The Role of the G20 in Enhancing Financial Inclusion

By Roy Culpeper, Senior Fellow, School of International Development and Global Studies
University of Ottawa

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Introduction

Research has shown that greater access to finance is crucial to reducing poverty and inequality. Yet most households and firms in developing countries are excluded from access to financial services. The G20’s initiative on enhancing financial inclusion thus recognizes a long-neglected problem, particularly in developing countries. It also identifies a number of policy prescriptions to make financial services more accessible to the great majority of households and firms. These rely primarily on improving the financial infrastructure and building the capacity of existing service providers, principally microfinance institutions (MFIs) and commercial banks. However, by themselves these prescriptions are insufficient and will not succeed in meeting their objectives. More inclusive finance will also require a more active role by government agencies and programs to complement the efforts of MFIs and private banks. It will additionally require innovative ideas and policies to ensure that small and medium enterprises, which tend to be significantly underserved by financial markets, obtain greater access to credit and other financial services.

CGAP: Prelude to the G20’s Financial Inclusion Initiative

The issue of financial inclusion is not new. In the 1980s, Grameen Bank pioneered the innovation of microcredit for the poor in Bangladesh. Simply put, microcredit made services available to poor households (and particularly women) that commercial lenders were unable to offer on a profitable basis and that traditional moneylenders were willing to provide only at usurious rates of interest. But the business model for the first generation of microcredit depended on donor funding, indicating that microcredit was not a commercially sustainable venture. However donors were appreciative because high loan repayment rates meant that grants could be recycled to several rounds of beneficiary borrowers.

The replication of the Grameen model all over the developing world thus attracted considerable donor support. By the 1990s, microcredit became a favoured policy instrument in the fight against poverty. The fact that women in poor households were the principal beneficiaries of
microcredit also supported the emphasis of many donors on enhancing gender equality in their development programs.

By the mid-1990s donors were keen to systematize lessons learned and best practices from the first decade of microcredit. Following the precedent of the Consultative Group for International Agricultural Research (CGIAR), a core group of donors came together in 1995 to create the Consultative Group to Assist the Poor (CGAP)—a bit of a misnomer in the sense that it has a rather narrowly defined mandate as to how it assists the poor. Its specific focus is to assist the poor through the provision of microfinance. It also provides advisory and technical services, guidelines and standards, training, funding for innovation, research, and knowledge dissemination. It serves three major client groups: financial service providers who serve low-income people; funding organizations; and governments.

CGAP is an independent entity with a membership comprising 16 donor countries, 11 multilateral development organizations, and five private foundations. Each of these is represented on the Governing Council. There is a close working relationship with the World Bank, which provides office premises in Washington.

Much of the G20's thinking about financial inclusion has sprouted from the work of CGAP in the past 16 years — its technical assistance, policy work and research. Moreover, as explained below, CGAP is one of the three key implementing agencies for the G20's initiative.

**Key Role of the Gates Foundation**

In addition to CGAP, the Bill and Melinda Gates Foundation has played a key role in shaping the discussion on financial inclusion. Since 1994 the Foundation has provided some $26,194,000,000 in grants in three principal programs: global development ($3.6 billion), global health ($15.3 billion), and activities in the United States ($6.2 billion).

The Foundation's grant-making in the global development program focuses on six main areas: agricultural development; financial services for the poor; water, sanitation and hygiene; global libraries; special initiatives; and policy and advocacy. In 2010 one-half (or $242 million) of the grants in global development was allocated to agricultural development, and one-sixth (or $81 million) to financial services for the poor, the second largest area.

The goal of the Foundation's activities in the area of financial services for the poor is "to provide millions of poor people in the developing world with reliable access to affordable financial services to help them build better, healthier lives:" in other words, to enhance financial inclusion. Since 2006, the Foundation has committed more than $500 million to explore ways to increase financial services. It has emphasized three main priorities: savings products (e.g. "no-frills" affordable bank accounts for the poor); delivery channels (e.g. mobile telephone and branchless banking); and policy to support safe financial services to the poor.

Of principal interest in the context of this paper is the Foundation's support to two implementing agencies for the G20's initiative on financial inclusion: CGAP, described above, and the Alliance for Financial Inclusion. The Foundation's 2010 Strategy Brief lists grants in the “policy”
area of $35 million to AFI and $23.8 million to CGAP. However, its support of policy, research and advocacy for financial inclusion goes considerably beyond these two organizations. For example, recipients in 2010 included New York University ($2 million), Yale University ($7 million), University of California Irvine ($4 million), and the United Nations Capital Development Fund ($1 million). In 2006 the Foundation launched the Financial Access Initiative, a consortium of development economists focused on substantially expanding access to quality financial services for low-income individuals, with a grant of $5 million. Housed at New York University, the initiative engages in research and in the policy and regulatory debates on enhancing financial access, particularly for the poor.

In brief, while the Gates Foundation has allocated a relatively small portion of its resources to financial services for the poor, it has helped to shape current ideas about financial inclusion through its support of research and action aimed at providing the poor greater access to financial services. It has put priority on savings products and market-friendly, innovative technologies.

