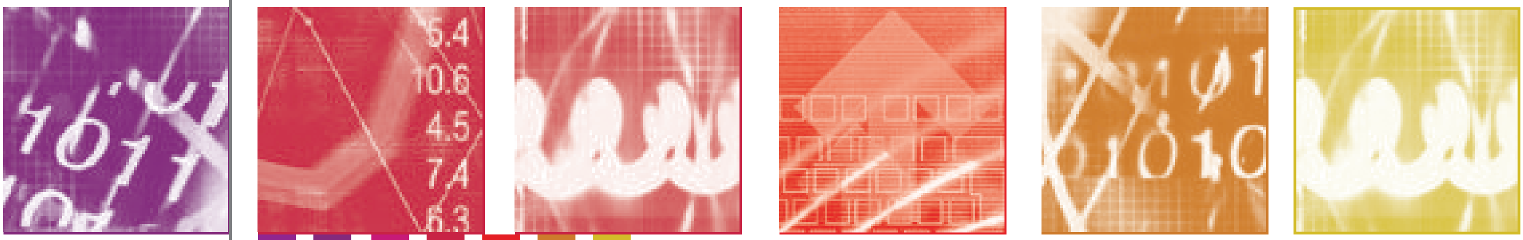

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APEC and Financial Exclusion: Missed opportunities for collective action

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APEC and Financial Exclusion: Missed opportunities for collective action

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LIST OF ACRONYMS

ADB	ASIAN Development bank
APEC	Asia-Pacific Economic Cooperation
BAAC	Bank for Agriculture and Agricultural Cooperatives
BRI	Bank Rakyat Indonesia
CU	Credit Union
EC	Economic Committee
GDP	Gross Domestic Product
MED	Micro-Enterprise Development
MFI	Microfinance Institution
NGO	Non-Government Organization
OECD	Organization for Economic Cooperation and Development
PRC	People’s Republic of China
ROSCA	Rotating Savings and Credit Association
SFI	Specialized Financial Institution
SME	Small and Medium Enterprises

KEYWORDS

APEC (Asia-Pacific Economic Cooperation)
Financial Exclusion
Microbanking
Microfinance
Microenterprise Development

ABSTRACT

APEC (the Asia-Pacific Economic Cooperation process) has quite recently recognized the phenomenon of ‘financial exclusion’ in its member economies, in consequence of a realization of the need to deal with the ‘losers’ in the globalization process, With leadership from Mexico in 2002. APEC considered the merits of ‘microbanking’ as a remedy for financial exclusion. With the developed economy members of APEC preferring to deal with financial exclusion as a ‘development’ issue, rather than as a general condition applicable to all APEC economies, APEC appears to have settled upon ‘microfinance’, rather than microbanking, as the solution to financial exclusion.

The paper examines issues of financial exclusion as a generalized problem applicable to all APEC economies. It notes that, in all APEC economies, significant population subgroups are excluded from access to the services of formal financial institutions. It argues that providing such access would bring economic benefits, both in terms of aggregate economic efficiency and in terms of interpersonal equity and equity between households. The paper examines the distinction between microbanking and microfinance, concluding that the latter is a subset of the former and primarily applicable to the developing economies, rather than representing a solution to the generalized problem of financial exclusion.

The paper then discusses the different forms that microfinance has taken in a wide range of institutional settings in developing economies within the APEC region. After this it examines ‘alternative financial service delivery systems’ that have developed in a representative ‘advanced’ APEC economy, Australia, and which are likely to have analogues in other such industrial economies in which financial exclusion persists.

This paper argues that Mexico made a promising beginning by introducing issues of microbanking and microenterprise development to the APEC agenda. Mexico secured the endorsement of the APEC Ministerial Meeting for a comprehensive statement of principles on microbanking development, regulation and supervision, which was paralleled by a comprehensive endorsement of microfinance as a measure for microenterprise development by the APEC Ministers responsible for SMEs. However, a lukewarm reception for the concept of financial exclusion by the advanced industrial member economies of APEC led to the issue becoming particularized as a ‘developing economy’ problem, rather than as a ‘whole-of-APEC’ concern.

Subsequently, in 2003, Thailand muddied the waters by focusing APEC’s attention on ‘specialized financial institutions’, representing these as a means by which financial exclusion, in a broad sense, might be remedied. This was a diversion designed to promote and validate meretricious policies of pump-priming through subsidized credit and politicized ‘policy’ lending. It had the effect of stopping the positive momentum of the Mexican push for the elimination of financial exclusion. It remains to be seen whether continuing efforts via the APEC SME Working Group process will suffice to keep the elimination of ‘financial exclusion’ alive as an issue within the APEC consultative process.

1. Introduction

Financial exclusion is a process which prevents poor and disadvantaged social groups from gaining access to the formal financial systems of their countries. This paper is concerned to examine the circumstances in which, quite recently due to the initiative of Mexico, the phenomenon of 'financial exclusion' has been recognized by the Asia-Pacific Economic Cooperation process (APEC). It will consider what potential lies within APEC to address the problems of financial exclusion affecting its diverse populations. It will discuss whether this potential may have been lost because developed member economies were not sufficiently concerned about their own domestic problems of financial exclusion to give wholehearted support to collective discussion of the issues. And it will describe how a developing member economy, Thailand, appears to have prejudiced the future constructive discussion of financial exclusion within APEC member economies.

APEC is an intergovernmental grouping established in 1989 to facilitate economic growth, trade and investment, and capacity- and community-building, in the Asia-Pacific region. It has 21 'member economies' located on and within the Pacific Rim. These account for more than a third of the world's population, over 50% of world GDP and some 41% of world trade. The member economies cover a wide span of development, ranging from transitional economies such as Vietnam (GDP per capita of around $420[1]) to developing market economies in Asia such as Indonesia (GDP per capita $810) and Thailand ($1,990), to developing market economies in Latin America, such as Chile ($4,400), to advanced market economies such as Japan ($31,400) and the United States ($36,400)[2].

