

THE FOUNDATION FOR DEVELOPMENT COOPERATION



THE RELEVANCE OF MICROBANKING TO APEC

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Paper prepared for the
*2002 APEC Economic Committee Symposium
on Microbanking Development, Regulation and Supervision
in the Asia-Pacific Region*
Mexico City, 25-26 July 2002

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LIST OF ACRONYMS

APEC	Asia-Pacific Economic Cooperation
ECOTECH	Economic and Technical Cooperation
CTI	Committee on Trade and Investment
CU	Credit Union
GNP	Gross National Product
HLMME	High Level Meeting on Microenterprise
ICT	Information and Communications Technology
IT	Information Technology
MED	Microenterprise Development
MFI	Microfinance Institution
M3	A money supply measure
NAFTA	North American Free Trade Agreement
NGO	Non Governmental Organisation
RoSCA	Rotating Savings and Credit Association
SHG	Self-Help group
SME	Small and Medium Enterprise
SMEWG	SME Working Group
SOM	Senior Officials Meeting
TILF	Trade and Investment Liberalisation and Facilitation
WTO	World Trade Organisation

ABSTRACT

The 2001 Declaration of APEC Leaders reaffirmed their commitment to the Bogor goals of free and open trade and investment. It also canvassed issues of 'globalisation and shared prosperity' and the need for social safety nets to protect the vulnerable in a globalising world economy. The impression of a growing APEC interest in matters of distribution and equity was heightened by the Leaders' call for APEC to build on its plan of action for SMEs and to 'place special emphasis on microenterprises'.

Mexico is responding by hosting two international meetings in 2002. They are a Symposium on Microbanking, for the Economic Committee (July) and a High Level Meeting on Microenterprises (August). Not all economies are equally convinced that these topics are relevant, either to their own domestic concerns, or to their priorities for APEC. The challenge is for these two meetings to demonstrate the relevance of microbanking and microenterprise development for every member economy, and to show the need for a 'whole-of-APEC' response to issues of common concern.

This symposium defines microbanking quite broadly. It includes provision of financial services to microenterprises, but also to 'low-income segments of the population'. This includes individuals and households as well as enterprises. Institutions providing microbanking services include formal and informal entities, and regulated and unregulated ones. The definition covers the disparate circumstances of the full range of APEC economies. It provides an excellent basis for discovering issues of common concern.

'Financial exclusion' is the issue of common concern. In every APEC economy, some proportion of enterprises, households or individuals is excluded from access to financial services for a variety of reasons. This exclusion requires a response, and the process of overcoming financial exclusion can be given the generic label of 'microbanking'. In developing member economies, microfinance may be the form of microbanking offering most promise. In developed member economies, the appropriate solutions may be more heterogeneous.

Based on the definition of microbanking, the household, and not the individual or the microenterprise, is the most appropriate unit of analysis. Households may be both units of production and of consumption. In the developing economies they are both of these. The household-based microenterprise is the most numerous business entity and the greatest source of employment. Microbanking in such countries can raise the productivity of households as producers as well as increasing the welfare of households as consumers.

In the developed economies, microenterprise is insignificant and the household is predominantly a unit of consumption. There are household production units in developed economy agriculture, but these are highly capitalised enterprises, not microenterprises. Financial exclusion impacts negatively on the consumption of a proportion of households, and microbanking can improve their welfare as consumers. The paper includes a brief discussion of financial exclusion in Australia, to illustrate the applicability of microbanking in one developed economy.

APEC can take up issues of microbanking within its established process of ECOTECH (economic and technical cooperation). ECOTECH activities in the various working groups were, from 1990, the earliest expression of Asia-Pacific economic cooperation in pursuit of common goals. The ECOTECH process continues and has recorded some successes.

TILF negotiations (trade and investment liberalisation and facilitation) came to dominate the APEC process after the Bogor goals were agreed in 1994. But the economic crisis from 1997

demonstrated the need for continuing attention to the foundations of development, as well as exposing the limits of APEC's comparative advantage in negotiating further reductions in border barriers to trade. This paper argues that APEC's comparative advantage lies in its capacity for economic and technical cooperation, and that ECOTECH complements the TILF agenda. ECOTECH has moved to the heart of APEC, and TILF is not achievable without it.

Despite successes, ECOTECH suffers from flaws. There is a proliferation of ECOTECH projects (more than 300 of them). Many have been the 'pet' projects of particular member economies with limited engagement of other economies. While the overall ECOTECH program has been worthy, it has not achieved either visibility or impact. APEC has not succeeded in launching any ECOTECH project of sufficient scale and scope to capture the imagination of all Leaders and to catalyse substantial private investment.

APEC needs a 'landmark' ECOTECH project (or perhaps a small number of such projects) to dramatise the real potential of ECOTECH as a process. Microbanking could form a worthy element in such a landmark project, since it acts to improve economic efficiency in all economies. It also contributes to the 'sharing of prosperity' called for by the Leaders in Shanghai.

Microbanking's contribution to economic efficiency derives from its capacity to promote financial deepening, particularly in the developing APEC economies. Secondly, it promotes the export competitiveness of developing economies by supplying low cost wage-goods and services demanded by industrial workers, thus helping to keep labour costs low. It contributes to the sharing of prosperity in all economies by raising the consumption levels of financially excluded households. In developing economies it assists poor households to meet both their production and consumption needs. And in all economies it assists female-headed households.

The most important outcome of this symposium will be a strategy for promoting microbanking and microenterprise in APEC. The simplest option (the 'default option') would be an ECOTECH project to add to the 300 or so projects already commenced. But Mexico has higher goals for APEC than that. A more innovative approach would be to put microbanking/MED into a context provided by other recent ECOTECH goals announced by the Leaders. The outcome of the recent Merida dialogue on globalisation and shared prosperity is also helpful in defining that context.

