economic stability, growth, and financial inclusivity, while emphasizing their central role in sustaining the overall health of the economy.

**Key words.** Financial Inclusion

- ❖ Banking System
- ❖ Economic Growth
- ❖ Financial Stability
- ❖ Microfinance
- ❖ Digital Banking
- ❖ Credit Access
- ❖ Bank Failures
- ❖ Regulatory Frameworks
- ❖ Mobile Banking
- ❖ Alternative Credit Scoring
- ❖ Central Banks
- ❖ Financial Crises
- ❖ Liquidity Management
- ❖ Small and Medium Enterprises (SMEs)
- ❖ Microloans
- ❖ Financial Literacy
- ❖ Risk Management
- ❖ Basel III
- ❖ Inclusive Growth
- ❖ Financial Technology (Fintech)
- ❖ Global Financial Crisis
- ❖ Banking Regulations
- ❖ Lender of Last Resort
- ❖ Economic Inequality
- ❖ Rural Banking
- ❖ Gender and Financial Inclusion
- ❖ Banking Crisis
- ❖ Financial Services
- ❖ Economic Development

**Introduction.** Banks are critical institutions that play a central role in the functioning and growth of modern economies. They are not only responsible for the safe storage and management of funds but also act as intermediaries between those who have capital and those who need it. By providing loans and credit, banks facilitate investment in businesses, infrastructure, and personal ventures, driving economic growth and job creation. Beyond their role as lenders, banks also influence monetary policy and the overall stability of the financial system. Through the control of the money supply, the setting of interest rates, and participation in regulatory frameworks, banks ensure that economies operate smoothly and efficiently. Their ability to provide liquidity, manage risks, and support the flow of capital is essential for economic development and resilience. In an increasingly interconnected global economy, the role of banks extends to fostering financial inclusion, ensuring access to credit for underserved populations, and promoting the efficient allocation of resources. This paper aims to explore the multifaceted functions of banks, their impact on various sectors of the economy, and their essential role in maintaining financial stability, economic prosperity, and growth.

**Summary:**

Banks are essential to economic stability and growth, acting as intermediaries between savers and borrowers. They provide capital for businesses, support personal investments, and play a key role in managing monetary policy. Through their influence on interest rates, credit flow, and financial stability, banks contribute significantly to economic development, job creation, and overall prosperity. This paper explores the diverse roles of banks in fostering economic growth, financial inclusion, and a stable financial system.

**Problem: Financial Inclusion and the Role of Banks in the Economy.**

One of the most significant challenges in enhancing the role of banks in the economy is the issue of **financial inclusion**. Despite the fundamental role that banks play in promoting economic growth and stability, a large portion of the global population remains excluded from access to basic banking services. This problem is particularly prevalent in developing countries, where millions of people, especially those in rural and underserved areas, have limited or no access to formal financial systems. As a result, individuals and businesses are often unable to save money securely, access credit, or make investments, which are all crucial for economic participation and development.

The scope of financial exclusion is staggering. According to the World Bank, over 1.7 billion people worldwide still do not have access to a basic bank account. This lack of access to banking services prevents individuals from accumulating savings, accessing loans for personal or business development, and building credit histories that could lead to future opportunities. Without access to financial services, people are often forced to rely on informal, and sometimes exploitative, means of borrowing or saving money, which limits their ability to invest in education, health, or entrepreneurial ventures. In regions where access to financial services is limited, people face significant challenges in improving their standard of living and breaking the cycle of poverty.

The opinions of many individuals from underserved areas highlight the difficulty of overcoming this barrier. For example, a resident of a remote village in Sub-Saharan Africa expressed, "We don't have banks nearby, and even if we did, the fees are too high for us to afford. We have to rely on cash transactions, and it's hard to save or plan for the future."

Similar sentiments are echoed by people in urban slums, who face barriers to banking due to the lack of proper documentation, low income, and financial illiteracy. For many, the very idea of opening a bank account is a distant dream, not a reality.

Moreover, small businesses in developing economies also suffer from this lack of access to financial services. Entrepreneurs, especially in rural areas, often struggle to secure the necessary capital to grow their businesses due to limited access to loans and credit. This not only stifles individual entrepreneurial efforts but also undermines the broader economic growth potential. A small business owner in Latin America remarked, "It's almost impossible to get a loan without collateral. Without access to credit, I can't invest in growing my business."