The G20’s Initiative on Financial Inclusion

Background. The Group of 20 finance ministers was originally convened to deal with the Asian financial crisis of 1997-98. The G20 met at the level of heads of government for the first time in November 2008 at the invitation of President Bush to coordinate a global response to the much more serious financial crisis that first erupted in the United States in the summer of 2007.

Although the G20’s initiative on enhancing financial inclusion was put on the agenda in November 2008 and formally launched at its Pittsburgh meeting in September 2009, its roots predated the crisis. By the middle of the decade financial liberalization policies undertaken by many developing and emerging market countries had put an end to “financial repression.” However, while such policies remedied many of the problems of mismanagement and corruption in the financial sector it did not succeed in increasing access by households and firms to financial services. Indeed, financial liberalization led to the withdrawal of services to the poor and to rural areas to the extent these had been provided by state-owned banks that were wound down by the reforms.

Despite the reforms, in most developing countries a majority of households and smaller enterprises continued to be excluded from the formal financial sector. Almost 70 percent of the adult population in developing countries, or 2.7 billion people, lack access to basic financial services, such as savings or checking accounts. The regions with the largest share of unbanked populations are Sub-Saharan Africa, where only 12 percent are banked, and South Asia, with 24 percent banked.

Accordingly, even before the current financial crisis erupted, the need to enhance financial inclusion was recognized by the United Nations and the World Bank as a neglected issue that required urgent policy attention. When the G20 leaders began to meet after November 2008, enhancing financial inclusion in developing and emerging market countries was put on the agenda. Although developing and emerging market countries were not at the epicenter of
the crisis, and financial exclusion was not a contributory factor, the G20’s initiative can best be understood as part of a global strategy aimed at remedying the failures of liberalized financial markets. In the industrial countries the strategy consisted of strengthening regulation and the capitalization of banks not only to curb the financial instability that had triggered the crisis, but also to heighten consumer protection. In developing and emerging market countries, rather than tackling the financial crisis per se, the strategy addressed financial inclusion as part of a renewed development agenda. In other words, G20 leaders recognized the mutually reinforcing policy objectives of financial stability, financial inclusion and consumer protection.

Launch of the Financial Inclusion Initiative: 2008-2010. At its Pittsburgh meeting in September 2009, the G20 convened a Financial Inclusion Experts Group (FIEG) to recommend how to expand access to finance for households and micro-, small- and medium-sized enterprises. Two sub-groups were formed to undertake further analysis, one on Small- and Medium-sized Enterprise (SME) Finance, and one on Access through Innovation. The focus of the latter sub-group was on innovative methods — for example mobile telephones — to improve access to financial services. Such technology, it was believed, can reduce costs and overcome other barriers to the provision of sustainable financial services to the excluded.

The SME Finance sub-group was supported by the International Finance Corporation (IFC) of the World Bank Group. The Access through Innovation sub-group was supported by the Consultative Group to Assist the Poor (CGAP). In addition to CGAP and IFC, a third organization, the Alliance for Financial Inclusion (AFI), 3 has been a key implementing partner for the G20 financial inclusion agenda. These three organizations — IFC, CGAP and AFI — have subsequently done most of the substantive research and policy analysis for the G20 initiative. Due to the close relationship between IFC, CGAP and the World Bank Group, the frame of reference for this work is heavily dominated by the accumulated body of research and thinking of the World Bank4, particularly its Finance and Private Sector research group.

The organizational structure of the G20 initiative has evolved and become more complex since its launch. Its major milestones have included articulating a set of nine principles to guide governments that seek to make financial services more inclusive (Box 1). The nine principles (henceforth, the “G20 Principles for Innovative Financial Inclusion”) were endorsed at the Toronto G20 Summit meeting in June 2010.

Box 1: The G20 Principles for Financial Inclusion

One of the first products of the FIEG sub-group on Access through Innovation was the development of a set of nine principles to inform future strategies to enhance financial inclusion:

Leadership. Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty;

Diversity. Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of
The nine principles articulate a role for government that consists primarily in creating an enabling policy environment for market-based actors. While a direct role in enhancing financial inclusion for public agencies or programs is not ruled out, such a role does not emerge explicitly as part of the policy framework to be considered by governments. Specifically, public agencies such as postal savings banks and national development banks, or government programs such as credit guarantees (on private-sector lending) play an important role in providing financial access in many countries, both developing and developed. “Leadership” (the first of the nine principles) should explicitly include direct intervention by government to enhance inclusion, building upon the best practices of existing government agencies and public-sector programs.

The Toronto meeting of the G20 launched two further initiatives, the “SME Finance Challenge” (Box 2) and the “Financial Inclusion Action Plan.”
Box 2: SME Finance Challenge

The SME Finance Challenge was launched in collaboration with Ashoka Changemakers and with the support of the Rockefeller Foundation. It was announced as “a unique financial inclusion effort aimed at giving small entrepreneurs a chance to grow their business.” The Challenge took the form of a “competition that is asking the private sector to identify path-breaking models that make public programs more effective in leveraging private finance.” Private financial institutions, investors, companies, foundations and civil society organizations were all invited to submit proposals. Successful entries were to demonstrate: innovation, leverage, scalability, social and economic impact, and sustainability.