Central to achieving APEC's vision are the so-called 'Bogor Goals' of free and open trade and investment in the Asia-Pacific region. However APEC is a multi-faceted process. The member economies engage in policy coordination and cooperative activities at the official and ministerial levels in a wide range of sectors, from environment to telecommunications and from fisheries to financial systems. These wide-ranging APEC activities are conducted in many fora, including working groups and committees composed of officials and representatives of industry, academia and civil society. In this respect APEC resembles OECD, the Organization for Economic Cooperation and Development. However, (as noted above) APEC embraces developed, developing and transition economies, whereas the OECD is a grouping of advanced industrial nations.

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[1] GDP per capita and other economic indicators for the APEC member economies are available at http://www.apecsec.org.sg/apec/member_economies/key_economic_indicators.html.

[2] A classification of the APEC economies for the purpose of this paper, focusing on aspects of financial sector development, is as follows:

a) Developing market economies

Brunei Darussalam, Indonesia, Malaysia, Papua New Guinea, Philippines, Thailand, Mexico, Peru, Chile.

b) Transitional (developing) economies

People's Republic of China, Vietnam, Russia.

c) Developed market economies

Japan, Republic of Korea, Canada, Australia, New Zealand, Hong Kong China, Chinese Taipei, Singapore, United States.

The outcomes of APEC's sectoral fora are reported to one or another of the APEC ministerial meetings conducted towards the end of each calendar year. In turn, the deliberations of these sectoral ministerial meetings are reported to the primary APEC deliberative body. This is the annual APEC Ministerial Meeting, attended by Foreign and Economic or Trade Ministers. The cycle culminates in an annual 'headline' event, the 'Leaders' Meeting', which is a quasi-summit of the APEC membership[3]. This paper draws upon recent work relevant to financial exclusion conducted by a number of APEC sectoral working groups and committees. In particular it is based on the deliberations of the APEC Economic Committee (EC) and the APEC Small and Medium Enterprise (SME) Working Group[4].

2. APEC, 'shared prosperity', microbanking and microfinance

In 2001, meeting in Shanghai, the APEC Leaders expressed concern to achieve 'shared prosperity' in the face of the pressures of globalization. This was to be coupled with attention to the problems of microenterprise, which was seen as providing livelihoods to the majority of the populations of the poorer APEC member economies. Then, during 2002, APEC turned its attention specifically to issues of financial exclusion, as means to achieve greater economic efficiency and equity in the Asia-Pacific region. Under President Vicente Fox, Mexico pressed for APEC governments to give more attention to microenterprise development (MED), to increase economic participation by the poor and to provide social safety nets for those displaced by globalisation. APEC's interest in MED has been parallelled by attention to the provision of financial services tailored to the needs of microenterprises and low-income people, known as 'microbanking'. This again was a Mexican initiative.

During 2002 a number of APEC committees and working groups studied microenterprise development (MED) and microbanking or microfinance, while several conferences and symposia also considered the issues. Microbanking was pursued through the Economic Committee process, while MED and microfinance both received attention in work directed by Ministers responsible for SMEs and for Women. The Economic Committee produced a comprehensive study of the requirements for microbanking development, regulation and supervision in the Asia-Pacific region[5], which was endorsed by the 2002 APEC Ministerial Meeting. The study adopted 'financial exclusion' as an analytical

[3] APEC eschews the term 'summit' because of political sensitivities, since not all APEC members are independent states. Thus APEC is the first, and so far the only, international forum which seats Chinese Taipei and Hong Kong at the same table as the PRC. This sensitivity also explains the use of the term 'member economies' instead of 'governments' to describe participants, and 'Leaders' Meeting' rather than 'heads of government meeting' to describe the annual quasi-summit.

[4] Information on the complex set of activities in the annual APEC working cycle is available on the site of the APEC Secretariat at www.apec.org/apec/enewsletter/march_vol2/publication.primarycontentparagraph.0001.LinkURL.Download.ver5.1.9

[5] See *2002 APEC Economic Outlook,* chapter 2, 'Microbanking Development, Regulation and Supervision in the APEC Region', posted at www.apecsec.org.sg/download/pubs/EC2002_Chap2_MicroBankDevRegNSupn.pdf

principle, and defined microbanking broadly as consisting of ‘the provision of small-scale financial services, such as credit, savings, insurance and remittance services, that are targeted towards low-income segments of the population and micro-enterprises’.

However, in regard to the financing needs of microenterprises, the SME Ministerial Meeting in 2002 saw the solution not in microbanking, but in microfinance. The SME Ministers stated that:

> ‘Ministers recognized the importance of micro-finance as a sustainable development tool for micro-enterprises…..[and] welcomed the recommendations to (1) develop an appropriate risk based regulatory framework for the commercial microfinance industry; (2) incentivize banks and financial institutions to enter the business of microfinance; (3) provide incentives, training and rewards to commercial institutions that demonstrate excellent performance; (4) limit microfinance subsidies to activities that disseminate information, develop financial tools, and train managers and staff; (5) provide capacity-building initiatives for the most promising institutions entering the micro-financing market; (6) and share lessons across APEC regarding the transformation of non-governmental organizations to commercial microfinance institutions’.

This statement by SME Ministers is admirable in a number of respects, including its emphasis on the sustainability and professionalism of institutions. It sets out alternative paths to the creation of workable models for microfinance provision; these may arise either because orthodox financial institutions modify their operations so as to incorporate microfinance clients, or because voluntary agencies ‘scale up’ and professionalize their operations to achieve sustainability, perhaps becoming formal financial institutions in the process. However, the statement does not appear to be directed towards financial exclusion seen as a ‘whole-of-APEC’ issue. The choice of the term ‘microfinance’ rather than ‘microbanking’ and the description of the former as a ‘development’ tool, both appear significant. SME Ministers seemed intent upon quarantining the issue strictly within the borders of APEC’s developing economies.

At the conclusion of the process for 2002, on 27 October, the APEC Leaders also endorsed microfinance and MED. Their *Declaration* stated that:

> ‘We agreed that micro-financing is crucial for the expansion of micro-enterprises, and we praise efforts to develop and promote market-based micro-finance to assure micro and small businesses and entrepreneurs have access to capital. We agreed that government action should create an enabling policy environment and a legal and regulatory framework for the growth and expansion of sound and sustainable micro-financing intermediaries, fostering their gradual and full integration into the domestic financial system’[6].