APEC Leaders made their first specific and verifiable ECOTECH commitment at Brunei in 2000. This was a pledge to secure universal Internet access across the region by 2010, at least at the community level. At Shanghai in 2001, Leaders focussed on human capacity-building, with particular reference to the 'New Economy'. But the ECOTECH process has so far lacked continuity. It does not yet have procedures to assure that successive APEC Chairs progress the commitments steered through by their predecessors. Thus the Brunei IT pledge has not secured the necessary momentum to become 'mainstreamed' into the APEC process. Nor has the Shanghai human capacity-building agenda, although it has demonstrated a capacity to catalyse private sector investment.

This paper suggests that the microbanking symposium should call for an initiative at Los Cabos later this year. This initiative would bind the Leaders' commitments to IT access and human capacity-building together with a complementary program for microbanking and MED. This would become the landmark ECOTECH activity, and could give the necessary visibility, coherence and momentum to economic and technical cooperation within APEC. It could catalyse private sector resources and (while not itself an 'aid' program) would be complementary to bilateral and multilateral programs of development assistance, as well as addressing issues of common concern to all the APEC member economies.

THE RELEVANCE OF MICROBANKING TO APEC

1. Introduction

The 2001 Declaration of APEC Leaders reaffirmed their commitment to the Bogor goals (and drew a 'roadmap to Bogor' which takes into account issues of globalisation and the 'new economy') as well as committing to the opening of a new WTO round in Doha. Less conventionally (at least in terms of APEC's historic preoccupations) the Declaration includes an instruction to ministers and officials to 'build on APEC's Integrated Plan of Action for SMEs and place special emphasis on micro-enterprises'.

In placing issues of microenterprise development on the APEC agenda, the Leaders appeared to demonstrate an interest in 'development' in a more multidimensional sense than heretofore, and a new concern for issues of distribution and equity. This impression was reinforced by their call for member economies to develop and strengthen 'social safety nets' to protect the vulnerable and by the proposals to commence an APEC dialogue on 'globalisation and shared prosperity' and to conduct a Ministerial Meeting on Women in 2002.

By convening this international symposium on microbanking, Mexico is extending the Leaders' concerns for microenterprise development and 'shared prosperity' to a new field of economic policy. This is concerned with a particular form of financial sector development, the creation of 'microbanking' institutions.

A problem arising from the new focus on microenterprise development and microbanking is that some economies, particularly the most developed, may question its relevance, either to their own domestic concerns or to their priorities for APEC. To respond convincingly to any such misgivings it will be necessary to demonstrate a significance for microenterprise development and microbanking in every economy, and to show the need for a 'whole of APEC' response to issues of common concern¹.

A High Level Meeting on Microenterprise, to be convened in August at the initiative of Mexico, is also concerned with issues of financial services for microenterprise, although it ranges across a broader landscape than this microbanking symposium. The High Level Meeting is to consider issues of financial services for microenterprise, but also other matters such as capacity-building and regulatory frameworks relevant to the goal of developing a flourishing microenterprise sector. By contrast, this microbanking symposium is concerned with a more discrete issue.

We need to think about how the issues thrown up by the two meetings convened by Mexico in 2002, on microbanking and microenterprise respectively, relate to those of the Economic Committee and

¹ During the decade or more I have been associated with the Foundation for Development Cooperation, it has developed two primary streams of research and advocacy. The first, from 1991 to date, has been concerned with microfinance, from a financial sector development perspective. The second has been concerned with the economic and technical cooperation agenda of APEC. In this latter cause, the Foundation has convened a Policy Dialogue Group of independent observers of APEC periodically since 1995. This group has been consulted by successive SOM Chairs and has contributed to defining and advancing the ECOTECH agenda in a unique 'second track' process. The confluence of these two primary interests of the Foundation in 2002 was quite unexpected, but represents a welcome opportunity to synthesise our experiences in these hitherto unrelated fields. I am grateful to my colleagues Andrew Elek and Paul McGuire for commenting on sections of this paper.

the SME Working Group of APEC. It will be important for us to consider how these issues might be progressed most effectively within the APEC process, rather than dropping quietly out of sight after this year.

2. The microbanking initiative

The microbanking initiative with which this meeting is concerned is aimed at:

'a) Reviewing recent experiences of APEC member economies regarding the regulation and supervision of these financial activities, considering specifically how they have contributed to the development and strengthening of more sophisticated intermediaries.

'b) Analyzing complementary promotional policies and specific institutions or mechanisms devoted to support microbanking activities.

'c) Assessing the concrete effects of microbanking on the targeted beneficiaries, that is, the low-income population and micro-enterprises demanding its services.' (www.shcp.gob.mx/ec2000)

For the purposes of this initiative, microbanking is defined as

'an activity consisting in the provision of small-scale financial services, such as credit, savings, insurance, and remittance services, which are targeted towards low-income segments of the population and micro-enterprises. This activity can be undertaken by a broad array of intermediaries, ranging from non-governmental organizations (NGOs) to credit unions, thrifts, savings banks, commercial banks, state banks, etc.' (www.shcp.gob.mx/ec2000).

This definition is broad, encompassing financial services demanded by both microenterprises and 'low-income segments of the population'. Further, financial service providers defined as 'microbanks' include both formal regulated financial institutions and a range of registered and unregistered entities operated by voluntary or civil society organisations. The definition is crafted to cover the disparate circumstances of the full range of APEC member economies, from the most to the least developed. This is useful because it permits the issue to be generalised, and its relevance to all economies explored.