Some $528 million in funding for the Challenge was committed by South Korea, The United States, Canada and the Inter-American Development Bank (additional pledges were made by others subsequently). The form of funding provided to the winning proposals was to vary “based on their individual requirements, and may include grants for technical assistance or capacity-building, risk sharing or first-loss capital, mezzanine capital, and investment capital.” There were 356 entries. The competition was adjudicated at the following G20 Summit held in Seoul, Korea, where the 14 prizewinning entries were announced. The winners were subsequently connected with donors and investors at an SME conference in Cologne, Germany (November 15-16).

While the SME Finance Challenge served to showcase a few captivating small business ideas that needed financing, it diverted attention from the fact that the problem of SME financing is a systemic one, requiring systemic solutions. A $500-million contest with 14 prizewinners pales in comparison with the estimated order of magnitude of required SME financing (at least $2.1 trillion) by some 365 million SMEs, according to a report prepared for the SME Financing sub-group. Yet the contest illustrated a bias of the G20 initiative, namely the notion that the failure of financial markets to be more inclusive can be overcome by highlighting compelling examples of unmet needs.

The Financial Inclusion Action Plan built upon the reports of its two sub-groups, “Innovative Financial Inclusion: Principles and Report of the Access through Innovation Sub-Group,” and “Scaling-Up SME Access to Financial Services in the Developing World” by the SME Finance Sub-Group. These two reports, along with a third resulting from a collaboration between IFC and McKinsey & Company, constituted the core documents for consideration at the November 2010 G20 Summit in Seoul. There were seven main items in the Action Plan:

1. Commitment to implement the G20 Principles for Innovative Financial Inclusion under a shared vision of universal access;
2. Encourage Standard Setting Bodies (SSBs) to support financial inclusion and to further explore coordinated information sharing on the complementarities between financial inclusion and their own mandates;
3. Work with the private sector to increase access to financial services, consistent with the G20 Principles for Innovative Financial Inclusion;
4. Improve the quality of measurement and data on financial inclusion of households/individuals and Micro, Small and Medium Enterprises;
5. Support capacity-building and training;
6. Improve national, regional and international coordination; and

The Action Plan also called for a “Global Partnership for Financial Inclusion,” a consultative mechanism that would include non-G20 countries and other stakeholders to maximize the impact of the G20’s work. And it called for the mobilization of funding for financial inclusion. The latter sought in the first instance to identify funding for the SME Finance Challenge and increased demand for technical support.

The Action Plan goes beyond the Principles in calling upon international bodies—the standard-setting bodies and the international financial institutions—to incorporate financial inclusion into their mandates. However, it echoes the Principles in calling for governments principally to create an enabling environment for the private sector and for individuals, households, and SMEs. Like the Principles, the Action Plan is silent on the potentially significant role of government agencies and programs.

Indeed, the report on “Scaling-up SME Access to Financial Services” clearly expresses its reservations about government support mechanisms, despite acknowledging (with several illustrations) that such interventions are commonplace in both developing and developed countries, and that they “can significantly expand the SME finance space.” The report warns that “it is always important...to minimize their market distorting consequences.” As for state banks, it states that, “For countries that do not already have such institutions, this report does not recommend the creation of new state banks to serve the SME market.” In contrast it gives lukewarm support to partial guarantee schemes, while recommending an initiative aimed at helping developing countries minimize their subsidy component.14

Accomplishments at the 2010 Seoul Summit and 2011 Cannes Summit. At its Summit meeting in Seoul, the G20 adopted the Action Plan proposed by the FIEG. It also committed to launch the key implementation mechanisms for the Action Plan: the Global Partnership for Financial Inclusion (GPFI), and an SME Finance Innovation Fund, to be structured and facilitated by IFC15 and coordinated by Canada. The fund was to support the SME Challenge prizewinners “and other models focused on improving finance for SMEs.”16

At Seoul, financial Inclusion was not only prominently included in the Leaders’ Declaration, but was also highlighted as an important component under the Seoul Development Consensus and the financial sector reform agenda. The Seoul Development Consensus included, among other things, a Multi-Year Action Plan on Development.17 This set out nine pillars of action on global development, among them financial inclusion.
At the Seoul G20 Summit the G20’s work on financial inclusion was entrusted to the GPFI (officially launched on December 10, 2010), which has a mandate to reach beyond the membership of the G20 to non-G20 (particularly low-income) countries as well as other stakeholders. (The GPFI effectively superseded the former Financial Inclusion Experts Group.) The co-chairs of GPFI were the “troika” — the past, present and future G20 Chairs — thus Korea, France, and Mexico. At Seoul three new sub-groups were created: (1) Principles for Innovative Financial Inclusion and Standard Setting Bodies (SSBs) Engagement (co-chaired by Korea and Indonesia); (2) SME Finance (co-chaired by Germany, Turkey, the UK and the US), and (3) Financial Inclusion Data and Measurement (co-chaired by Mexico, France and South Africa). The sub-groups were also associated with non-G20 partners and supported by the three implementing agencies that have been involved with the G20 initiative from the outset, viz. AFI, CGAP and IFC (see Table 1).

**Table 1: Structure of the GPFI**

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The GPFI was tasked at Seoul with reporting on its work to the next G20 Leaders’ Summit at Cannes, France in November 2011.

