

ASEAN Financial Inclusion for What?

Connecting the Region's Prosperity to
People's Prosperity Post-2015



Australian Government

Department of Foreign Affairs and Trade

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Aid** 

ABOUT SHIFT

UNCDF's Shaping Inclusive Finance Transformations (SHIFT) programme is a financial market facilitation, technical assistance and funding facility for the ASEAN region. SHIFT aims to facilitate the transition of low-income people's—especially women's—use of financial services from informal mechanisms to formal, regulated and higher value services.

PARTNERING FOR A COMMON PURPOSE

SHIFT collaborates with key stakeholders including Association of Southeast Asian Nations (ASEAN) governments, intergovernmental working groups, financial service providers to micro, small and medium enterprises, and development partners dedicated to expanding financial inclusion in the region, particularly in least developed countries.

UNCDF's SHIFT programme is jointly co-funded by UNCDF and Australia's Department of Foreign Affairs and Trade (DFAT). The Netherlands Development Finance Company (FMO) provides earmarked funding to UNCDF's Making Access Possible (MAP) programme in Cambodia.

ABOUT UNCDF

The United Nations Capital Development Fund (UNCDF) is the UN's capital investment agency for the world's 48 Least Developed Countries (LDCs). UNCDF uses its capital mandate to help LDCs pursue inclusive growth. UNCDF uses 'smart' Official Development Assistance (ODA) to unlock and leverage public and private domestic resources; it promotes financial inclusion, including through digital finance, as a key enabler of poverty reduction and inclusive growth; and it demonstrates how localizing finance outside the capital cities can accelerate growth in local economies, promote sustainable and climate resilient infrastructure development, and empower local communities. Using capital grants, loans, and credit enhancements, UNCDF tests financial models in inclusive finance and local development finance; 'de-risks' the local investment space; and proves concept, paving the way for larger and more risk-averse investors to come in and scale up.

BACKGROUND

This paper is built on UNCDF's contribution to the 2014 ASEAN Financial Inclusion Conference, hosted by the Government of Myanmar in its capacity as Chair of ASEAN. The Conference was held in October 2014 in Yangon, Myanmar and forms part of SHIFT's policy, research and advocacy agenda.

The analysis is founded on new disaggregated data collected from poor households about their own financial decisions by the UNCDF Making Access Possible (MAP) programme and the World Bank's FinDex, insights from the Consultative Group to Assist the Poor (CGAP) Human-Centered Design project, and from preliminary consultations with selected Ministry of Finance and Central Bank officials of ASEAN Member States and the ASEAN Secretariat.

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The views expressed in this publication are those of the author(s) and do not necessarily represent those of the United Nations, including UNCDF, their Member States or their partners.

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Abbreviations and Acronyms

ASEAN	Association of Southeast Asian Nations
CGAP	Consultative Group to Assist the Poor
GDP	Gross domestic product
HCD	Human Centred Design
IOM	International Organization for Migration
MAP	Making Access Possible
PCF	People's Credit Fund
SEZ	Special Economic Zone
SHIFT	Shaping Inclusive Finance Transformations
UN	United Nations
UNCDF	United Nations Capital Development Fund

Executive Summary

Bringing the majority of people into the formal financial sector by giving them access to regulated financial products and services, known as 'financial inclusion,' can and should be an essential policy pillar in the quest for equitable growth in ASEAN¹ countries. This note makes specific recommendations, both at the national and regional levels, that requires cooperation and coordinated action by national governments and development partners, including private sector companies, to shape financial market development in the ASEAN region.

Financial inclusion is increasingly seen as a preferred policy to enable poverty reduction and economic growth. Recent data provided by household-level surveys in the region are reinforcing these policies. The data suggests that financial inclusion does not always follow economic growth but that, conversely, inclusion can help trigger growth. This paper goes on to make recommendations about how to achieve financial inclusion in a way that will move both households and small enterprises out of poverty while sustaining growth for the region's 600 million people. This could prove particularly significant for countries aspiring to graduate from least developed country status or to break out of the middle-income trap.²

Key recommendations

At the national level, ASEAN member states would benefit from **integrating financial inclusion as a central pillar of their overall development policy**. Beyond delivering a full portfolio of financial services offered by a variety of service providers, this requires **developing comprehensive financial inclusion policies** that address the development of financial sector infrastructure and distribution networks to ensure physical access for the majority of people. These initiatives would need to be tailored to the specific needs of each market segment. Policies could, for example, address barriers that exclude women, youth and other potentially marginalized groups like the rural poor (meaning people who earn an income of US\$1.25 or less per day).