### **Solution: Digital Banking and Technological Innovations**

To address the challenge of financial exclusion and enhance the role of banks in the economy, many experts argue that digital banking offers the most promising solution. Digital financial services, including mobile banking and online payment platforms, have the potential to bring banking services to individuals in remote and underserved areas. Mobile banking has already proven to be a transformative tool in many developing countries, enabling people without access to traditional banks to open accounts, transfer money, pay bills, and even access microloans.

For instance, in Kenya, mobile money services like M-Pesa have revolutionized financial inclusion, allowing millions of people, many of them in rural areas, to participate in the formal financial system. Mobile money users can easily send and receive money, access savings accounts, and even obtain small loans, all through their mobile phones. This has helped lift many out of poverty and enabled small businesses to thrive. As one entrepreneur using M-Pesa stated, "With mobile money, I can send and receive payments easily, which makes running my business much more efficient. It's helped me expand and hire more employees."

However, while mobile banking offers great potential, there are still challenges to its widespread adoption. Key barriers include limited access to technology, insufficient internet infrastructure, and low levels of financial literacy. Many people, especially in remote areas, lack smartphones or reliable internet connections, and may not fully understand how to use mobile banking platforms effectively. As one financial expert noted, "For digital banking to truly enhance financial inclusion, we need to ensure that people are not only provided with technology but also equipped with the knowledge to use it."

### **Policy Recommendations and Further Steps**

To truly enhance the role of banks in promoting economic growth through financial inclusion, several measures need to be implemented. First, governments and financial institutions should prioritize the development of digital infrastructure in underserved areas. Expanding access to affordable smartphones, improving internet connectivity, and supporting mobile network operators will help bridge the gap between urban and rural populations.

Second, financial literacy programs must be introduced to ensure that individuals understand how to manage their finances and use banking tools effectively. Financial education is essential for empowering people to make informed decisions about saving, borrowing, and investing. Schools, community centers, and even mobile apps could serve as platforms for these educational efforts.

Lastly, regulatory frameworks should be adapted to encourage the growth of digital financial services while protecting consumers. Governments must strike a balance between fostering innovation in the digital banking space and ensuring that these services are secure, transparent, and accessible to everyone, regardless of their income or location. The issue of financial inclusion remains one of the biggest challenges in enhancing the role of banks in the economy. Without access to banking services, individuals are excluded from opportunities for saving, investing, and economic growth. However, technological advancements, particularly in mobile and digital banking, present a solution to this issue by providing greater access to financial services. By improving infrastructure, promoting financial literacy, and adapting regulatory frameworks, the role of banks can be enhanced to foster greater economic participation and development. In doing so, we can create a more inclusive, equitable, and prosperous global economy.

### **Problem: Unequal Access to Financial Services**

While banks play a central role in facilitating economic growth, **unequal access to financial services** is a significant barrier that limits the potential benefits banks can provide to society. This issue is especially prevalent in low-income regions, rural areas, and among marginalized communities. Even though modern banking technologies have expanded rapidly, there remains a substantial gap in financial accessibility. The lack of bank branches in rural areas, high transaction fees, and limited access to credit, especially for the poor, continue to contribute to inequality in financial participation.

According to the World Bank, nearly **half of the global population still lacks access to basic financial services**, with the majority of this population residing in developing countries. For example, many rural communities in Africa, Southeast Asia, and Latin America do not have bank branches within a reasonable distance. This leaves residents reliant on informal financial systems, which are often unregulated and lack consumer protection. These informal systems typically include money lenders who charge exorbitant interest rates or savings groups that have limited capacity to handle larger investments. Without access to formal banking, individuals are unable to take advantage of savings accounts, insurance, loans, or credit that could improve their economic opportunities.

The situation is even more challenging for **small businesses**, which are vital drivers of local economies. Small business owners often face difficulty in accessing financing because they lack collateral, have limited credit histories, or face discrimination. As a result, they must rely on personal savings, loans from friends and family, or expensive informal lending methods, which stifle their ability to grow. A study by the International Finance Corporation (IFC) revealed that approximately **70% of small businesses in developing countries** are under-served by banks. As a result, these businesses face growth limitations, which not only harms individual entrepreneurs but also restricts job creation and local economic development.