From these statements by the APEC Leaders and by Ministers we can draw an important distinction. On the one hand, the Economic Committee report endorsed at the APEC Ministerial employed the generic term ‘microbanking’ to describe a range of financial service delivery options. These appear to have the potential to address ‘financial exclusion’, seen as a ‘whole-of-APEC’ problem. On the other hand, the statement from the SME Ministerial adopted the more narrow term ‘microfinance’, which (by implication at least) is seen as the solution to a developing economy problem. This approach, ‘partial’ rather than ‘whole-of-APEC’, seems to have won the day at the 2002 Leaders’ meeting, and was reflected in their Declaration. This was unfortunate, in my

[6] The full text is at http://www.apecsec.org.sg/virtualib/econlead/10th_Leaders_Declaration.html

view, because microbanking is the more inclusive concept and has the potential to address a failure of financial sector development common to *all* APEC economies.

3. The relevance of financial exclusion to APEC's economies

If financial exclusion is to be seen as relevant to all economies, it is necessary to frame the discussion in a manner which captures the diversity *within APEC*. One way of approaching this is to accept that in all APEC economies, whether 'developed' or 'developing', and whether market-based or transitional, there are population subgroups which are neither adequately served by formal financial systems, nor by conventional financial institutions, especially the banks. Thus in the wealthiest APEC economy, the Economic Committee's report on *Microbanking Development, Regulation and Supervision*[7] notes that 'the existence of 40 million Americans who are not using mainstream banking services led the Treasury Department to launch the program "First Accounts" in late 2001'. The report documents this program.

This failure of access occurs in developing member economies, where the informal or un-enumerated sector is of major importance as a source of livelihood for the poor and the household is the primary unit of both production and consumption. Considerations such as geographic isolation, low population density and gender also play a part in determining patterns of unequal access in economies where financial sector development is limited. Particular sectors, notably smallholder and peasant agriculture, with their associated post-harvest and off-farm economic activities, pose special challenges for financial service provision. A general problem in the developing member economies is the inability of many lower-income households to meet lenders' requirements for formal physical collateral[8].

Inequality of access occurs also in developed economies, where the forces of privatisation and rationalisation impelled by the internationalisation of finance have wrought massive structural changes in domestic financial markets. In some cases such restructuring has led to the withdrawal of conventional financial institutions from particular geographic areas or demographic categories. In other cases, increasing economic and social polarisation has caused conventional financial institutions to focus their services on 'high yield' market segments and to neglect others, such as low-income and otherwise disadvantaged households. Gender is a variable influencing access in developed member economies as well as in the less developed.

From the above it can be seen that in all economies there are households whose members, in consequence of 'financial exclusion', face obstacles in realising their economic and social potential. This is most commonly because their income levels and the quantum of their financial service needs are pitched substantially lower than those of the population groups which have access to formal financial services. This is not to say that the deprived subgroups are always minorities. Indeed they may be a majority by

[7] Referenced at footnote 3, above.

[8] Although as Hernando de Soto has shown, land tenure and land titling deficiencies often prevent the poor from collateralising assets they have accumulated.

number, though not by share of income, within their economies. In the least-developed economies formal financial institutions may serve only between 15 and 50 per cent of households.

Thus in regard to access to financial services there is a unifying feature, which enables us to bind together the concerns of all economies, developed and developing. In all cases, the economic unit which experiences least adequate access to financial services is the household. An important distinction exists, however, between the developing and developed economies. In the developing economies (including those in transition), households are disadvantaged both as units of production and consumption. Improved access to financial services has the potential to increase both efficiency in production and equity in consumption in those economies. In the developed member economies, households are disadvantaged primarily in their role as units of consumption, given their very limited importance in production. In the developed economies the benefits of improvements in access are primarily in terms of interpersonal and inter-household equity.

4. The contribution of microbanking and MED to economic efficiency

In all economies, developed as well as developing, microbanking can contribute to the process of financial deepening, which is an important concomitant of economic development. There is real significance for financial sector development in the extension of savings facilities to millions of poor householders. This is true no matter how small the mean balance of their accounts. The poor, especially in the developing economies, can demonstrate a surprisingly high propensity to save. This is particularly true if they have access to safe, liquid, deposit facilities bearing positive real rates of interest. Extension of financial services to the poor, especially deposit-taking, lays the foundation for a cumulative process of financial deepening.

A second important contribution to economic efficiency relates to the developing economies and concerns their competitiveness in international trade. Microenterprises in these economies are, as previously discussed, mainly household-based and are the most numerous units of production as well as the largest source of employment. It is true that microenterprises, especially the typical 'survival' enterprises of the poor, make little direct contribution to exports. However in some economies, for example Chinese Taipei, there are well established supply-chain relationships in export industries which reach down into the household-based microenterprise sector. Lower wage rates paid in that sector can be a factor in the international competitiveness of industries where such relationships prevail.

The most important (if indirect) contribution to export promotion of microenterprises consists in their capacity to supply wage-goods and services to the industrial workforce. For developing economies to exploit comparative advantage in manufacturing based on low labour costs, it is necessary for workers to have access to low cost wage-goods and (particularly) services. It is the comparative advantage of microenterprise to produce such goods and services, which can form a substantial proportion of the consumption-basket of manufacturing workers. This is especially the case where workers in export-oriented manufacturing are employed away from their homes and families. In such circumstances, microenterprises spring up to serve the needs of an industrial workforce. Street stalls supply food and drink, while other microentrepreneurs offer ‘homestay’ accommodation, minibus transport, outdoor haircuts, tailoring and a host of other workers’ needs. Microbanking institutions can play an important role in increasing the productivity and profitability of such microenterprises, by funding the capital requirements of microentrepreneurs.

Microbanking institutions serving the needs of industrial workers can contribute to export competitiveness in other ways. By providing deposit services they can assist industrial workers to accumulate savings. And by providing funds transfer services, they can reduce the transaction costs of remittances to families. By increasing the net rewards of participation in the industrial workforce, such services tend to reduce wage pressures in export industry and thereby act to maintain its international competitiveness.