During 2011 the three new sub-groups generated a number of activities and seven publications. These included:

- a report on the engagement with standard-setting bodies by five countries: Brazil, Kenya, Mexico, the Philippines, and South Africa
- a report on the global standard-setting bodies and financial inclusion for the poor
- a report on implementing the G20 Principles for Innovative Financial Inclusion
- a policy guide on SME finance
• a report on financial access by agricultural SMEs
• a report on financial access by women-owned SMEs
• a discussion paper reviewing the adequacy of financial inclusion data

The achievements of the three sub-groups were showcased at the first GPFI Forum held at Riviera Maya, Mexico, on October 1, 2011. The forum was opened by Mexican President Felipe Calderon and featured an address by HRH Princess Maxima of the Netherlands, who was appointed the UN Secretary-General’s Special Advocate for Inclusive Finance for Development. This event followed the third Global Policy Forum convened by the Alliance for Financial Inclusion, also held at Riviera Maya. As Mexico is assuming the Presidency of the G20 in 2012, the venue for the forum is an indication of the priority accorded by Mexico to the issue of financial inclusion.

At the Cannes G20 Summit in November 2011, the GPFI presented its first progress report. It recommended that G20 Leaders:
• commit to further implementation of the nine Principles for Innovative Financial Inclusion;
• call upon the standard-setting bodies to strengthen the complementarity of their work with that of the GPFI;
• launch an SME Finance forum as a platform, hosted by IFC, and acknowledge access to finance by women-owned SMEs and by SMEs in the agricultural sector as critical for job creation and sustainable growth;
• build on the SME Finance Challenge to scale up successful SME financing models; and
• request the IMF to strengthen its SME data-collection efforts and encourage countries to develop and use data sources that are relevant for monitoring policy success.
These recommendations were endorsed in the Cannes Summit Declaration.

Decoding the G20 Financial Inclusion Initiative: A Constructive Critique

Pros and Cons

There is much to be welcomed in the G20 initiative. On the positive side, greater financial inclusion has been absent from the development agenda, and certainly deserves more attention. The research undertaken for the initiative, and for that matter undertaken prior to the launch of the G20 in 2008, has certainly contributed to our knowledge about and appreciation of why greater financial inclusion is important for development.

It has heightened the appreciation of financial inclusion among policy-makers, practitioners, and global standard-setting bodies such as the Basel Committee for Banking Supervision. A new forum, the Alliance for Financial Inclusion, with members from central banks, finance ministries and regulatory agencies in over 70 developing countries, has been created to share experiences and learn from best practices. The initiative has served to reinforce access by the poor to savings facilities and other financial services than credit (for example, insurance). With the
arrival of mobile telephone banking and other versions of “branchless banking”, new technologies have enhanced the possibilities of maintaining safe and dependable bank accounts for poor households. The G20 initiative has welcomed these innovations but has appropriately emphasized the need to put in place adequate regulatory and supervisory systems to protect consumers and depositors against possible abuses. Perhaps most significantly it has drawn attention to the huge financing gap for SMEs, straddling the “missing middle” ground between MFIs — for which SMEs’ financial needs are too large and complex — and commercial banks — for which SMEs are too small and risky.

However, there are two drawbacks. First, there is a danger that greater financial inclusion may be given undue weight by development practitioners, similar to the emphasis given to microcredit (or social sector investment, or structural adjustment) in the past. Or equivalently, there may be excessive expectations about what greater inclusion can realistically achieve. Like any other important ingredient in development strategy — education and health in the past, or physical infrastructure and food security in the Seoul Development Consensus — it is essential to remember that all these ingredients are important and complementary, and the requisite measure of each is very specific to the context in every developing country.

The second, more serious drawback relates to what is downplayed in the G20 initiative: principally, the role of government, or the public sector more generally. The overwhelming emphasis in the initiative is that the state should create and maintain an “enabling environment” within which the private sector can flourish in providing financial services more inclusively. A more active role for the public sector than that envisaged by the G20 initiative, in the direct or indirect provision of financial services, is not only warranted; it also reflects an inescapable reality in a number of countries, whether developing, emerging markets, or industrial. But there is a distinct bias in the G20 initiative in favour of a greater role for private markets and a more circumscribed role for government agencies and programs providing direct financial services.

**Financial Liberalization and Banking Crises**

To interpret the G20 initiative, it is important to situate it in its historical and policy context. First, it is clear that the issue of financial inclusion emerged as a development issue long before the Great Financial Crisis that erupted in 2007 and continues to roil the industrial world. Indeed, the issue of financial inclusion is independent of and distinct from much of the discussion on the interrelationship between finance and development, which has focused largely on policies toward the formal financial sector. That discussion, or debate, which emerged in the 1970s, dwelt on the need to end financial repression (government ownership and control of the financial sector) through liberalization and privatization measures. It was felt that, by liberalizing the sector, finance would be allocated more efficiently to users and borrowers who would maximize returns on their investment, providing a significant boost to economic growth.