3. Generalising the microbanking issue for all APEC economies

If microbanking is to be seen as relevant to all economies, it is necessary to frame the discussion in a manner capturing 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 not adequately served by formal financial systems, nor by conventional financial institutions, especially the banks². This failure of service can be described as

² A classification of economies for the purpose of this paper, focussing on aspects of financial sector development as it relates to microfinance and microbanking, 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.

'financial exclusion' and the definition of microbanking clearly anticipates such situations. The concept of financial exclusion, observable to a greater or less degree in all APEC economies, provides a basis for generalising the issue of microbanking. Microbanking can be seen as a response to the common problem of financial exclusion.

Financial exclusion occurs in developing member economies, where the informal or unenumerated sector is of major importance as a source of livelihood for the poor. 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 people to meet lenders' requirements for formal physical collateral³.

Financial exclusion 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. Gender is a variable influencing access in developed member economies as well as in the less developed.

Thus in all APEC economies there are groups whose members, in consequence of this denial of service, 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 necessarily minorities. Indeed they may be a majority by number, though certainly not by share of income, within their economies. In the least-developed economies of APEC formal financial institutions may serve only between 25 and 50 per cent of populations.

Microbanking is a concept obviously applicable to developing country circumstances, but less obviously so in the depopulated farmlands of the Australian 'outback' or in blighted inner urban areas of the US. And what is described as 'micro' in the operations of the Vietnam Bank for the Poor differs enormously from the 'microcredit' operations of Women's World Banking, Japan, an NGO working with female microentrepreneurs in the latter country. But in each of the cases mentioned, Vietnam and Japan, outback Australia and inner city Chicago, attempts are being made to develop alternative, non-conventional, financial service delivery mechanisms for households without access.

In the developing member economies, 'microfinance' is a useful summary term to capture the variety of financial service mechanisms being developed to meet the needs of financially excluded households. 'Microfinance' (in its various manifestations) is the form of 'microbanking' most applicable in those economies. Annex 1 contains a brief description of the most common models of microfinance.

³ As Hernando de Soto has shown, land tenure and land titling deficiencies often prevent the poor from collateralising assets they have accumulated.

However 'microfinance' is an unhelpful term to apply in the circumstances of developed economies, for a host of reasons. These include the limited success of developing economy microfinance models when transposed to the setting of high income countries. Effective solutions to financial exclusion in developed economies are likely to be a good deal more heterogeneous than the various models of microfinance which prove successful in the developing economies of APEC.

4. The household as the basic unit of analysis

The definition of microbanking we have been given includes 'low-income segments of the population' among the clients of microbanks. I suggest this should be interpreted as referring to households. Households may serve dual roles as productive units and as units of consumption. In developing member economies, households are the primary units of both production and consumption. Households are the basis of the great majority of microenterprises in those economies, and microenterprise itself is the most common mode of productive activity. By contrast, while in the most developed APEC economies there are some household production units organised as microenterprises, microenterprise itself is not a significant element in their economic systems. Hence the principal economic function of the household in the developed economies is as a unit of consumption.

In this paper I argue that, in the developing member economies, the household and the microenterprise are one and the same and any distinction between household expenditures for production and consumption is problematic. Microbanking services are properly directed to satisfying both the production and consumption needs of the household. Microbanking services can improve the productivity of household enterprises while also increasing the welfare of households as consumption units.

The financial service needs of poor households are simple but their satisfaction can be life-enhancing. They need access to convenient, liquid and safe deposit services which are protected against inflation by positive real rates of interest. With savings in reserve, householders are able to smooth their consumption expenditures in the face of uncertain income streams. Savings provide a shield against catastrophic events which, by forcing the vulnerable to divest productive assets, would otherwise tip them over the dividing line between meagre sufficiency and poverty. Microinsurance is a related financial product with potentially profound welfare benefits. Similarly, poor households which make their living in a myriad of activities in the informal sectors of developing member economies, many of them either landless or with insufficient agricultural land, need access to credit to increase the productivity of their labour or to free them from exploitative financial relationships.

By contrast, microenterprise in the developed member economies is of quite limited significance; production is very largely external to the household. In these circumstances we should see the role of microbanking as being primarily to serve the consumption needs of households and the communities in which they live. In these developed economies, the relevance of microbanking to APEC's concerns is that it has the potential to contribute to 'shared prosperity' among households excluded from conventional financial services. And to the extent that this ameliorates the impact of market-opening measures in developed economies, on those who would otherwise bear a disproportionate share of their costs, microbanking could increase the political feasibility of moving towards the Bogor goal of free and open trade and investment.

5. Financial exclusion in a developed economy: Australia

I want to illustrate the general relevance of the concept of 'financial exclusion' by referring to the developed APEC economy with which I am most familiar. Australian researchers 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'. Connolly and Hajaj noted the withdrawal of commercial banking services from particular geographic areas and social categories, compelled by forces of rationalisation and restructuring, discussed above in section 3.

According to the researchers, '[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'⁴. According to these Australian researchers, the impacts of the withdrawal of services are suffered by households and small business (although there is no discussion of microenterprise, *per se*, in this study).

In Australia, there have been a number of responses, both governmental and community-based, to the removal of banking services and consequent financial exclusion. 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 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. They have undergone progressive modernisation and embraced technology, as well as reaching 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 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. The other developed member economies of APEC could no doubt provide similarly heterogeneous lists of popular initiatives to address problems of financial exclusion.