5. The contribution of microbanking and MED to distributional equity

The 2001 *Shanghai Declaration* of APEC Leaders, as we have seen, called for member economies to develop and strengthen ‘social safety nets’ to protect the vulnerable. This call reflected concern for ‘shared prosperity’ in the face of globalization. The introduction of microbanking and MED to APEC’s agenda reflects an assumption that these activities act to improve distributional equity within economies.

Firstly, microenterprise conducted at the household level provides income to poor and low-income people in the developing member economies. It is a mechanism which enables the benefits of economic growth to flow to poor and low-income people, and to facilitate their participation in that growth. Action to improve the productivity of microenterprises, including increasing their access to financial services, will have direct distributional benefits, because these enterprises are the major source of non-agricultural employment in developing APEC economies.

Microbanking could be regarded as trivial in financial terms, in the sense that the transactions of microbanking institutions would scarcely register in the consolidated balance sheets of the financial sectors of any APEC economy[9]. But microbanking transactions are significant in the lives of millions of people who are not served by formal financial institutions. Microbanking can assist the sharing of prosperity in developing economies by assisting poor households to meet both their consumption and production needs. In developed economies, microbanking and MED can raise the consumption levels of the financially excluded. And, in all economies, female-headed households are over-represented among the poor, and stand to gain disproportionately from access to microbanking services and MED opportunities.

Finally, support for microbanking and MED has the potential to ameliorate the impact of market-opening measures on those who might otherwise bear the brunt of the costs of adjustment. Such measures may result from multilateral trade negotiations through the WTO, or as the result of bilateral and/or regional trade agreements. In the case of the

[9] Indonesia, where a range of regulated financial institutions caters to the needs of a substantial proportion of lower-income people, is an exception to this generalisation.

APEC economies, such support for microbanking and microenterprise development could increase the political feasibility of moving towards the Bogor goals of free and open trade and investment. In the meantime, given the proliferation of less comprehensive 'free' trade agreements of a bilateral or regional nature, having access to financial services increases the capacity of low-income households and microenterprises to withstand the shocks of adjustment imposed by international trade treaty obligations.

6. Microbanking and microfinance

The distinction between microbanking and microfinance is important, and is discussed at length in this paper. In brief, however, one could say that microfinance is a subset of microbanking, and is more adapted to the circumstances of developing member economies. Microbanking on the other hand could be regarded as applicable to the circumstances of all member economies. For the developing member economies, microfinance is often proposed as the solution to the financial exclusion of households operating in the informal economy. It is certainly the most publicised, due to the many published accounts, both professional and popular, of the achievements of Grameen Bank and its founder, Dr Muhammed Yunus. The energetic advocacy of the 'Microcredit Summit' publicity machine has also increased popular awareness of microfinance.

For developing economies of the Asia-Pacific, it is appropriate to accept the specific definition of microfinance used in the Asian Development Bank's Microfinance Development Strategy for the region (ADB 2000, 1):

> 'Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their micro-enterprises'.

The Asian Development Bank's definition is a good deal more inclusive than those adopted by many microfinance practitioners, who would apply strict criteria for loan size and targeting of clients, excluding from consideration the supply of services to people who are merely 'low-income', rather than poor. However, for our purposes, it is appropriate to focus on the supply of financial services to the bottom half or two-thirds of the income ladder. This is so because all of the poor and most informal sector entrepreneurs are likely to be found there. Such a frame of reference enables the discussion to consider the achievements of such accomplished formal development financing institutions as BRI (Bank Rakyat Indonesia), BAAC (Thailand's Bank for Agriculture and Agricultural Cooperatives) and Banco del Estado (Chile) which finance the microenterprise sectors in their respective economies.

'Microfinance' encompasses access to savings and other financial services, as well as credit. The term has come into greater currency since the early 1990s and has largely (but not entirely) supplanted the term 'microcredit' in the professional literature. The latter term is now recognised as unfortunate because its use has focused attention on a single aspect of microfinancial services, lending to the poor, and diverted attention from the need to develop systems of financial intermediation in which the poor are involved.

Savings is often described, in a memorable phrase, as 'the forgotten half of rural finance' (Vogel 1984). Using the term 'microcredit' perpetuates this amnesia[10].

Microfinance Institutions (MFIs) are developing forms of 'microinsurance' to protect the vulnerable from misfortunes, such as ill-health, which can tip them over the edge into poverty. In addition, microfinance practitioners are working to introduce newer services, such as money transfers to facilitate remittances by migrant workers. These are valued by poor and low income workers and their families, given their high degree of spatial mobility (both domestically and internationally) and the difficulty and expense they experience in remitting funds.

7. Microfinance in APEC's developing member economies

There is great diversity among APEC member economies in the degree to which systems of microfinancing have emerged, in the institutional forms developed or adapted for them and in the policy and regulatory environments which shape those institutions. This account of patterns of development in the various microfinance sectors is designed primarily to give some indication of the diversity that exists. APEC economies are classified as 'developed', 'developing' and 'transitional', according to the schema outlined above (footnote 1) and a distinction is made between activities in Asia and Latin America.

(a) APEC developing market economies in Asia

Among the developing market economies in Asia there are considerable differences, both in the incidence of poverty, which might stimulate microenterprise development and microfinance initiatives as a response to disadvantage, and in the balance between private and public involvement in the process. For example, Malaysia and Thailand have considerably higher levels of per capita income than their APEC neighbours, Indonesia and the Philippines. In Malaysia in particular, absolute poverty was (at least until the financial crisis from 1997) regarded as a residual and diminishing problem which could be eliminated early in this current century.

The official Malaysian approach to microenterprise development, and to the provision of microfinancing services as an element in that process, has been essentially 'social-welfarist'. Microfinance services for households without access to conventional financial institutions have been seen within the framework of a redistributive social policy involving substantial subsidies. For the poorest Malays, the Government has nurtured a major MFI operated by an NGO, while the State agricultural bank has extensive rural outreach. For the off-farm microenterprise sector, another State institution, the Credit Guarantee Corporation, underwrites commercial bank lending to small- and microenterprises, down to the level of street hawkers.