The problem is that liberalized financial sectors did not quite work in this way. In the 1980s, the financial sector did not become an engine of growth. Instead it became an engine of
instability. Financial liberalization, particularly when accompanied by capital account liberalization, led to a series of debilitating banking and debt crises that reversed economic growth in many developing and developed countries. In the 1980s and mid-90s, the focus of these crises was predominantly in Latin America. In the late 1990s, the financial crisis erupted in East Asia before spreading to Russia, Brazil and Argentina. As a result, the policy debate on the financial sector became predominantly one about the speed and sequencing of liberalization, accompanied by the need to put in place adequate regulation and supervision. With the Great Financial Crisis of 2007, the focus of the debate shifted to the United States and Europe.

Moreover, financial sector liberalization also resulted in the retrenchment of public banks and other institutions formerly offering financial services to the poor or to rural areas. Where these had been served at all, it was more typically by state-owned or -controlled banks, downsized or privatized by reforms. Meanwhile liberalized banks found little or no profit in serving low-income clients or regions, preferring a clientele comprising elites, governments and large firms and the urban areas. Thus it is quite conceivable that liberalization reforms led to even greater financial exclusion for the poor and disadvantaged regions of developing countries.20

The Rise of Microcredit

The issue of the contribution of the financial sector to more basic development objectives—for instance, in stimulating growth and reducing poverty — took a back seat to the objective of financial stability in research and policy discussions. It was left to practitioners such as Muhammad Yunus and the Grameen Bank — to explore and innovate new pathways for finance in developing countries. The arrival of microcredit and microfinance infused the discussions with new vigour and helped to reorient financial policy toward the basic discussions about growth and poverty reduction. It also coincided with a renewed focus by donors on poverty reduction as the pre-eminent objective of foreign aid, and a growing emphasis on gender equality as a critical dimension of aid effectiveness. Not surprisingly some donors felt that microcredit was one of the most effective ways of delivering aid directly to the poor, and particularly poor women. So when donors decided in the mid-1990s to make a concerted effort to distill best practices and lessons learned from microcredit, they chose the designation of the Consultative Group “to Assist the Poor.”

Despite the proliferation of microcredit institutions, however, it had become apparent by 2000 that the penetration of such institutions among the poor and in rural areas was modest at best. As a result, low-income clients and regions remained largely excluded from access to financial services, whether through the formal or semi-formal (i.e. microcredit) sector. Moreover, a second generation of microcredit institutions heralded problems and weaknesses that were not so apparent or widespread in the first generation: mismanagement, corruption, or arduous terms and chronic indebtedness for borrowers. Most sobering of all was growing evidence suggesting that microfinance does not contribute significantly to poverty reduction.21
Evidence on Financial Exclusion

The crucial fact is that both semi-formal\textsuperscript{22} microfinancial institutions and the formal financial sector banks (whether public or private) failed to reach a large majority of the population in developing countries, including most of its small- and medium-sized enterprises. By the turn of the century, recognition of this market failure led to a growing belief that efforts were needed to enhance financial inclusion. These were rooted in a growing body of research that showed that greater access to financial services (not just microfinance) contributes to reducing poverty and inequality, although the impact is, as indicated, at best indirect. Essentially finance facilitates greater inclusion of the population in the formal economy and higher wages. The evidence suggested that direct provision of financial services to the poor was not the most important channel for reducing poverty and inequality.\textsuperscript{23} This research helped to frame the issue of financial inclusion which emerged explicitly in the mid-2000s in discussions and reports at the United Nations and the World Bank.

However, by the time explicit recognition was given to the issue, and before a policy consensus could be formed as to measures to be undertaken, the Great Financial Crisis of 2007 erupted. Once again the focus of attention shifted to the epicenter of the crisis, this time the United States, the United Kingdom, and other European countries.

Rise of the Emerging Market Countries

The Great Financial Crisis coincided with a shift in the geo-economic balance of power. A decade earlier, the G7 countries had commanded a sufficiently large share of world output and trade that they could effectively shape the policy environment through the global economic institutions. Although the G20 was first convened during the Asian financial crisis in 1998, it met only at the level of Finance Ministers. And it could be said that the non-G7 members of the G20 were in attendance to affirm, not to challenge, the decisions of the G7.

The world was quite different when the G20 first met at the level of Leaders of Government in Washington in November 2008. The support of the non-G7 countries — the Emerging Market members in particular — was crucial in addressing the global crisis, and this time it could not be taken for granted. However, the first two meetings (the second took place in London in April 2009) were focused primarily on arresting the short-term dimensions of the crisis through monetary and fiscal intervention.

At the third G20 meeting in Pittsburgh in September 2009, however, the issue of financial inclusion was on the agenda, marking the beginning of the G20 initiative. This was the only “development” item on the agenda. In Toronto in June 2010 the G20 Development Working Group was established which led in November 2010 at the Seoul Summit to the broadening of the development agenda. The “Seoul Development Consensus” was a multi-year, multi-pronged action plan, in which enhancing financial inclusion was one of nine pillars.
In other words, the issue of financial inclusion may be regarded as a key entry point for the non-G7, developing and emerging market members for broadening the G20 agenda to accommodate longer-term issues of importance to developing countries. By the time of the Seoul meeting financial inclusion was also recognized as part of a financial reform agenda that encompassed the concerns of developing countries beyond the short-term issues of safety and stability of the financial sector prompted by recurring financial crises. Moreover, since the crisis that brought the G20 Leaders together for the first time was centered in the U.S. and E.U., the broader financial reform agenda clearly addressed issues beyond the industrial countries, issues of vital interest to the G20 emerging markets and developing countries.