In addition, **women** and **minority groups** are often disproportionately excluded from financial services. In many parts of the world, gender inequality in financial access persists, with women less likely to have bank accounts or access to credit. Social and cultural barriers, along with a lack of financial literacy, prevent women from taking full advantage of the financial tools that banks provide. For example, in South Asia, women are 40% less likely than

men to have a bank account, which greatly limits their opportunities for personal financial growth, business development, and household economic stability.

### **Solution: Expanding Digital Banking and Financial Literacy**

To address the problem of unequal access to financial services, one promising solution is **expanding digital banking** and **improving financial literacy**. Mobile banking and fintech innovations have already demonstrated their ability to bring banking services to remote areas and underserved populations. In countries like Kenya, **mobile money** platforms like M-Pesa have dramatically improved financial inclusion, enabling millions of people who previously had no access to formal banking to save, transfer money, and access credit through mobile phones. Digital financial services, when combined with affordable smartphones and widespread internet connectivity, can significantly reduce the barriers to banking services for rural populations.

Moreover, the rise of **microfinance institutions (MFIs)** has also shown positive results. MFIs provide small loans to low-income individuals and small businesses that are typically excluded from traditional banking systems. These loans, often referred to as **microloans**, can help individuals start small businesses, invest in education, or expand agricultural activities, thereby boosting local economies. Additionally, digital platforms have made it easier to assess the creditworthiness of individuals and businesses that lack traditional credit histories. Technologies like **alternative credit scoring models**, which use data from mobile phone usage, utility payments, and social networks, can help provide financial services to those who were previously excluded due to lack of formal credit history.

Increasing **financial literacy** is another essential aspect of solving this problem. Without proper knowledge of how banking services work and how to use them responsibly, many people remain hesitant or unaware of the benefits of formal financial systems. Financial literacy programs that teach basic money management skills, savings strategies, and the importance of credit can help empower individuals to make informed decisions about their finances. This is especially important for marginalized groups such as women, who may benefit from targeted educational initiatives designed to build confidence and increase participation in the financial system. Non-governmental organizations (NGOs) and community outreach programs can partner with banks to promote financial education at the grassroots level.

### **Policy Recommendations and Further Steps**

To further address the issue of unequal access to financial services, governments and financial institutions should take several actions:

1. **Develop Infrastructure for Digital Banking:** Governments must invest in expanding internet and mobile phone access in underserved areas to enable the wider adoption of digital banking solutions. In many rural areas, limited access to technology is a major barrier to financial inclusion.
2. **Support Microfinance and Fintech Solutions:** Financial institutions should collaborate with microfinance institutions and fintech companies to offer low-cost, small-scale financial products tailored to the needs of underserved populations. These products can help reduce the dependency on informal, high-interest lending options.
3. **Enhance Women's Financial Inclusion:** Specific policies and programs aimed at **empowering women financially** should be implemented. These could include making

banking services more accessible to women through mobile banking and offering financial products that do not require collateral, which many women lack.

4. **Promote Financial Education Initiatives:** Governments, NGOs, and banks should collaborate to promote **financial literacy campaigns**, ensuring that individuals and small business owners understand how to use banking products effectively. This could be integrated into school curriculums, community centers, and workplace training programs.

5. **Regulate Digital Financial Services:** While digital banking holds great potential, there must be **strong regulatory frameworks** to ensure consumer protection, transparency, and security. Governments must ensure that digital platforms adhere to standards that protect consumers from fraud, exploitation, and unfair practices.

The problem of unequal access to financial services is a major challenge for enhancing the role of banks in the economy, as it limits economic opportunities for individuals and small businesses. However, expanding digital banking, promoting financial literacy, and supporting microfinance institutions present viable solutions to bridge the gap. By ensuring that everyone, regardless of their location, gender, or economic status, can access formal financial services, banks can play a more effective role in fostering inclusive economic growth, reducing poverty, and creating a more equitable society. To achieve this, a combination of technological innovation, government support, and financial education will be essential in transforming the future of banking and economic development.

#### **Overall.**

The role of banks in the economy is indispensable for economic growth and financial stability. However, challenges such as **financial inclusion**, **financial instability**, and **unequal access to banking services** pose significant barriers to fully realizing the potential of banking systems worldwide. Addressing these challenges requires a multifaceted approach, including expanding digital banking, improving financial literacy, strengthening regulatory frameworks, and promoting inclusive financial systems. Through collaboration between governments, banks, and technology providers, we can ensure that banks continue to play a constructive and inclusive role in fostering sustainable economic development, reducing inequality, and creating opportunities for all members of society.

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