At the **regional level**, financial inclusion can be further advanced with a better **understanding of cross-border financial flows at a household level**, so that government policies can encourage families to move more money through formal financial institutions channels and also at real economy³ enterprise levels. While there are ASEAN working groups dedicated to boosting the transition of countries from one stage of market development to the next, ASEAN would benefit from an advisory group to oversee the coordination and implementation of actions addressing common financial inclusion issues. Since the existing levels of financial inclusion across ASEAN countries vary greatly, as do levels of financial sector development in general, policies should be tailored to each country's specific circumstances. For example, countries such as Cambodia, Lao PDR, Myanmar and Viet Nam **would benefit from moving beyond thinking of financial inclusion purely in terms of microfinance and begin offering people a broader range of financial services**. Meanwhile, countries including Indonesia, Malaysia, the Philippines and Thailand already offer a broader range of services, but would benefit from further developing their financial inclusion strategies. Countries that miss this window of opportunity to address financial inclusion will likely be left behind in the post-2015 world.



01

ASEAN

governments are searching for innovative solutions in the face of relatively fewer resources, growing inequality and greater scrutiny

Governments across the globe are facing new economic and development challenges with far fewer fiscal and human resources than they enjoyed in the closing three decades of the last century. The UN's post-2015 development discussions illustrate that many of these challenges are shared by countries in the ASEAN region. A distinct political economy, culture and history shape the particular set of pressures faced by ASEAN countries, especially those in the least developed and lower-middle-income countries.



The sharp rise in inequality will lift fewer people out of poverty

The developing economies of Asia have attracted enormous attention over the last four decades because of their ability to combine high rates of economic growth with relatively low levels of inequality and impressive rates of poverty reduction. These growth drivers were seen to be spearheading the “rise of the rest,”⁴ in a wholesale remake of the global economy. However, a series of shocks, including the Asian financial crisis of the late 1990s and the global financial crisis of 2008-09, have contributed to economic instability, and lowered expectations that Asia will be able to repeat the spectacular successes of the past. Growth rates are now significantly lower compared to the 1980s and 1990s and inequality has risen sharply over the last two decades (Kanbur et al., 2014).⁵ This rise in inequality means that growth will yield a lower rate of poverty reduction and fewer new jobs than was the case previously. The ongoing economic recession in many developed economies following the 2008-09 financial market meltdown further illustrates for Asia the dangers of over-reliance on exports to a narrow set of markets. Fortunately, as a result of the Asian financial crisis, many countries within ASEAN have already reoriented their trade towards neighbouring, intra-Asian markets.



There is a growing vulnerability to poverty in the face of diverse and unpredictable shocks

A large proportion of the global population has escaped poverty but remains just above the poverty line and is thus highly vulnerable to financial shocks, health problems, food price fluctuations and natural disasters (Chen and Ravallion, 2012).⁶ Over the past decade, governments have often responded to such shocks by providing social safety nets to prevent people from falling back into poverty. Such social protection measures have helped counteract the worst potential effects of these problems. However, existing just above the poverty line, low-income households remain vulnerable.



Opportunities to reap the demographic dividend through healthier and more educated young people risk turning into a liability

It is clear that ASEAN countries should invest in their young people to raise productivity and attract further investments in the real economy. If these investments are made wisely, these young people will represent an important 'demographic dividend.'⁷ However, if managed poorly, healthy, educated young people could just as easily become a liability, reinforcing the cycle in which households and countries are unable to break out of their respective middle-income traps. In trying to raise the overall participation rate of young people, women in particular have an extraordinary potential to contribute and risk missing this opportunity. If growth is dependent on securing maximum workforce participation, women must be financially included, given they constitute half the population. Unfortunately, women's economic activity across ASEAN-6⁸ countries is substantially lower than that of men's, with a gap of around 30 percent between the two groups in Indonesia, Malaysia and the Philippines (Credit Suisse, 2012).



The consequences of subnational inequalities need to be carefully managed

Increasingly, economists and development partners worry that the economic integration and liberalization of financial markets, both globally and throughout the ASEAN region, will result in narrow corridors of spectacular growth surrounded by a hinterland of poverty and near stagnant sub-economies. Finding ways to ensure that regions and groups are not excluded from the benefits of growth is a looming challenge for policymakers who seek to reduce the risk of future social tension over economic inequality.