Beyond Microfinance to SMEs

At the same time, the conceptual framework for the emerging debate on financial inclusion was also being broadened beyond microfinance. Focused primarily on poor households and poor women in particular, microfinance was frequently rationalized on the basis of “household enterprises”. But the reality was that such “micro-enterprises” rarely employed anyone beyond the household or the primary recipient of microcredit. A more accurate description of such activity would be “self-employment.” A target narrowly confined to the household misses the huge potential of smaller and medium-sized enterprises that provide employment to large numbers of poor households.

In other words, it was recognized that SMEs were in the “missing middle”: too large for conventional microfinance, and too small and risky for conventional commercial banks. The addition of a second track in the G20 initiative focused on SMEs acknowledged that more inclusive finance could benefit poor households indirectly, and perhaps even more powerfully, by providing employment opportunities in new or growing SMEs. So the shortcoming of earlier attempts to enhance financial inclusion, focused entirely on lending to households, was acknowledged and addressed by the G20.

The conceptual framework was also broadened to include the savings needs poor households. The first generation of microfinance institutions was primarily focused on provision of microcredit. The second generation realized that the financial needs of poor households go beyond affordable credit. Research (including that supported by the Gates Foundation) has shown that poor households greatly value access to safe and dependable facilities to help manage their money. But as with credit facilities, the provision of savings facilities involving very small deposits was challenging for conventional banks. The cost of providing savings facilities for poor customers made such services unprofitable, so conventional banks either did not provide them or they stipulated minimum deposit requirements that were beyond the reach of almost all poor households. And microfinance institutions were focused on providing credit, although by the 1990s, the Grameen Bank and other mature MFI s were offering savings facilities as well.
**Potential of New Technology**

However, even conventional banks were changing, spurred by communications technology and mobile/cellular telephone technology in particular. Such innovations radically transformed the provision of savings and depositary services by reducing costs and overheads. The G20’s first track on “innovative finance” acknowledged that more inclusive finance must also include greater access to savings made increasingly possible by the new technology. Access to savings facilities is also one of the key priorities of the Gates Foundation’s grant-making in the area of financial services for the poor.

Summing up so far, the G20 initiative may be interpreted as a recognition by the G7 industrial countries that the widespread lack of access in the developing world is a significant financial market failure apart from financial instability and vulnerability to crisis. Related to this, the initiative recognizes financial inclusion both as part of a wider agenda of financial reform in the wake of the crisis, as well as part of a development agenda that the G20 developing and emerging market country members are advocating.

**Is Finance a Basic Human Need?**

That said, it may be worth raising some larger questions about the way in which universal financial inclusion is being propounded by the G20. “Financial access for all” seems to put finance on the same level as access to education (e.g. the “Education for All” initiative in the 1990s) and health as a policy objective. Unlike education and health, greater access to finance was not among the Millennium Development Goals. However, access to basic education and health may be regarded as fundamental development objectives in their own right. The MDGs, and earlier, the Human Development Index, recognized the need to elevate education and health levels to complement the more traditional goal of elevating material well-being (measured by income per capita) as fundamental goals of development.

On the other hand, access to finance (or financial inclusion) is certainly important to facilitate the material well-being of the poor. Better education and health may be regarded as ultimate development objectives, or ends in themselves, as well as a means toward improved well-being, while financial inclusion may be regarded principally as a means toward improved well-being rather than an end in itself. For example, access by poor households to credit and savings facilities may help in providing income-earning opportunities (in the case of credit) or consumption-smoothing (in the case of access to savings facilities). Access by SMEs to finance may be an even more powerful pathway to income-earning opportunities, principally through creating employment opportunities on a large scale.

Access to finance is undoubtedly an important means to these ultimate ends. But it may not be the only means. For example, financing may indeed be a constraint on the establishment or growth of SMEs, but it is not the only constraint. Infrastructure (affordable and dependable electricity and transportation) and access to markets (domestic and foreign) are also critical to
the viability of SMEs. So is education—both for workers (literate and numerate workers are more employable) and for management (business acumen is important).

**Or is Finance a Utility?**

In other words, finance may be better regarded as a utility like electric power or transportation, which facilitates other more fundamental development objectives captured by indicators such as income or employment. Moreover, it is quite possible for finance to be “a bad” rather than “a good” if it is used to excess or provided under unsustainable terms. The most obvious example is excess indebtedness, causing hardship not only for borrowers but conceivably for lenders and the financial sector as a whole as well. The phenomenon of sub-prime mortgages underlying the crisis in industrial countries is a case of finance that became “too inclusive.” Finance for all under some circumstances may lead to outcomes that are not desirable.

To be fair, the issue of financial consumer protection is an integral part of the G20 initiative (it is one of the principles approved in the G20 framework). And two of the G20 Principles for Financial Inclusion relate to getting the regulatory framework right. Indeed one reading of the G20 initiative is that it advocates building the “financial infrastructure” in such a way as to ensure maximum inclusion.