In the case of Thailand, elements of subsidy (and implicit redistribution) have also been present in financial policy for lower income rural households. However, there are marked differences between Malaysia and Thailand in microfinance policy and practice. One such is that the voluntary or NGO sector of financial service provision is relatively

[10] In this context, the decision of the UN General Assembly to declare 2005 as the 'International Year of Microcredit' encourages the continued use of this unfortunate misnomer.

undeveloped in Thailand. Instead, a government agricultural bank has primary responsibility for microfinancing, and has become both an international leader in its field and an integral part of the Thai financial system.

There is a division of labour between financial institutions serving the MED and informal sectors. The State agricultural bank, BAAC, primarily serves small and medium farms, cooperatives, and associations (with the last two of these serving many of microentrepreneurs). The poor and landless are served mainly by informal finance and a few government programs and NGOs. Agricultural cooperatives and village-level credit unions also reach poorer segments of the rural population to some extent. More recently, politically-driven rotating credit funds have been established in most Thai villages, but it is not clear that their financial sustainability is an important objective. Recently, under the Thaksin government (from 2001) 'specialized financial institutions' have been employed as instruments for policy lending. This development is discussed below, in an APEC context.

Indonesia and the Philippines also provide some marked contrasts, both with one another and with Malaysia and Thailand. Indonesia has adopted a model of microfinance service provision based very largely on the operations of regulated financial institutions, whereas NGOs are of relatively limited significance. This is sometimes described as a 'rural financial systems' approach to household and microenterprise financing. The emergence of sustainable and effective models of microfinancing within the formal financial system, many of them privately owned and operated, has been more a by-product of Indonesia's efforts at financial sector development than of any conscious policy to stimulate microfinance, *per se*.

The 'Village Units' of BRI, the State agricultural bank, have acquired an international reputation for the effectiveness of their outreach to middle and low income households operating microenterprises in rural Indonesia. Indeed, the profitability and savings mobilization capacity of these Units kept Bank Rakyat as a whole afloat during the Asian financial crisis. Indonesia has also developed a range of small regulated financial institutions which serve the communities in which they are embedded effectively.

By contrast, Indonesia also provides some examples of mass 'microcredit' programs involving NGOs and other community organisations (especially in the late Suharto era) which were politically-driven and not at all concerned with financial sustainability. There is also a long history of ill-targeted and subsidised schemes of directed credit serving the SME sector.

Microfinancing in the Philippines has followed a more conventional course, based primarily on the energies of a burgeoning NGO community. The influence of Grameen Bank methods of service delivery has been very strong in that NGO community, and the Philippines also has a regulatory environment favorable to the operation of small regulated banks suitable for microfinance. The Philippine Government has explicitly incorporated microfinance into its poverty alleviation strategies, has encouraged NGOs to develop sustainable microfinance programs, and is beginning to promote the transformation of successful microfinance NGOs into regulated financial institutions.

In the Philippines there are three categories of MFI, each of which answers to a different regulator. These are rural and thrift banks, NGOs which provide microfinancial services, and credit unions or cooperatives. Of these three institutional types, the rural banks appear to deal with somewhat higher-income clients and to make larger loans than the microfinance NGOs. Many of the NGOs have adopted variants of the Grameen Bank model and, in general, group organisation of one sort or another is their most common mode of service delivery. The assets of these three types of MFIs were equivalent to only about four percent of the assets of the commercial banking system in 1996. However, the combined number of MFI offices, some 7,900 outlets, was more than twice the number of commercial bank offices.

Procedures exist for successful MFIs operated by NGOs to 'transform' themselves into regulated financial institutions. The government has established a 'second tier' financial institution specifically for the purpose of providing loanable funds for MFIs, as well as setting up capacity-building mechanisms for these institutions. The government has also acted to rationalise the proliferation of *ad hoc* credit schemes operated by line agencies of government, eliminating subsidies and ensuring that credit provision as part of targeted government programs becomes the sole preserve of regulated financial institutions.

Microfinance is in its infancy in Papua New Guinea, and indeed financial sector development in general has not proceeded very far by comparison with the other developing market economies of APEC. Variants of the Grameen model are being trialled in a number of centres, and the Asian Development Bank is supporting the creation of a second tier microfinance fund and capacity-building facilities for MFIs. There is a single small regulated financial institution[11], with as yet limited outreach, concerned to reach a low income clientele and to serve microentrepreneurs. The Savings and Loan movement is in a revival phase, as is the State agricultural development bank.

(b) APEC developing market economies in Latin America

I present here some generalisations about microfinance in Latin America, even though APEC's concern is with only three economies in the region, Mexico, Chile and Peru. However, there appear to be some commonalities in the regional microfinance culture, perhaps based on language and intraregional communication (the latter assisted by the activities of international agencies, especially the Inter-American Development bank, and umbrella bodies with affiliates throughout the region). And commonalities observable in Latin American microfinance provide some interesting contrasts with what is seen in Asian APEC economies.

In general, the focus of Latin American MFIs is on providing financial services to microenterprises as businesses, rather than on providing services to households of the poor. Loan sizes appear to be larger than in many parts of Asia, and the financing of agriculture and rural economic activities is relatively neglected in favour of servicing an urban clientele.

In a number of countries the commercialisation of microfinance has proceeded relatively far, although larger banks which entered the field have in many cases now withdrawn. Instead, commercialisation has occurred more due to the operations of small regulated financial institutions, with many MFIs established by NGOs and community groups transforming themselves into such institutions. The creation of enabling legislative

[11] Currently inactive, but seeking restoration of its banking license.

regimes in a number of countries has been a factor in this ‘transformation’ pattern of commercialisation.

Growth has been rapid in the regional microfinance sector. Over the period 1998-2001, according to one report, the sector grew at 25 to 30 per cent annually. With a loan portfolio of around $1.4 billion in 2000, the continuation of such growth would require as much money again for loanable funds in less than three years. Borrower numbers were estimated at around 1.5 million, while a similar number are served by credit unions. Historically, some credit unions appear to have been established more as conduits for external grant funds than as savings mobilising institutions. This reverses the normal CU priorities, and in fact deficiencies in savings mobilisation appear to be a general weakness of MFIs in the region.