6. The mandate for microbanking's introduction into APEC

⁴ 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>

Mexico's advocacy of microbanking as an initiative for APEC 2002 responds directly to the Shanghai APEC Leaders' Declaration of October 2001. As mentioned above, the declaration emphasised development, distribution and equity, as well as introducing 'globalization and shared prosperity' to APEC's agenda. For the Leaders to affirm the importance of these issues was not to de-emphasise APEC's goals of free and open trade and investment, as agreed by the Leaders at Bogor in 1994. Instead, it recognised that APEC also has the explicit goal of narrowing the disparities between member economies in levels of development. This is not controversial; the Manila Declaration of 1996, which codified APEC's agenda for economic and technical cooperation (ECOTECH), was quite unambiguous on the subject.

The Manila Declaration also implied that the reduction of economic disparities *within* member economies is an appropriate goal of economic and technical cooperation. It stated that promoting 'the full participation of all men and women in the benefits of economic growth' is a 'guiding principle' of ECOTECH.

By placing microenterprise development on the agenda of APEC's Small and Medium Enterprise (SME) Working Group, APEC Leaders have given prominence to an issue that affects the lives of a majority of households in developing member economies (and at least some households in all economies). It reflects an appropriate response to the issues of 'globalization and shared prosperity' cited by the Leaders in Shanghai, and certainly has the potential to support the 'full participation of all men and women' called for in Manila. Mexico, as chair of the APEC process throughout 2002, has responded by adopting microenterprise development (and, associated with this, microbanking) as a major theme for APEC this year⁵.

Mexico has shown leadership in submitting an initiative on microbanking development, regulation and supervision to the APEC Economic Committee. By proposing to devote the 'structural' chapter of the 2002 APEC Economic Outlook to an examination of this subject, Mexico has placed issues of microbanking at the centre of an influential document presented annually to the Leaders. In doing so it has accepted the challenge to demonstrate the relevance of microbanking to the central economic agenda of APEC. This will require Mexico to consider issues of economic efficiency, in addition to the equity and distributive goals encapsulated in the term 'shared prosperity'.

7. Economic and technical cooperation in APEC

APEC can take up microbanking as an issue most appropriately as a new element in the 'economic and technical cooperation' (or ECOTECH) process. And just as some member economies may have reservations about the relevance of microbanking to their domestic concerns, some also may fear the neglect of APEC's supposed 'main game', the TILF (trade and investment liberalisation and facilitation) agenda. Any such apprehension is uncalled for.

Although TILF has dominated the APEC process for most of its short history, it is useful to be reminded by two champions of Asia-Pacific economic cooperation that 'APEC set out with the broad aim of sustaining the momentum of successful economic growth in East Asia and the Pacific'⁶.

⁵ However the SME Working group appears to regard 'microenterprise' as consisting of the smallest enterprises in the formal, trade-oriented, sector. The Working Group may not be sufficiently sensitive to the concerns of informal household-based enterprises. Definitional confusion may account for discrepancies in the reporting of data by particular economies. See Annex 2 for a discussion of this issue.

⁶ Andrew Elek and Hadi Soesastro (1999), 'ECOTECH at the heart of APEC: Capacity building in the Asia-Pacific region'. Brisbane, The Foundation for Development Cooperation, page 9.

Consistent with this 'broad aim', activities which have come to be known as ECOTECH were commenced from the very beginning. Thus, according to the inaugural SOM Chair:

When APEC was established in 1989, the process was expected to deal with far more than international trade and investment. By 1991, APEC working groups had commenced exchanging information, identifying shared interests and options for co-operative activities in ten aspects of economic development, ranging from human resource development to transport and telecommunications. The Committee on Trade and Investment (CTI) was not established until 1993.

However, following the Bogor commitment of APEC Leaders to the vision of free and open trade and investment by 2010/2020, promoting trade and investment liberalisation and facilitation (TILF) soon overshadowed other aspects of the APEC process. The Osaka Action Agenda relegated ECOTECH to the status of a separate, and somewhat secondary, endeavour of APEC.⁷

Nevertheless, policy-makers in some APEC economies, particularly developing ones, were determined to prevent the eclipse of ECOTECH. Thus in 1996, under Philippine leadership, the Leaders adopted the *Manila Declaration on an Asia Pacific Economic Cooperation Framework for Strengthening Economic Cooperation and Development*. According to the 1996 SOM Chair, the *Declaration* was a response to the need

to develop a clear conceptual framework which allowed economic cooperation and development cooperation being promoted jointly by APEC governments to be clearly distinguished from 'old-style' foreign aid, which carried overtones of patron-client relations, policy conditions and leverage. A new model of development cooperation was needed, based firmly on the guiding principles of mutual respect and mutual benefit which underline the APEC process.⁸

The *Manila Declaration* sets out goals for economic and technical cooperation, including 'sustainable growth and equitable development', the reduction of economic disparities, improved economic and social well-being of the APEC peoples, and a deepened 'spirit of community' among them. It defines guiding principles for ECOTECH which reflect the APEC culture of mutual respect and mutual benefit referred to in the quotation above, together with genuine partnership and consensus. Finally, it lists a number of specific themes to be pursued as priorities in economic and technical cooperation among the members.

The economic crisis from 1997 demonstrated the need for continuing attention to the foundations of growth. It exposed severe deficiencies in economic policy and institutions, including the need to rebuild domestic and international financial architectures. This has focussed attention on the potential for economic and technical cooperation between member economies to contribute to the rebuilding process.