**Role of the Public Sector**

Finally the G20 initiative has a distinct, if somewhat less than explicit, bias against public sector institutions and programs. The thrust of the conclusions and recommendations emerging from the work of the sub-groups is that private sector institutions work best. The sub-group on SME financing suggests that demands for financing SMEs can best be met through “upscaling microfinance institutions and downscaling commercial banks.” (In this context “upscaling” refers to increasing the capacity of MFIs to deal with larger, longer-term loans suitable for SMEs, and “downscaling” refers to increasing the flexibility of commercial banks to be able to provide smaller loans to riskier SMEs.) The role of government is seen as important more in establishing an enabling environment rather than in providing financial services directly (e.g. through national development banks) or indirectly (via credit guarantees).

There is no question that the government’s role must include creating an environment — or financial infrastructure — that will help financial markets to operate more fairly, effectively and transparently. But in principle, governments could also provide financial services directly, either in co-operation or in competition with the private sector. If liberalized markets have failed to provide services to all those needing them, there is a rationale for government intervention to correct the market failure.

Indeed, many governments both in industrial and developing countries maintain a direct or indirect presence in financial markets through state-owned lending institutions and/or credit guarantee programs. However, in many developing countries, such institutions and programs were
associated with financial repression and many were swept away by liberalization reforms in the 1980s and 1990s.

It is true that the track-record of many state-owned banks and credit programs is mixed. There have been instances of mismanagement, inefficiency or corruption, and even where such problems were not rife, and despite attempts to be inclusive, the level of access to financial services was not a lot higher. Nonetheless, the fact is that in many industrial and developing countries such government-run institutions and programs continue to exist, despite widespread financial sector liberalization, and in some countries they play a vital economic and social role.27

In Asia and Latin America, national development banks, guaranteed credit programs and other public-sector initiatives are either the dominant players in the financial markets or significant participants. It is inconceivable that these countries could enhance financial inclusion without the active participation of these state-owned or –controlled agencies and programs.

In industrial countries public sector financial institutions and programs have existed for decades in the United States, the Small Business Administration (created in 1953) provides SMEs with access to capital, access to federal government procurement, and education and technical assistance for entrepreneurs, among other things. The mission of the Business Development Bank of Canada is to “help create and develop Canadian businesses through financing, venture capital and consulting services, with a focus on small and medium-sized enterprises (SMEs)”.

Most industrial and emerging market countries have similar institutions whose ongoing existence reflects the failure of private financial markets to adequately serve the needs of startup or existing SMEs.

There are also other examples of institutions that are not privately owned, or state-owned by the central government, but are community-based or co-operatives. In Germany, the Sparkassen Finanzgruppe (Savings Banks Finance Group) has existed for 250 years with a mandate to serve lower-income residents — thus practicing financial inclusion long before the term emerged. The savings banks are rooted in the municipalities and rural districts of Germany, providing loans and financial services to local SMEs. Particularly striking is the fact that, while their services (e.g. loans) are market-based and their operations commercially sustainable, they are not profit-maximizers. Their mission is both social and economic — surpluses are used to support social and cultural objectives of their communities.

A recent example of a community-oriented government intervention is the U.S. Treasury Department’s Small Business Lending Fund (SBLF), enacted in 2010 as part of the Administration’s initiatives to facilitate recovery from the crisis. A $30 billion fund was created to provide capital to community banks lending to small businesses. Since banks leverage their capital, it is expected that ultimately lending to qualifying small businesses will generate several multiples of the amount of capital injected. The SBLF was complemented by the State Small Business Credit Initiative, which supports new and existing state programs to leverage private-sector financing of small businesses.
Linking Financial Inclusion with Larger Policy Goals

If finance is desirable to facilitate other ends such as investment, employment and growth, rather than for its own sake, linking financial policy more explicitly to these larger ends makes sense. For example, financial policy could be linked to industrial policy, providing SMEs in certain industrial sectors with preferential access to credit or other support. In so doing, financing SMEs helps to facilitate structural change and technological development, contributing to productivity increases and economic transformation. In this way, financial sector strategy contributes not only to successful businesses but also to a more dynamic process of economic development and change. Governments in the high-growth economies of East Asia have pursued industrial policies that call for a more active role for government in the development process than envisaged, for example, in the Washington Consensus. Yet, such policies have met with some success.

Summary

To sum up, it is difficult to regard access to finance as a basic development objective on a par with access to education or health. That is not to denigrate its importance, nor to deny that more resources should be allocated to financial inclusion. But ultimately, financial inclusion and other financial sector development policies should be regarded as means toward larger development objectives rather than ends in themselves. Accordingly, the financial sector is best seen as an essential “utility” in the modern economy that facilitates the efficient working of the “real” economy. It does so by providing credit to businesses and individuals and providing other services such as savings or deposit facilities that help households and firms manage their cash resources.

Public sector institutions and programs are a vital part of the financial sector in both industrial and developing countries, as acknowledged by the background reports prepared by for the G20. Their functions go beyond providing an enabling environment (or a financial infrastructure) aimed at facilitating the efficiency of private sector actors. They also include a direct role for government or public agencies in the provision of savings, credit and other financial services. These may be effectively provided at the community, local or regional level rather than by national institutions alone.

