ADDRESS TO THE PNG ASSOCIATION OF MICROFINANCE INSTITUTIONS (PNGAMFI)

POLICY BACKING TO ENABLE MICROFINANCE

By

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Good evening and thank you to the PNG Association of Microfinance Institutions for the invitation to speak tonight.

I must commend you for inviting speakers on a Friday night to continue discussing work, after a long week, when you'd probably all prefer to relax and be entertained!

Unfortunately, I'm not a stand up comedian and not sure I'll be too entertaining, but I'll endeavour at least not to drag on too much!

I've been asked to talk on policy backing to enable microfinance, but perhaps first we need to take a step back and consider the purpose of microfinance itself; what it's there to achieve, or what niche it's meant to fill, and then we can consider the policies to make microfinance achieve those objectives, and perhaps also what other means are also needed to achieve those objectives.

There has been long recognition, going back even hundreds of years in some countries, that the formal banking system has limited reach through the community. Demand for broader services led, for example, to early innovations like credit unions, cooperative banks, mutual societies and savings and loan societies.

Microcredit, which evolved into the broader functions of microfinance, has been a more recent response to this need in developing countries, triggered by the devastating impact of the 1974 famine in Bangladesh, which shamed some social innovators there into action.

The famous Indian economist Amartya Sen examined famines around the world, notably in Africa and the Indian sub-continent, and recognised that these were not simply the result of natural factors, like floods or drought, and sometimes even occurred alongside relative plenty; he identified that the victims of these famines simply lacked access to food which was still available, at a cost, on the market. So there was not necessarily a total shortage of food, but the poor lacked adequate 'entitlements', or, if you like, access to the capital and resources needed to acquire basic necessities, particularly in the face of major household or external risks, such as during times of relative shortage, when market prices of essential products appreciated or were driven up.

The Bangladeshi economist, Prof Muhammad Yunnus, founder of the Grameen Bank, was shaken out of the comfort of teaching, by the mass starvation during 1974, occurring just outside his own rural university. He was dismayed at the failure of the system, which allowed people to die from incapacity to buy even small daily quantities of rice. He figured that the economic theories he was teaching were unrelated to the lives of the majority of Bangladeshis, including those living on his university's own doorstep, and decided he needed to understand the local economy and these peoples' needs better. He learnt the precarious lives of the poor, and how lack of capital trapped them into a cycle of poverty, which provided little safety net from risks (like illness or accidents) and offered few avenues to escape poverty, as the cost of capital from the local moneylenders was so prohibitive that it readily dragged borrowers back down.

He approached the local bank to see why they wouldn't lend to the poor or even accept the savings of low income earners, but was told the costs to the bank would be prohibitive and illiterates wouldn't be able to complete the bank's paperwork and in any case would be unable to service their debt. His research, however, demonstrated that the rural poor in fact operated highly complex financial and exchange arrangements within their community and were reliable in honouring their obligations, but constrained by inadequate capital from lifting themselves out of their poverty, as they were effectively always chasing their tale just to survive or recover from invariable periodic difficulties. He thought if only they could access modest extra resources at an affordable rate (like that available to wealthier counterparts), so that they weren't always so close to the edge, they could utilise their very real skills and resourcefulness to lift themselves out of poverty and perhaps in some cases even prosper more comfortably.

So he undertook some trials with low cost micro-credit, to test its uptake and usefulness with poor local borrowers, using unpaid students as his banking staff to keep transaction costs down. This study evolved in 1977 into the Grameen Bank, undoubtedly the most powerful role model from microfinance, and which developed into an entity with an extensive branch network in Bangladesh and a wide range of savings, credit and insurance products. These have been emulated within Bangladesh and around the developing and even developed world and adapted to different conditions.

Initially, the model endured great scepticism from government, international aid agencies and the banking system, but there were enough supporters to support the initiative, even within some major Bangladesh commercial banks, aware of their own inadequacies and high cost structure, for example linking the Grameen Bank, which could handle large numbers of small savers and borrower with its own grass roots cost structure and community support and pressure system, with the formal financial market. But a key principle of the Grameen Bank has been the need for viability in its own right, and for each of its branches, rather than any sustained dependency on outside sources.

The Grameen Bank was established to empower people, notably women, to provide them choices and enable them to lift themselves and their families out of poverty through their own effort, rather than as recipients of handouts from government , NGOs or donors. The initial credit focus (with Grameen and elsewhere) was adjusted over time to reflect people's own needs and priorities better, including their requirement particularly for safe savings, generally the most used facility, but also for transfers and micro-insurance, providing a more comprehensive set of financial services and safeguards for all normal circumstances.