(c) APEC Transitional economies

In the ‘transitional’ economies (China, Vietnam, Russia) there is a range of experience and some marked contrasts in terms of overall economic and financial sector development. The PRC offers a potentially enormous market for microfinance services, but effective financing for microenterprise development is hampered pending the resolution of major macroeconomic, fiscal and financial sector policy issues in the transition to a ‘socialist market economy’. In the meantime, interest rate controls remain a significant impediment to the emergence of sustainable microenterprise financing.

There are a small number of MFIs adapting the lessons of international microfinance experience to Chinese conditions, in association with bilateral agencies and under conditions agreed with central and local authorities. But the Chinese NGO sector operates within narrow confines and there is little official tolerance for unregulated financial service ‘experiments’. Without the official approval enjoyed by bilateral projects, MFIs would experience problems with their legal identity and institutional status.

The primary source of microcredit is government, which has adopted it as a poverty eradication tool. It is appropriate to call these programs ‘microcredit’ rather than ‘microfinance’ since there is no attempt to incorporate savings into the model. The official policy of providing microcredit primarily in backward, resource-poor regions, rather than in regions (including cities) where greater economic opportunity exists for microenterprise, is another impediment to its success. This, together with the substantial interest rate subsidies involved, reflects the fact that microcredit is seen as a social rather than a financial sector program. There is a need to allow local level financial institutions, including the Rural Credit Cooperatives, greater flexibility in setting interest rates for loans and deposits and to develop a range of bank and non-bank financial institutions (the latter including MFIs) engaged in microenterprise financing.

Vietnam is experiencing a difficult transition to financial liberalisation. It remains one of the poorest economies in the world. Among many elements in a poverty reduction strategy, the Government has focussed on the financial service needs of the poor, particularly in rural areas. Government efforts in the field have involved central bank regulation of interest rates, direction of the state banking system to provide subsidised credit to target groups and the creation of specialised financial institutions for the purpose. International agencies and NGOs have drawn the Government’s attention to the potential of microfinance to alleviate poverty and stimulate MED, and have supported a number of projects trialing imported microfinance models.

An autonomous NGO movement, as distinct from mass organisations set up by the State, is still substantially lacking The mass organisations are important agencies for the provision of credit under official schemes. All these developments have occurred while Vietnam has been moving to establish the institutional framework for a modern financial system and to introduce elements of liberalisation as possible and appropriate. The growth of outreach of State banks during the last few years is a notable feature of the Vietnamese financial system.

In the states which comprised the former Soviet Union, there was typically very little micro- and small enterprise, since the environment of the centrally-controlled economies was not conducive to their development. During the economic difficulties of the 1990s, income inequality increased in the Russian Federation, with some 35 per cent of population below the official poverty line at the end of that decade. These circumstances might be thought favourable to the flowering of informal sector and microenterprise activity, but the data suggest that less than 10 per cent of the labour force were employed in the micro (up to 10 workers) and small (up to 200 workers) enterprise sectors at that time. This does not, however, allow for underenumeration in the informal sector, where operators have good reason to remain unobtrusive.

Observers attribute the stunted development of microenterprise to a harsh legal and regulatory environment, to a repressive taxation regime, and to high transaction costs of operation. Under these circumstances, the issue of microenterprise financing is only one element in a complex web of problems. A cohesive approach to this complex of obstacles would be required to create an enabling environment for microenterprise development in Russia.

Internationally-supported efforts to establish microfinance in Russia commenced during the 1990s, and took one of two forms. One was ‘downscaling’. This was a process in which commercial banks were encouraged, in projects supported by the European Bank for Reconstruction and Development, to adapt their financial technologies to the service of lower-income customers. The second approach is described as ‘upscaling’, supported by bilateral development assistance and international NGOs. This requires the creation of grass-roots organisations to offer specialised savings and credit programs, with either group or individual client relationships (by contrast with which the downscaling efforts of the banks were strictly on an individual client basis). The financial crisis of 1998 set back all these efforts, with the systemic problems of Russian banking posing particular difficulty for the downscaling approach.

8. Microfinance and other financing alternatives in the developed economies

By employing the concept of ‘alternative financing mechanisms’ for the reduction of financial exclusion, among which microfinance is simply one possibility, we are able to extend the discussion beyond the informal sector in developing economies. This enables us to embrace, in addition, certain deficiencies of financial service provision in more developed economies. There is a wide range of alternative financial mechanisms, outside the conventional operations of commercial banks, which may be observed in these economies. Indeed the appropriate 'alternative mechanisms' may be a good deal more heterogeneous than those needed in the developing economies.

In this paper I confine myself to sketching some details of the situation in my own country, Australia. First, however, it is appropriate to discuss the status of microenterprise in developed APEC economies and to consider the reasons why conventional microfinance, as practiced in the developing economies, has not flourished in developed economies. Microenterprise in the developed industrial APEC economies is of relatively minor importance. The micro sector employs a small proportion of their workforces (for example the self-employed are only around a tenth of the male workforce in the US) whereas in developing economies a majority of workers may be in the sector. In the US, Canada or Australia, microenterprise suffers from the competition of large firms, whereas in developing economies there is marked segmentation of markets with the poor meeting most of their basic needs for services and commodities from informal sector sources. Industrial structure in Chinese Taipei is marked by the strength of its SME sector, with firms typically in complex supply chain relationships with one another and with large enterprise, while with economic growth microenterprise has become a diminishing residual.

Microenterprise methods of production and distribution often come into conflict with regulatory standards in developed economies, whereas in developing countries the regulatory environment is often more permissive, or at least more open to negotiation. And the existence of social safety nets in high income countries acts as a disincentive to engagement of the poor in microenterprise.