Over the same period, and in response to the same forces at work in the global economy, APEC has developed a better understanding of its own limitations as a vehicle for negotiating further reductions in border barriers to trade. During the crisis, and with a new round of WTO negotiations thought likely to commence, Andrew Elek and Hadi Soesastro commented that

⁷ Andrew Elek (2000), 'Capacity-building in the Asia Pacific: a way forward for ECOTECH'. Brisbane, The Foundation for Development Cooperation, page 10.

⁸ Federico Macaranas, 'Foreword', in Andrew Elek (ed) 1997, 'Building an Asia-Pacific Community: development cooperation within APEC'. Brisbane, The Foundation for Development Cooperation.

As a voluntary process of cooperation, APEC is not likely to provide an effective framework for negotiating and enforcing involuntary reforms of trade and investment policies... the negotiation of involuntary reforms should be left to the WTO⁹.

So, if APEC does not have comparative advantage in the negotiation of involuntary trade reforms, perhaps it has an edge in the field in which it took its earliest steps? Elek and Soesastro suggested that

Having built up new channels for region-wide communications, APEC leaders and officials do have comparative advantage in designing options for economic and technical cooperation which can draw on information, experience, expertise and technology from throughout the region and make it available widely to many Asia-Pacific economies.

They argued that, in consequence of the crisis, ECOTECH had 'moved to the heart of APEC', and that

Rather than attempting to mimic WTO negotiations within the region, APEC governments can develop cooperative strategies to prepare the ground for successful WTO outcomes.

This would involve both strengthening individual economies to meet the challenge of further liberalisation and a concerted approach among APEC members to a new WTO round. Elek and Soesastro argued for

an integrated view of the APEC process within which all cooperative activities are seen as ways to strengthen the capacity of Asia-Pacific economies to reach their full potential for sustainable economic growth [and] ... to enhance their productive resources and to allocate them in an increasingly efficient and sustainable way.

In practice, ECOTECH has suffered from a proliferation of activities, organised by the working groups or via *ad hoc* arrangements. There have been well over three hundred projects in total since 1989. Most of these activities have been small, involving the collection and exchange of information. Many have been in the nature of 'pet' projects of the government sponsoring and funding the activity, and have involved relatively few other member economies. The very diffusiveness of this set of activities has prevented ECOTECH from demonstrating its value conclusively.

APEC has not so far succeeded in launching any ECOTECH project of sufficient scale and scope as to capture the imagination of all its leaders or to catalyse substantial business support. APEC badly needs one or a small number of landmark ECOTECH projects to dramatise the potential benefits of its cooperative approach to development. It should reflect the agreement of APEC Leaders, expressed collectively, to assure appropriate political support and the certainty of follow-up by successive APEC Chairs. I will return to this subject in section 9, below, in the context of discussing a strategy for promoting Mexico's microbanking and microenterprise initiatives within APEC.

8. The Relevance of Microbanking to APEC

The arguments for microbanking's relevance to APEC, and hence for its incorporation into APEC's program of economic and technical cooperation derive from a number of sources. These include microbanking's potential to contribute to the economic efficiency of all economies and hence to their capacity to engage in free and open trade and investment. They also include microbanking's capacity to promote that sharing of prosperity for which the APEC Leaders have called. These attributes make microbanking a highly appropriate addition to the ECOTECH agenda.

⁹ Andrew Elek and Hadi Soesastro (1999), 'ECOTECH at the heart of APEC', op. cit., page 15.

a) Microbanking's contribution 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. Broadly speaking, financial deepening is observable in increases in the stock of financial assets (as measured, most commonly, by M3) relative to the flow of economic activity (as measured by GNP). Higher-income economies tend to have 'deeper' financial systems than lower-income economies. Moreover, when comparing economies at similar levels of development, those growing relatively fast tend to be financially deeper than slower-growing ones.

As far as I am aware, no central bank in the world actually counts the deposits of non-regulated microbanks in its measure of M3. Financial sector authorities are slow to appreciate either the nature or significance of microbanking as an instrument for financial service delivery to the poor or its capacity to support financial deepening. In fact, with the possible exception of Bangladesh, the transactions of microbanking institutions are of minimal significance in the financial aggregates of all economies, so the lack of interest in measuring them is understandable.

Nonetheless, there is real significance, in terms of financial sector development, in the extension of savings facilities to millions of poor householders. This is true no matter how low 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 deposits, 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 economies 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, as is often the case.

This relationship between microenterprise and export-oriented industry is seen, for example, in the neighbourhood of the *maquiladores*. These are manufacturing and assembly plants, many of them established with foreign capital and clustered along Mexico's northern border with the US, producing for the US market. The *maquiladores* grew rapidly in numbers and employment with the benefit of market-opening measures agreed under NAFTA.

Microenterprises have sprung up around the *maquiladores* 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.

b) Microbanking's contribution to 'shared prosperity'

To repeat a point made in the previous section, 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. However these transactions are significant in the lives of millions of poor people who are not served by formal financial institutions.

The crude 'trickle-down' analogy for the diffusion of the benefits of growth may be discredited. But if, for heuristic purposes, we were to adopt that analogy and pursue its implications, microbanking could be described as a mechanism which opens capillary systems to enable the benefits of growth to flow to poor and low income people, and to facilitate their participation in it.

The Shanghai Declaration, as we have seen, called for member economies to develop and strengthen 'social safety nets' to protect the vulnerable. It also proposed an APEC dialogue on 'globalisation and shared prosperity' (subsequently commenced at Merida in May 2002) as well as calling for a ministerial meeting on women.

The focus on microenterprise at Shanghai is consistent with these statements of concern for distributional equity. Firstly, microenterprise conducted at the household level provides income to poor and low income people in the developing member economies. Action to improve the productivity of these microenterprises will have direct distributional benefits.

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 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.