The Grameen model cannot be applied lock stock and barrel elsewhere. It's well attuned to the high population and very unequal societies, like India and Bangladesh, where there is also strong community peer group pressure. Where that model has been applied directly in some other societies it has worked less effectively. Nevertheless, the model has taken off worldwide in a variety of adapted forms, with remarkable success, including here in PNG.

To some of its disciples, but also some politicians, it's conveniently seen as some universal panacea for addressing poverty, providing extraordinary benefits if accessible to all poor households; Clearly, this is mistaken. (Some politicians here, I understand, mistakenly think microfinance is for funding SMEs rather than micro-enterprises – i.e. the informal economy!) Microfinance can help level the playing field, enabling low income earners to access a range of modest but valuable financial services, but there are clearly conditions which microfinance itself cannot address, and in nearly all circumstances microfinance is only one of the necessary instruments for poverty alleviation and opening opportunities. Microfinance itself needs the right operating conditions, including public policy environment, to function effectively.

For a start microfinance essentially operates in a monetised economy, so has little or no role in a purely subsistence or bartering society. It can help its savers, borrowers and insured avoid the direst poverty, through their own efforts, but it cannot really handle extreme catastrophes, where people's livelihoods are really wiped out by conflict, flood or other major human-induced or natural event, and can provide little opportunity to those who really have no resources or income to start with. So it doesn't replace government, or faith- based or other NGOs providing emergency relief, food for work or basic social cash transfer programmes to lift the least empowered, particularly women and children up to the first step on the ladder to access basic public services.

Likewise, if government simply fails to perform its core functions, of providing basic infrastructure and law and order services, the micro-enterprises, or informal economy, which microfinance seeks to support, simply cannot operate, or are severely handicapped. Likewise, maintaining mal-performing monopolies in service provision, as occurred with mobile telephony in PNG, and still occurs with provision of key utilities, like water and sewerage or electricity, generally undermine the informal economy, as they does (less so) the formal, although some deficiencies do provide the informal economy a few opportunities themselves , such as fuelwood instead of cheap electricity or hand-carrying goods across broken roads and bridges!

PNG is very different from Bangladesh, with its 120 million people squeezed into a compact, fertile land that lies barely above sea level. PNG is blessed with natural resources, although geographical barriers and historic factors combine to raise costs of access, business and service provision. Until recently PNG was a relatively egalitarian society, although latterly opportunities for immense wealth from resource extraction and rental and public funds have fuelled growing distortion, corruption, including through crude devices like out of court settlements and land grabs, whilst hierarchical concepts, like chiefdoms, have recently been propagated.

Clearly favourable policies and legislation are important for equitable and inclusive economic development and the effectiveness of microfinance as an instrument. But this must be policy, as put into practice, not merely policy on paper. PNG has made strong commitments since it's inception to fair and equitable development, between regions and between men and women, as well as safeguarding the natural resources and interests of future generations, notably in the National Goals and Directive Principles of the Constitution, Millennium Development Goals, as well as medium and longer terms development plans and strategies.

How many of you, for example, know PNG's National Goals and Directive Principles?

***Under the 1st Goal it states:* "everyone to be involved in our endeavours to achieve integral human development of the whole person for every person and to seek fulfilment through his or her contribution to the common good;**

***Under 2nd Goal:* every effort to be made to achieve an equitable distribution of incomes and other benefits of development among individuals and throughout the various parts of the country; and**

Equalization of services in all parts of the country, and for every citizen to have equal access to legal processes and all services, governmental and otherwise, that are required for the fulfilment of his or her real needs and aspirations; and

Equal participation by women citizens in all political, economic, social and religious activities; and

The maximization of the number of citizens participating in every aspect of development; and

Under the 4th: **economic development to take place primarily by the use of skills and resources available in the country either from citizens or the State and not in dependence on imported skills and resources;"**

This is the country's National Constitution, but how far have we strayed? The rhetoric falls far short of reality, as highlighted by PNG's invariable failure to achieve any of the MDGs by 2015, and with the worst social indicators in the Pacific and much of the Asia region, particularly in the areas like the atrocious level of maternal and child mortality and the very low level of educational intake and retention. This are all indicators of poverty, yet some leaders seemed to be blind to the prevalence of poverty in PNG; found it insulting!

How can this be so, in the midst of all this mineral and other wealth? Unfortunately the post independence zeal seems to have slipped away and been replaced by an increasingly divided society, with growing skewdness in income. The wealthy (individuals, provinces or resource owners) are increasingly reluctant to share and the poor cannot afford to share, so the worst off are really squeezed and we have a growing number of displaced/marginal persons in need of social protection (in what was always a caring society).