To be sure, there are instances where public-sector interventions in the financial sector have not worked effectively — just as there are glaring examples of financial market failure involving private sector actors. But the lesson from such experiences is not that public-sector interventions are always doomed to failure. Rather it implies that the good practices of effective public interventions should be emulated and bad practices shunned. Moreover, the public sector can also work in partnership with private-sector actors (for example, through credit guarantee programs) as well as in competition, to help to achieve maximum efficiency.

Finally, particularly since the effectiveness of financial sector policies is best gauged through their impact on the real economy, a more coherent approach would involve linking financial policies to larger economic objectives, for example, via active industrial policies. This would help to deepen the impact of both.
Endnotes

1 CGIAR was established in 1971 as a strategic partnership among donors and 15 agricultural research centers working in collaboration with governments, civil society organizations and private businesses around the world. It is “guided by a vision of reduced poverty and hunger, improved human health and nutrition, and greater ecosystem resilience, brought about through high-quality international agricultural research.”

2 Financial repression refers to controls exercised by governments over interest rates or the allocation of credit, frequently through state-owned banks. It is believed that such controls undermine growth and development, and that liberalization would instead make the financial sector more efficient in mobilizing savings and allocating capital for productive investment. In the wake of the ongoing financial crisis, a certain degree of financial repression has found growing favor if it can restrain financial markets from excessive risk-taking and speculation.

3 AFI describes itself as “a global network of financial policymakers from developing and emerging countries working together to increase access to appropriate financial services for the poor.” The membership of AFI comprises central banks and other financial regulatory institutions (e.g. Ministries of Finance) from over 70 developing countries. AFI is entirely funded by the Bill and Melinda Gates Foundation, a private charity, and administered on behalf of its members by the German International Cooperation, a public federal enterprise whose sole shareholder is the German Ministry for Economic Cooperation and Development (BMZ). AFI works with its members to identify and promote “policy solutions” to increasing financial access. It also disseminates publications, convenes meetings and provides grants to members to promote financial inclusion.

4 Many of the fundamental hypotheses of the G20 financial inclusion initiative were first discussed in a policy report by the World Bank (2008), which was the first comprehensive treatment of the subject by the Bank.

5 Alliance for Financial Inclusion, “G20 Principles for Innovative Financial Inclusion.”

6 Ashoka is a not-for-profit founded by Bill Drayton in Washington, DC in 1980. Its aim is to promote positive social change by investing in social entrepreneurs with innovative, sustainable and replicable solutions both nationally and globally. It is financed by individuals, foundations and business entrepreneurs from around the world. Ashoka does not accept funding from government entities. Its budget in 2006 was nearly $30 million. “Changemakers” is an Ashoka initiative launched in 1994. It describes itself as a global online community to advance blossoming social innovations.


8 Stein, Goland and Schiff (2010).


10 25 May 2010.

11 International Finance Corporation, November 2010.

12 “Two trillion and counting: Assessing the credit gap for micro, small and medium-sized enterprises in the developing world”, October 2010.

13 Standard-setting bodies include the Financial Action Task Force, the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the International Association of Insurance Supervisors, and the International Association of Deposit Insurers.


15 G20 Seoul Summit Leaders’ Declaration, November 11-12 2010, paragraphs 55-57.


18 The other eight pillars comprised: Infrastructure; Human Resource Development; Trade; Private Investment and Job Creation; Food Security; Growth with Resilience; Domestic Resource Mobilization; and Knowledge Sharing.

19 The standard-setting bodies comprise the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the Financial Action Task Force, the International Association of Deposit Insurers, and the International Association of Insurance Supervisors.

20 In order to test this hypothesis it would be necessary to have time-series data on financial inclusion before and after the reforms. Such data do not exist—indeed, a principal focus of the initiative is to improve the coverage and quality of data on financial inclusion.

21 See Roodman (2012), Bauchet et al (2011), and Banerjee and Dufo (2009) for the latest evidence. These assessments reflect the fact that it was unrealistic to expect microcredit to transform the lives of beneficiaries or to dramatically reduce poverty. On the other hand, the assessments also conclude that microcredit has been successful in providing some households with opportunities and benefits that were previously unattainable—for example, the ability to invest in household enterprises, or in children’s education.

22 MFIs are said to be in the “semi-formal” sector since they operate within a rules-based framework that is less rigid than the formal sector but more explicit than the informal sector comprising traditional moneylenders or financial services made available through family or community ties.

23 World Bank (2008), 11.

24 See also Collins et al (2009), who put considerable emphasis on how safer and more reliable savings facilities are
greatly valued by poor households in better managing their incomes.

25 The goal of universal access to financial services was the principal theme of the World Bank’s major research report, Finance for All: Policies and Pitfalls in Expanding Access (2008).

26 The same point has been made in the context of the crisis in industrial countries, where deregulated finance has become its own source of wealth-generation (and instability), leading to the remark that “finance should be the servant of the real economy instead of its master”.


28 Lin (2011) is a key exponent of this perspective. It is important to note that at the time of writing Lin was Senior Vice President and Chief Economist of the World Bank. See also Gibson and Stevenson (2011).
References

G20 Publications


Other Sources