9. A Strategy for promoting microbanking in APEC economies

The value of exploring solutions to financial exclusion through microbanking will be greatest in the developing member economies, where the degree of exclusion is greatest. These are the economies in which household-based microenterprise is most significant as a form of economic activity.

However, all member economies stand to benefit to some extent from the cooperative examination, within the APEC framework, of issues of financial service provision for financially excluded households. There will be particular value in bringing together the experience of microbanking mechanisms in Asia and Latin America, where rather different approaches are being taken. Similarly, there will be value in comparing the approaches taken to reducing financial exclusion in the developed member economies. APEC needs a process by which every member economy could discover and institutionalise appropriate forms of microbanking for its circumstances.

The simple and obvious solution would be to initiate a discrete project on microbanking, perhaps in the broader framework of a microenterprise development (MED) project, but in all other respects similar to many of the several hundred 'good ideas' which have so far been progressed under the ECOTECH framework. That could be described as the 'default option'. I believe Mexico has higher ambitions for microbanking and MED.

A more innovative solution might be to place Mexico's concern for microbanking and MED in the context of other priorities for economic and technical cooperation set by the Leaders at recent annual meetings. For this we should start with the Leaders' commitment, given at Brunei Darussalam in 2000. This was for the APEC economies to achieve Internet access, at least at the community level, for all the people of the region by 2010. This was the first such agreement by Leaders to a specific and verifiable ECOTECH goal.

Brunei assured some follow-up for this goal in 2001 by agreeing with China to the joint sponsorship of a High Level Meeting on Human Capacity Building, in Beijing in May 2001. This event was concerned with capacity building for the 'New Economy', *inter alia*. There have since been some follow-up commitments of business resources in support of the Brunei goal (for example, a Chinese regional training initiative supported by major international IT corporations and a recent agreement between Mexico and Microsoft).

However it is not clear that there is sufficient momentum yet for the Brunei Internet access goal to be pursued coherently and successfully in an ECOTECH framework. APEC has not developed mechanisms, such as those which exist for the prosecution of the Bogor trade goals, to push forward major ECOTECH commitments.

This account of recent APEC history is relevant to Mexico's interest in microbanking and MED, and to its desire to see these important issues taken up by APEC. Are APEC's discussions and resolutions on these subjects during 2002 to be simply a 'one-off' exercise, politely neglected by future APEC Chairs? We must hope not.

A more valuable outcome would be to set a realistic goal for better access to financial services for microenterprises and households, backed by a substantive strategy to achieve that target. Such a new target would need to be, and be understood to be, a goal which complements the already agreed goals of free and open trade and investment and community-based access to ICT.

Earlier this year, at the Merida Dialogue on globalisation and shared prosperity, consensus emerged that APEC should give more emphasis to goals that complement the goal of free and open trade and investment. Specifically, it was thought APEC should give attention to issues that improve the distribution of the potential gains from free and open trade and investment. These could include improved access to basic needs and to income-earning opportunities.

It was also agreed at Merida that the Brunei Darussalam vision of community-based access to ICT by 2010 will be given renewed momentum by APEC leaders. This formulation gives us the direction to take, by providing a framework in which we can bind together previous agreements, to pursue mass access to ICT (Brunei) and human capacity-building (Shanghai), with Mexico's goals for MED and microbanking, all in a manner supportive of the Bogor goals of free and open trade and investment.

The next question is whether APEC can take a significant new initiative on microbanking and microenterprise at Los Cabos, without overcommitment and in directions consistent with ECOTECH goals agreed at Brunei and Shanghai. A consultation on ECOTECH will be held at Acapulco, in August, in association with SOM III. This will provide possibly the last opportunity this year before the Leaders meeting to discuss the outlines of such an 'omnibus' proposal. Perhaps this symposium on microbanking could lay some of the foundations for further discussion in Acapulco.

It would also be necessary for APEC to differentiate such an activity from the bilateral development assistance activities of member economies, to assure that it is not seen as taking on "aid" functions. Instead, APEC could catalyse resources from agencies such as the World Bank and the regional development banks, providing them with new opportunities to build capacity in more efficient ways. The Brunei goal for ICT is capable of catalysing business sector resources, as has been shown by the agreements made by China and Mexico with leading international IT firms.

10. The relevance of APEC to microbanking

Section 8, above, discussed the relevance of microbanking for APEC. In it I concluded that it had positive potential for both the sharing of prosperity and the economic efficiency of member economies, and thereby the capacity to support the achievement of the Bogor goals of free and open trade and investment.

It is now relevant to turn the question around and consider the relevance of APEC to microbanking. This is because microbanking (better known as 'microfinance' in developing economies and best known, although misleadingly so, as 'microcredit') is a well-established developmental tool employed in multi- and bilateral programs of development assistance. The question of whether APEC has any particular comparative advantage in regard to microbanking must be considered.

Perhaps APEC has no more comparative advantage in regard to promoting microbanking than it does in promoting trade liberalisation, given the mandate of the WTO in the latter field. For that matter, the Telecommunications Working Group, or numerous other APEC working groups, may appear to have no particular comparative advantage in their respective fields, given the existence of other specialised international agencies dealing with the issues concerned.

However, discovering APEC's comparative advantage in any cooperative process requires an understanding of its unique character. It is a group of economies closely linked by ties of trade and investment, whose members are at various stages of development and include transitional as well as

market economies, drawn from both sides of the Pacific. The ECOTECH process draws its strength, as Elek and Soesastro point out, from the 'new channels for region-wide communication' created by APEC leaders, officials, academics and business leaders. These channels 'enable them to draw on information, experience, expertise and technology from throughout the region' and to disseminate it, both among the member economies, and more widely.