The NEFC reports tell much of the story how inadequate the government funding has been for basic routine functions, like infrastructure maintenance, primary education and health services at the provincial level; so the policies say one thing and reality another. We drain vast sums in bloated bureaucracies, with inadequate operating funds, and through mechanisms entailing patronage (like the District grants), conspicuous consumption and white elephants, like the Falcon jet, proposed elite hospitals (until fortunately finally dropped) and extravagant administrative overheads, including incessant overseas travel and lucrative allowances.

Today there's little sense of accountability over public government services. The responsibilities to improve governance, conditions and opportunities for the poor and opportunities for micro-finance belong to both government and the wider community, including the poor themselves. Widespread literacy and education and financial literacy combined with access to information empowers people and enables them to help themselves better and better hold government institutions accountable, inlcuding pressure government to allocate funds to the community's real priorities and then spend in accordance with those priorities.

Worldwide studies and experience have undermined past presumptions that poverty was closely aligned with ignorance or lack of capacity or effort. Of course malnutrition or long term unemployment will sap motivation and energy, but studies of household income and expenditure have demonstrated the considerable talent, ingenuity and drive being utilised constantly within the poorest households, but which can be unleashed if various constraints are withdrawn, including access to loan funds, but also with basic communication access (including roads, shipping and mobile phones) and other facilities. Not everyone can be a great or successful entrepreneur, but the poor survive largely through skills and adaptability, consisting largely of microenterprise of some sort, and could readily handle some scaling up of operations, using existing skills. The provision of literacy and some life skills training, to help rural people adapt to new conditions and opportunities is potentially useful.

Economic growth in PNG has latterly been strong, especially since about 2004, driven directly and indirectly by high commodity prices (of mineral and some renewable resources) and strong forecasts of major future developments, notably LNG, fuelled by strong demand in China and other parts of Asia. This has also driven the boom in urban housing and office property prices and rentals in major centres in PNG. There has been some growth in the small formal sector workforce, but this has barely been translated into improved opportunities for the majority, who live in rural areas and suffer from the inadequate infrastructure and often non-existent services, or are in the urban informal economy, also suffering poor services and the exorbitant cost of food and housing.

This is the PNG syndrome and it risks getting significantly worse in the next years, as the extractive industries, particularly LNG are developed, unless there is very concerted effort by the authorities to establish both suitable macro and microeconomic conditions for broad-based opportunities, including for the informal economy and microfinance. PNGLNG will, incidentally, slash their workforce back to a mere 500 full time staff once operational in 4 years time, so the main benefits from LNG in due course will be government revenue, but it will provide few sustained jobs, and probably jeopardise the already inadequate employment in other industries unless strong counter-measures are taken. So the new Informal Economy policy, which Minister Carol Kidu took to Cabinet recently, and gives primary emphasis to microfinance, is a really critical document, if applied together with other sound strategies, and not left to gather dust in what’s too often deemed a relatively marginal Department

Papua New Guinea has the lowest level of financial inclusion in the Asia-Pacific region according to a 2008 World Bank survey. There used to be an extensive branch system in the past, with some 280 PNGBC outlets, using District Offices, but declining transport access, including government charters, security and administrative capacity killed off much of that network. A recent microfinance pilot survey, commissioned by BPNG, reminded us that until the late 1980s commercial banks went to schools and introduced passbooks, but the banks found it a cost burden and have subsequently added a stack of paperwork and charges which prohibit or at least frighten off most small customers. Many, however, recognise and aspire to the benefits which such accounts can provide, particularly for safeguarding any savings. The relatively organised oil palm industry is the only agricultural industry with large numbers of small farmers holding bank accounts.

PNG launched its first micro-credit organisations in Sepik and the Highlands in early 1990s, with international NGO (e.g. from CAA – now Oxfam) support, based upon Grameen principles and giving a special focus on women to enable broader family benefit. Some schemes started well, with good repayment performance, but the Grameen's community approach and peer pressure, didn't adapt too well to PNG, and PNG's commitment to slush funds, including using some State banks, and the outbreak of ponzi scheme fever in the economically turbulent mid-90s severely undermined the prospects for microfinance repayments or savings; why borrow if you could can get a grant or large loan written off or expect massive returns from cargo-cultish pyramidal schemes, like Uvistract and MoniRain, which particularly targeted certain provinces and denominations. But, of course, it was only the selected prominent elite who benefit from these schemes, funded largely by the vast number of mostly small contributors. But these schemes did immense damage to the fledgling microfinance schemes, with those in Bougainville and some other provinces foundering barely before they'd begun.