Attempts to apply microfinance principles in developed industrial economies encounter difficulties for a number of reasons. The poor have access to conventional sources of finance, notably credit cards. Group methods of organisation encounter particular difficulties in the urban industrial setting. The reasons for this have to do with trust, and with people's valuations of their own time (influenced in part by the availability of social welfare benefits). Also, the principal vehicle for asset-building in developing economies is incremental investment in home improvement, a process suited to microfinancing. But this is much more difficult in industrial economies where building codes and the commoditisation of housing impede incremental home improvement by owner-occupiers.

The universe of 'alternative financial service delivery systems' in developed member economies is substantial and diverse. Research conducted for the study of microbanking development, regulation and supervision by the APEC Economic committee in 2002[12] provided some information on the diversity of alternative financing mechanisms in operation. Much successful practice in alternative systems of financial service delivery is based upon local, sub-national, action by community groups and agencies and is not usually well-publicized. The best approach to our substantial information deficit in this area would be to commission studies, based on a sound analytical framework, of financial service delivery mechanisms in developed economies. As an example of a developed economy situation, I give below some information relating to my home country, Australia.

[12] See footnote 3, above.

9. Financial exclusion in Australia

A study conducted in Australia noted the withdrawal (or at least the distancing) of commercial banking services from particular geographic areas and social categories, compelled by forces of rationalisation and restructuring, discussed above in section 2. According to Connolly and Hajaj, '[t]he most basic, and the most important financial service for most Australians is the bank account. The provision of a bank account is essential for receiving pay and benefits and making and receiving payments. Having a bank account is no longer a mere convenience - it is a prerequisite for engaging in the economic process'[13].

According to these Australian researchers, the impacts are suffered by households and small business:

> ‘Less affluent communities which have lost banking services have tended to go into a steep decline which in due course touches almost every aspect of community life. This is not surprising in view of the significant manner in which Australian communities are geared through access to banking services. In many cases, ‘the bank’ acts as the main mechanism for attracting people to a given shopping locale. Over many years, other businesses have developed around a bank site, assuming that consumers would be attracted by the convenience of completing their financial transactions as well as their household shopping in the one place. The banks’ presence is critical for individual banking needs (and for the provision, through local knowledge, of the capital needed for business to grow and re-invest)'

Text box 1 contains a more detailed discussion of the consequences of 'financial exclusion' drawing on this Australian study. It details conclusions that would probably apply in other developed APEC economies, such as Canada, the US and New Zealand.

In Australia, there have been a number of responses, both governmental and community-based, to this removal of services. They include the establishment of ‘transaction centres’ for financial services in post offices, supermarkets and other places in communities from which the banks have departed. They include the emergence of ‘Community Banks’ in a growing number of towns and suburbs, facilitated by a ‘franchising’ operation in which a particular dynamic provincial bank (Bendigo Bank) offers citizen groups access to its banking license under a strict set of conditions as to capital commitment, community involvement and operational standards.

The responses also include initiatives by the Australian credit union movement to fill financial service gaps in some communities. The Australian credit unions are, quite apart from their responses to these more recent changes in the Australian financial landscape, an interesting and instructive study of alternative approaches, given their progressive modernisation and embrace of technology and their efforts to reach out to new communities, including Aboriginal people and migrants.

There is also some evidence of the reinvigoration of a nineteenth century social institution, the ‘Friendly Society’ as a base for providing access to financial services to the long-term unemployed and low income families. Efforts are being made to associate

[13] Connolly C & Hajaj K, Financial Services and Social Exclusion, Financial Services Consumer Policy Centre, University of New South Wales, Sydney, 2001. http://www.fscpc.org.au.

TEXT BOX 1: FINANCIAL EXCLUSION IN AUSTRALIA

Connolly and Hajaj have studied the consequences for households and communities of *financial exclusion*, defined as 'the processes that prevent poor and disadvantaged social groups from gaining access to the financial system'. They focused particularly on the effects of closure of bank branches and agencies.

Community consequences of financial exclusion:

In urban areas

- ♦ Increased travel requirements
- ♦ Higher incidence of crime
- ♦ General decline in investment
- ♦ Difficulties gaining access to credit
- ♦ Decreased choice in local shops and businesses, and
- ♦ Increased unemployment.

In regional and remote areas

- ♦ Financial drain from the community, as people travelled to larger centres to do their banking and shopping, with 88 per cent of respondents reporting that their expenditure locally had decreased
- ♦ Loss of financial investment, with 30 per cent of respondents indicating that the new financial environment had persuaded them not to proceed with undertaking a loan, and
- ♦ Loss of confidence in the community, with 90 per cent of respondents indicating they were now more pessimistic about the future of their community and 39 per cent reporting that they would leave if they could.

Business consequences of financial exclusion in urban areas

- ♦ General decline in passing trade
- ♦ Loss of access to middle class and higher income consumers
- ♦ Higher retail tenancy vacancy rates
- ♦ Less investment
- ♦ Difficulties in gaining access to banking staff with local knowledge – especially regarding lending
- ♦ Higher cash handling costs
- ♦ Higher insurance premiums, and
- ♦ Increased risk of crime.

In regional and remote areas

Consequences for small business seem to be exacerbated. Research suggests that small business were the first to feel the effects of any withdrawal of financial services. These consequences included:

- ♦ Increase in cheque cashing
- ♦ Loss of cash sales
- ♦ Accumulation of excess cash
- ♦ Delay in deposit of cheques; and
- ♦ Increase in bad debts.

Another study cited by Connolly and Hajaj added the following consequences:

- ♦ Increased security concerns due to the lack of secure facilities to deposit takings and the need to transport large amounts of cash to and from the nearest bank branches in an unsuitable vehicle such as a private car
- ♦ Difficulties in obtaining small change, and
- ♦ Farming businesses being particularly disadvantaged by the loss of bank staff with intimate knowledge and experience in rural banking.

Connolly and Hajaj cite British research findings that a lack of local knowledge among financial institutions can perpetuate a cycle of urban degeneration. They note also that loss of local knowledge is a significant issue in both urban and regional areas, as it tends to make financial institutions more cautious in local lending, falling back on 'national' lending models which may not be appropriate in the local area.