APEC's engagement with microbanking should be complementary to that of multilateral agencies and international financial institutions already active in the field. It should also complement the activities of bilateral programs of development assistance, being at all times careful to differentiate its programs from those of bi- and multilateral agencies, and to avoid any suggestion that it has become an 'aid' agency in the conventional sense.

Finally, there is another characteristic which emphasises the 'beyond aid' character of ECOTECH. This is that APEC's economic and technical cooperation is applied to solving problems and filling needs which are generalised to all the member economies, developed and developing, market and transitional. For all these reasons I have no doubt that APEC *is* relevant to microbanking, just as it is to exploring common approaches to a host of issues confronting the member economies.

Economic and technical cooperation between APEC member economies should be conducted on issues of microbanking, in the forms of policy dialogue, exchanges of information and technical cooperation. These activities should be directed, *inter alia*, to policy development appropriate to the circumstances of each economy. Technical cooperation between economies could contribute to institution building and human capacity building for the microbanking sector. Annex 3 provides a summary list of issues which could be addressed by such cooperation.

The scope of activities should be generalised to cover the range of alternative financial service delivery options practiced in member economies for the benefit of poor and low-income people who lack appropriate access to financial services from conventional sources. This would contribute to the more effective operation of microenterprise in those economies where it is of most economic significance and would support the more effective 'sharing' of prosperity in all economies.

ANNEX 1: Models of microfinance in the developing member economies

Among the proliferation of microfinance institutions (MFIs) in developing countries, a number of distinguishable models have emerged. The **Grameen Bank model** has been applied in many countries. It requires careful targeting of the poor through means tests, usually with a focus on women and intensive fieldwork by staff to motivate and supervise the borrower groups. Groups normally consist of five members, who guarantee each other's loans. Some compulsory saving requirements are imposed, but in general quite limited voluntary saving occurs. Sustainability is achieved by increasing the scale of operations, and by decentralising control and carefully managing costs. While some other models have as their goal the creation of autonomous institutions, this is not expected of the individual borrower groups. In Bangladesh, where the greatest numbers of Grameen-inspired institutions exist, considerable innovation is being applied to this model.

The **Village Bank** is a widely replicated model, found mainly in Latin America and Africa, but with substantially less total outreach than the many Grameen Bank replications. Typically, an implementing agency establishes individual village banks with between 30 and 50 members and provides capital for on-lending to individual members. Individual loans are repaid at weekly intervals over 16 weeks, at which time the village bank returns the principal, with interest, to the implementing agency. A bank repaying in full is eligible for subsequent loans, with loan sizes linked to the performance of village bank members in accumulating savings. Peer pressure operates to maintain full repayment, thus assuring further injections of loan capital, and also encourages savings. Savings accumulated in a village bank can be loaned out to members. Village banks are intended to become autonomous institutions.

Somewhat less structured than village banks (and a good deal less so than Grameen banks) are **Credit Unions (CUs)**. These are democratic, non-profit financial cooperatives owned and controlled by their members. CUs mobilise savings, provide loans for productive and provident purposes and have memberships which are generally based on some common bond. CUs generally relate to an apex body that promotes primary credit unions and provides training while monitoring their financial performance.

A fourth model, based on '**self-help**' groups (SHGs) is somewhat similar to the village bank concept, although less structured. SHGs have around 20 members who should be relatively homogeneous in terms of income and social status. The primary principle of SHGs is the lending of members' savings but they also seek external funding to supplement internal resources. The terms and conditions of loans differ among SHGs, depending on the democratic decisions of members. Typically, SHGs are promoted and supported by NGOs, but the objective (as with village banks) is for them to become freestanding institutions.

In a quite different category from the four models discussed above, each of which has strong voluntary elements involving the action of NGOs or community-based entities, is what might be called a '**rural financial systems model**'. As practiced in Indonesia, this model exhibits a diversity of regulated financial institutions providing rural financial services. These range from a national-level institution with substantial outreach and extensive networks to small, local institutions occupying particular market niches. Also, depending on the regulatory environment in a particular country it may be possible for an NGO to transform a successful MFI into a regulated financial institution, while maintaining its mission to provide microbanking services.

ANNEX 2: APEC's SME Working Group

The SME working Group reports to a ministerial-level meeting on SMEs, conducted annually as part of the APEC cycle. Ministers adopted an Integrated Plan for SME Development at their meeting in Kuala Lumpur in 1998. This plan, to which the Leaders referred in the Shanghai Declaration of 2001, notes that

SMEs form the backbone of the economies of APEC. They employ as much as 80 percent of the work force, contribute 30 to 60 percent of the GNP and account for around 35 percent of total exports in the region. They also make up over 95 percent of all enterprises.

From this description of the scope of the SME sector, it seems likely that self-employed workers in the informal sectors of the APEC economies are, in principle at least, covered by the mandate of the SME Working Group. This impression is strengthened by the Ministers' statement that

The objectives of the Plan take into account the differences in the levels of development of each economy. In some of the developing economies there is also a need for special consideration of the interests of the micro-enterprises and SMEs operated and managed by women as they form the core of poverty alleviation and rural income augmentation programmes.

Further, on the subject of women and microenterprise, Ministers noted that

In the case of SMEs operated and managed by women entrepreneurs it is necessary to discern the extent to which these enterprises face gender-bias impediments in their attempts to seek financing, skills, technology and training and in marketing their products. The interests of women entrepreneurs form an integral part of an overall approach to entrepreneurial development. Measures to address gender-bias impediments should seek to change mind-sets and publicise the fact that women have better repayment records as experience with rural credit institutions testifies.