The role of the State, including the Central Bank, should be specifically to ensure a suitable environment to foster competitive and extensive microfinance operations. These must be sound and viable, but not overly regulated, aimed at supporting a growing and vibrant microenterprise culture and encouraging more secure financial conditions for low income earners. This is achieved through better and lower cost money management, and greater escape from the usurious 50-100% fortnightly interests rates prevalent from money lenders. These microenterprises are not primarily intended to become SMEs, but to ensure broad-based participation and benefits from the monetised economy, although it's a bonus if some do achieve greater growth.

The State's broader role is provision or ensuring reliable infrastructure, security and other services essential both for any finance and large or micro-business enterprise to function, including through encouraging competition to ensure lower cost provision of communication including ICT services in PNG's unreliable and high cost business and living environment. The arrival of competition in mobile phones enabled the phone to be a liberating tool for microenterprises, and also a potential instrument for delivering microfinance itself, like Kenya's widely adopted M-Pesa mobile banking service, now being introduced in some forms in PNG by some bank, IT companies and MFIs .

Generally banks are competing to gain wealthier clients, but, as we've seen are constantly exploring new ways of making money, especially when encouraged by Government. So safe as houses or banks has proven a misnomer in recent years, even in the richest countries, notably the US, where even normally prudent bank demonstrated irresponsibility in extending services into very risk areas, such as consolidating sub-prime housing loans to borrowers with no capital and inadequate earnings. On the other hand we do need the financial sector in PNG to find effective but prudent ways to embrace lower income earners more, particularly in the future when it is critical to extend the benefits away from a small elite of enterprises and households, and, fortunate, or unfortunate, landowner groups.

In PNG the incumbent mobile provider saw rural areas as too costly, until Digicel swept in, recognising rural households as markets and potential. The rules governing microfinance need to flexible enough to embrace major technical and institutional change. Commercial banks have shunned micro-clients, as they impose a net cost, but, as with mobile banking, which has often been led by innovative ITC companies, the banking industry around world is exploring ways of accessing this market affordably, either directly through low unit cost electronic banking mechanisms, including for m-banking, but also in partnership, or in the case of BSP, by owning low cost MFIs and channelling the lowest income clients there.

Low income people do have wide network of financial transactions, focused often upon tight cash flow management, especially to cater for more major expenditure (like school or medical fees). Residents of NCD settlements agreed that the commercial banks are their preferred safest place for savings, but the high users charges and paperwork are prohibitive; then people choose chose elderly female relatives for safeguarding money, working down to burying it in the ground or in bamboo! Microfinance needs to cater adequately for this priority need.

In detailing the specific policy requirements for microfinance, I can particularly refer you all to the new Informal Economy Policy. It's just been approved by NEC, and was developed following extensive consultation, facilitated by CIMC, with stakeholders in government, private sector, including financial sector and especially the main target group in the informal economy, or 'people's economy' as it's also been termed.

This is a vitally important policy for PNG and a large segment of the country's population. It's not something to be trampled underfoot in the rush to pursue LNG dreams and for most, mirages. To work, however, it requires active cooperation from a broad range of government and local government agencies, as well as a supportive – rather than hostile - approach from the private sector and wider community, which sometimes shuns the informal economy, as making our cities scruffy. A vibrant, but orderly, informal economy, providing broad-based income-earning opportunities provides more harmonious, safer and potentially more colourful towns and cities, whilst the formal sector only grows slowly. The new microfinance support from ADB, also just approved, is also particularly welcome to help consolidate the industry, but recognising that in the end it needs to be primarily self-financing.

The first policy ‘arm’ of the Informal Economy Policy is financial inclusion of all households, and I quote “To be ‘financially included’ means having access to formal financial institutions and services. Without that access, people are said to be financially ‘excluded’’ as they have been in PNG with about 90% excluded.

The Policy argues that “<u>No single area of public policy is more important</u> for the support of viable informal economic activity in PNG, quite apart from the more general macro-economic benefits that would be generated”.

It goes on that “**Microfinance** is the appropriate policy instrument for achieving greater financial inclusion in PNG. Microfinance institutions (MFIs) in many countries have developed the capacity to provide access to the financial services needed by households in the informal economy. These services include deposit (or savings) services, remittances, payments and micro-insurance, in addition to credit. Access to savings services is the most important of these, and is the service most valued by low-income people in PNG.