Source: Connolly C & Hajaj K, Financial Services and Social Exclusion, Financial Services Consumer Policy Centre, University of New South Wales, Sydney, 2001. http://www.fscpc.org.au**.**

friendly societies and credit unions with RoSCAs (rotating savings and credit associations) which operate along traditional lines among the recently-arrived in some migrant communities. Other initiatives are being taken by voluntary welfare agencies to free low-income earners (the 'working poor') who do not have access to bank credit from dependence on so-called 'payday lenders' who operate at the factory gate. Such schemes have often started as low- or no-interest lending, but experience has convinced some agencies to attempt a greater degree of cost-recovery.

It is obvious that most of the Australian microbanking services described above are directed to households rather than to enterprises, and to financing consumption rather than investment. This serves to remind us of an important difference, discussed in section 3, above. This is between the developed economies, in which there is usually a clear distinction between household and enterprise, and where relatively few enterprises are household-based, and the developing economies where, typically, the household *is* the enterprise.

10. Thailand's promotion of 'specialized financial institutions'

In 2003, Thailand became Chair of APEC and, among other initiatives, introduced the topic of 'specialized financial institutions' (SFIs) to the agenda of APEC's Economic Committee. SFIs were described as institutions underwritten by governments and designed to fulfill specific social purposes, filling gaps in financial service provision left unfilled by commercial entities. Thailand represented this theme as an extension of the positive initiatives taken by Mexico in 2002 to focus attention on financial exclusion in APEC economies.

In fact, APEC was used by Thailand to promote and validate its own financially-repressive policies of subsidized credit, debt moratoria and 'policy lending'[14]. These are associated with the 'pump-priming' policies of Prime Minister Thaksin and his broader economic policy agenda, which has become known as 'Thaksinomics'[15]. Thus the Thai study of SFIs published by the Economic Committee appeared to endorse their engagement in 'industry policy' despite APEC's commitment to trade liberalization. It endorsed SFIs that prop up protected industries on the pretext of their 'multi-functionality'. And it endorsed SFIs providing subsidized credit to low-income households and microenterprises despite negative implications for financial sector liberalization[16].

[14] See John Conroy, 'APEC and Specialized Financial Institutions: The influence of Thaksinomics', unpublished paper available from the author.

[15] See the semi-official Thaksinomics website at

http://www.thaksinomics.com/Elements_of_Thaksinomics.htm

[16] See the full report, chapter 2, 'Role and Development of Specialised Financial Institutions', in the *2003 APEC Economic Outlook* posted at:
www.apecsec.org.sg/apec/apec_groups/committees/economic_committee.downloadlinks.0004.LinkURL.Download.ver5.1.9

That APEC governments passed this report through the Economic Committee does not mean that they had committed themselves to such financially-repressive policies. Instead its passage represented an abuse of the APEC process from which most governments would politely have averted their eyes. It arose because of the institutional culture of APEC itself, which is reliant upon voluntarism, consensus and cooperation among member economies, and which is ill-equipped to protect itself from abuse of the process. In fact the developed economies (which were, as we have seen, already lukewarm on the subject of financial exclusion) largely abstained from any participation in the study of SFIs. It is not likely the subject will figure in APEC's deliberations again.

Unfortunately, the cost of Thailand's intervention in the process is likely to have been high. Any momentum Mexico had achieved within APEC for the promotion of policies to reduce financial exclusion may also have been lost. At the same time it is unclear how vigorously APEC will continue to pursue the related agenda for microenterprise development through the SME Working Group process under Chile as chair in 2004. On the other hand, it was heartening for those who support the development of cooperative working relationships among APEC economies to see that the SME Ministerial statement for 2003 explicitly endorsed microfinance as 'an instrument to reduce the "financial exclusion" often experienced by micro-enterprises in the APEC economies'. It was also a positive development when SME Ministers declared that '...there should be a clear policy framework and development plan for a micro-finance system in APEC economies where the need exists for the extension of the financial system to incorporate the financially excluded'. This represents the explicit admission of the concept and language of 'financial exclusion' into the APEC lexicon, and provides a basis for further progress should future APEC members be disposed to progress the issue in future.

11. Conclusion

After explaining the circumstances under which microbanking and MED issues were introduced into the APEC agenda over the period 2002-2003, this paper has argued the case for the continuing relevance of the concept of 'financial exclusion' to all of the APEC economies, whether advanced industrial, developing or transitional. It pointed to evidence that, in all APEC economies, significant population subgroups are excluded from access to the services of formal financial institutions. It argued that providing such access would bring economic benefits, both in terms of aggregate economic efficiency and in terms of interpersonal equity and equity between households. The paper examined the distinction between microbanking and microfinance, concluding that the latter is a subset of the former and primarily applicable to the developing economies, rather than representing a solution to the generalized problem of financial exclusion.

The paper then discussed the different forms that microfinance has taken in a wide range of institutional settings in developing economies within the APEC region. After this it examined 'alternative financial service delivery systems' that have developed in a representative 'advanced' APEC economy, Australia, and which are likely to have analogues in other such industrial economies in which financial exclusion persists.

This paper has argued that Mexico made a promising beginning by introducing issues of microbanking and microenterprise development to the APEC agenda. Mexico secured the endorsement of the APEC Ministerial Meeting for a comprehensive statement of principles on microbanking development, regulation and supervision, which was paralleled by a comprehensive endorsement of microfinance as a measure for microenterprise development by the APEC Ministers responsible for SMEs. However, a lukewarm reception for the concept of financial exclusion by the advanced industrial member economies of APEC led to the issue becoming particularized as a ‘developing economy’ problem, rather than as a ‘whole-of-APEC’ concern.

Subsequently, in 2003, Thailand muddied the waters by focusing APEC’s attention on ‘specialized financial institutions’, representing these as a means by which financial exclusion, in a broad sense, might be remedied. This was a diversion designed to promote and validate meretricious policies of pump-priming through subsidized credit and politicized ‘policy’ lending. It had the effect of stopping the positive momentum of the Mexican push for the elimination of financial exclusion. It remains to be seen whether continuing efforts via the APEC SME Working Group process will suffice to keep the elimination of ‘financial exclusion’ alive as an issue within the APEC consultative process.