The Ministers' comment on good repayment performance of women in rural financing appears to be informed by the much-publicised experience of microfinance institutions, such as the Grameen Bank, serving poor and low-income borrowers, especially women.

The objectives of the Plan for SME development are stated as follows:

- to accelerate the pace of SME development in accordance with its growth potential in the APEC region
- to maximise SME efficiency goals along the region's key economic sectors - primary, industrial, trade and services
- to enhance SMEs' dynamism by facilitating their access to markets, technology, human resources and skills, financing and information
- to strengthen the resilience of SMEs to withstand adverse macroeconomic and financial developments including external shocks
- to achieve socio-economic goals through SMEs as a source of growth and employment especially in the rural sector of the developing economies of APEC

In regard to the financing difficulties of SMEs, the Plan notes (in terms that apply perfectly well to microenterprises operated by the poor, and which explain why microfinance has been seized upon as the answer to their financing needs) that

[they] have difficulties in defining and articulating their financing needs. The small size of these enterprises and the high transactions costs arising from the lack of collateral and thus high risks, explain the reluctance of bankers to provide financing.

However the Plan's discussion of measures to overcome these obstacles leaves one with the impression that, in practice, the SME Working Group is not concerned with either microenterprise development or the associated financing needs. It is suggested that

...export credit refinancing schemes may be instituted to reduce the risks arising from exporting...and that ..[o]ther forms of financing should also be made known to the SMEs. These include equity financing, issue of debt and venture capital especially in the high-technology industries. SMEs also need to be trained in managing various financial risks, in particular those arising from exposure to foreign exchange volatility which has now become a major feature of globalisation.

The SMEWG's concern is primarily with larger enterprises, those likely to be directly 'trade exposed'. It is not concerned with petty traders and the providers of services in the informal sector, still less with the 'survival enterprises' of the very poor.

However, there are other measures proposed which do have relevance for the microenterprise sector as well as for SMEs, such as the suggestion that

Governments can set up credit guarantee corporations to insure commercial banks from default arising from advancing loans to SMEs without collateral...or that Documentation difficulties can be overcome by designing simple forms for loan applications rather than insisting that SMEs submit detailed project proposals.

But overall it seems clear that the SMEWG has not yet given attention to the specific needs of financing for MED, particularly as it is found in the less developed economies, as distinct from those of its close but much larger relative, SME. Since the SME Working group has focussed its attention so much higher up the scale, there must be doubt whether it is prepared to handle the agreement of principles for, and the conduct of cooperation concerning, microenterprise financing and MED issues between APEC member economies.

ANNEX 3: The Policy and Regulatory framework for Microbanking

A. Policy objectives

1. persuading all relevant agencies (both within the APEC structure itself, and domestically within the economies) to commit to the principle that creating mechanisms for sustainable microbanking is an objective of financial sector development
2. creating an enabling policy environment for microbanking, starting with the freedom for service providers to set interest rates at levels which assure institutional sustainability and freedom of entry to the market by institutions, subject to their satisfying regulatory and prudential standards
3. designing an appropriate domestic financial sector architecture: creation and/or facilitation of appropriate institutions, including some or all of the following:
 - small banks or other small regulated financial institutions
 - dedicated microbanking services cells within commercial banks
 - licensed non-bank micro-financial institutions (for profit, non-profit)
 - reformed State rural and agricultural development banks
 - a viable and socially inclusive credit union movement
 - second tier institutions for microfinance institutions (MFIs)
 - ratings agencies for MFIs to facilitate capital raising
 - apex institutions for MFIs
 - deposit guarantee mechanisms for regulated MFIs
 - accountable civil society organisations performing financial and/or social intermediation.
4. avoiding the unintended adverse consequences for microbanking of other financial sector policies, and of public policy more generally
5. designing criteria and arrangements for direct government promotion of microbanking
6. supporting capacity-building for staff of microbanks and supervisory authorities; establishing systems of accreditation to facilitate professionalisation
7. finding the appropriate balance between assistance to financial and business development services for microenterprise
8. supporting the commercialisation of microbanking, by means including the 'downscaling' of commercial bank operations and the 'transformation' of MFIs into regulated institutions
9. creating a policy and regulatory environment for telecommunications which facilitates the introduction of ICT to all appropriate microbanking applications: transactions, training and public education, supervision

B. Regulatory and supervisory issues

1. choice of institutions for regulation and supervision, and appropriate authority(s) to regulate and supervise
2. performance and reporting standards for regulated microbanks
3. prudential regulation, including
 - capital adequacy
 - liquidity
 - loan provisioning
4. governance standards and appropriate self-regulation for institutions
5. development and application of risk-based supervision techniques appropriate for microbanks; application of ICT to data collection for off-site supervision and other purposes
6. capacity-building for supervisory agencies and staff
7. oversight of civil society organisations engaged in microbanking
8. sensitive and supportive approaches to informal self-help financial activities.

C. Operational issues

1. Achieving operational and financial sustainability.
2. Benchmarking for performance and reporting standards.
3. Governance and transparency.
4. Managing arrears.
5. Savings mobilisation through development of attractive savings products.
6. Mobilising other financial resources for scaling up.
7. Human capacity building for staff, management and boards of MFIs, including the application of ICT for training.
8. Human resource management, including remuneration and career structures.
9. Effective management of group-based microfinance.
10. Creating mutually beneficial working relationships between regulated financial institutions and other MFIs and informal financial service entities: financial linkages and social intermediation.
11. Offering appropriate non-financial services; measuring and recovering their costs.
12. Harnessing ICT for operational efficiency.
13. New product development