Around the world, microfinance services are being provided by regulated financial institutions, both banks and non-banks. Services are offered by private, for profit, entities. They are offered by public entities and public-private partnerships, and by voluntary sector agencies and informal entities. Papua New Guinea needs to diversify and multiply the ‘service points’ at which financial services can be obtained, and to spread them right across the country. This will require, among other things, massive efforts to increase the ‘financial literacy’ of the people”

The policy specifies that financial sector policy should encourage the phased and cautious introduction in PNG of the ‘six roads to financial inclusion’ proposed by the Alliance for Financial Inclusion, recognising that some should be applied immediately and others over an extended period, “with the role of government to provide an enabling policy and regulatory environment while assuring consumer protection and the safety of deposits”. The six roads are, namely:

1. ***Agent banking***: This policy solution refers to policies and regulations governing non-bank agents partnering with banks and others to provide distribution outlets for payments and other financial services. Typical agents include retail commercial outlets such as lottery kiosks, pharmacies and post offices.
2. ***Mobile phone banking***: With the explosive growth of mobile phone usage around the world, a range of operations can be facilitated, including cash deposits and withdrawals, third-party deposits into a user account, retail purchases, over-the-air prepaid top-ups using cash in the user’s account, transfer of cash or airtime credits between user accounts, and bill payments.
3. ***Diversifying providers***: This solution deals with policies that lower the regulatory barriers for start-up institutions and offer savings and insurance products geared to low-income clients.

4. ***Reforming public banks***: This solution requires innovative policies that improve the governance and management of these institutions to help them provide more effective, commercially sustainable financial services.
5. ***Financial identification:*** This innovative policy solution helps to build inclusive financial identities that will lead to an increase in access to formal financial services. Furthermore, it helps to transform a client's transaction history into a financial asset, which can be used to gain access to a greater variety of financial services.
6. ***Consumer protection:*** This solution covers policies that address fair treatment, data privacy and security, predatory lending, clear and transparent disclosure of information, efficient and accessible dispute settlement, and comparability of rates and terms.

The policy emphasises the need for;

- a growing economy with low inflation, positive real interest rates on deposits (which is a challenge in PNG where banks tend to hold substantial major deposits, and providing little lending, so are often unenthusiastic to attract further costly deposits) and low 'spreads' between deposit and lending rates.
- Improved access to financial services, overall:
  - Lower-cost solutions to providing remittance and payment services.
- Improved access specifically for rural households to financial services.
  - Achieving the transition from subsistence agriculture by producing and monetising surpluses of traditional staple foods.
  - Increased productivity of monetized household production, driven by capital accumulation (including borrowing) and investment, as well as by capacity to access more land.
  - Shifting to higher value crops, post-harvest processing and off-farm economic activities, specifically for market and requiring more capital.
  - Household enterprises become incorporated into supply chains, involving relationships with larger and more formal enterprises. They may graduate from 'micro' to 'small' status and/or to the formal sector.
  - Linkages between rural financial service providers and formal financial institutions.
- For avoiding politicised lending, and I'd argue against grants to businesses that undermine other micro and SMEs.
- Alternatives to conventional (land-based) collateral, i.e. lending on past savings and investment performance, and
- Adequate consumer protection.
- On regulation, avoid the 'rush to regulate' MFIs , and, as I said, ensure sufficient flexibility to take on board changing technology and governance issues, and avoid unnecessary regulatory barriers to the engagement of commercial banks in microfinance, as they find new ways to engage in low unit cost activities, but facilitating professionalism in operations of unregulated MFIs.

- Set up cost- and risk-sharing arrangements for public/private partnerships.
- Encourage Credit Unions and Savings and Loans Cooperatives to stabilise and modernise their operations and to learn from microfinance.

The most important Public Goods and services which need to be provided to enable rural and urban microenterprises to function, as highlighted in various surveys carried out by INA/CIMC and partners over recent years include: -

- Reliable and affordable access by land, sea or river, particularly, including adequate routine maintenance
- Conducive market-places and other venues for buyer and sellers who may spend long periods there, and have a role in its management, with sympathetic rules, which reflect the needs, opportunities and hazards, e.g. with Betelnut
- Effective and communicative agricultural research and extension services, provided by government or other service providers.
- Other ‘spaces’ and structures in urban areas that are available for informal economy activities.
- A law and order regime in the immediate environment of market places, other ‘spaces’ and within the community (e.g. protecting food and cash crop gardens) for the informal economic activity.
- Suitable and competitive transport, telecommunications and other services.
- Adequate ‘voice’ for informal economy operators, with particular concern for the needs of women
- Supportive literacy, education and training and business development services, including for financial literacy
- Consumer protection

Ladies and gentlemen, this is a critical policy to be taken seriously, spelling out the needed measures to back microfinance and the players involved. It must not be supported widely and not left on the back burner

Thank you and everyone have a great evening.