Governments are being asked to do much more with fewer resources

Globally, governments are expected to deliver a wider set of economic and social welfare results than ever before. However, the environment within which some governments are operating is far from ideal: declining state resources for capital investments, transfers and revenue expenditures; decreasing foreign aid flows, mobile capital flows and supply chains relative to other financial flows; and higher domestic consumption that puts a downward pressure on domestic savings. All of these factors are putting pressure on the fiscal resources of the state and limiting its fiscal leeway to act.



Governments are under pressure to find new solutions to real economy problems for the many, not just the few

The rise of a well-informed, middle class across much of developing Asia has required governments to formulate policy under much greater public scrutiny and higher expectations than ever before.



There is less confidence about drivers of growth and in traditional approaches, leading to a search for new, forward-looking policy instruments

During the 1980s and 1990s, governments achieved growth by raising investment to gross domestic product (GDP) ratios. After the economic shocks of the last two decades, there is a growing interest in raising not only the pace but also the quality of output growth.⁹

ASEAN government concerns about the diminishing returns from high investment to GDP ratios coupled with an emphasis on equity and decent jobs has led to higher levels of public investment in education and innovation. For example, Indonesia now spends a fifth of its total budget on education while Cambodia has begun prioritizing human capital development. Other public policy concerns include how best to build partnerships between private sector companies and communities in order to expand the financial space needed for change.

ASEAN countries, especially the least developed countries in the region, Cambodia, Lao PDR, Myanmar and Viet Nam, as well as lower-middle-income countries, are in search of new ways to tackle these public policy challenges to growth and equity.



02

Ensuring that access-for-all financial services complements other policies in the drive towards equitable economic growth

This report lays out six ways that financial inclusion can trigger equitable growth and address current public policy challenges in post-2015 ASEAN countries.

There is growing evidence that when financial sector development is inclusive it can reduce rates of poverty and inequality. The availability of appropriate and affordable financial services improves the welfare of poor people since they can use their money more efficiently. Not only can they start saving but they can also gain access to financial products such as loans and insurance. Furthermore, banks and other financial institutions are able to mobilize these savings for investments that, in turn, can help grow the country's productive sector. The whole financial system becomes more efficient and a driver of economic growth. Meanwhile, an improved financial infrastructure¹⁰ reduces contracting and transaction costs, which can further accelerate growth.

Evidence shows that financial inclusion allows individuals and households to participate in the national economy, manage consumption and health risks, expand small businesses that create jobs and contribute to national savings and government revenue. Consumption levels will be raised, increasing the size of the domestic market for goods and the fiscal space, which provides the government with the resources it needs to invest in education and better governance. This includes more capacity to implement regulation or state-administered support. By allowing the poor, as well as the rich, to move up the economic ladder, financial inclusion can also be a powerful, market-friendly tool to manage latent social conflict. As social unrest is often caused by poverty, access to financial services provides the tools to reduce vulnerability of the poor by providing a way out of poverty, reducing inequality and providing access to basic services. Greater investment in young people and lower levels of social conflict will, in turn, attract higher volumes of foreign direct investment as well as likely long-term investments in technology and infrastructure.

Research has shown that in countries with developed financial infrastructure, the income of the poorest quintile grows faster than average GDP per capita, income inequality falls more rapidly, infant mortality reductions are larger and rates of child enrolment in primary schools increase (Beck et al., 2004). Conversely, high levels of financial exclusion pose a risk to political stability and impede economic advancement. Hence, there are many reasons to argue that financial inclusion could and should become a policy instrument of choice for developing countries generally, and within developing Asia and ASEAN in particular. However, it is crucial that development allows for a broad diversity of financial service providers to meet different markets and needs, combined with a robust regulatory environment and enabling infrastructure.

The increased availability of data produced by comprehensive, consumer-focused surveys like FinScope and FinDex provides an evidence-based approach to measure levels of access to financial services in particular countries across income ranges and other demographics. These sources are generating new national data that allow for disaggregation of the adult population into discrete segments with differing profiles, needs, behaviour and usage of financial services, across products and providers. When these kind of data are combined with the supply-side picture (such as formal and informal financial service providers), it produces a complete picture that will help policymakers create a road map to ensuring financial inclusion for everyone (see Figure 1).

Additionally, the growing body of behavioural research produced by projects such as Financial Diaries and Human Centred Design, are complementing national-level surveys and data sources to paint a more

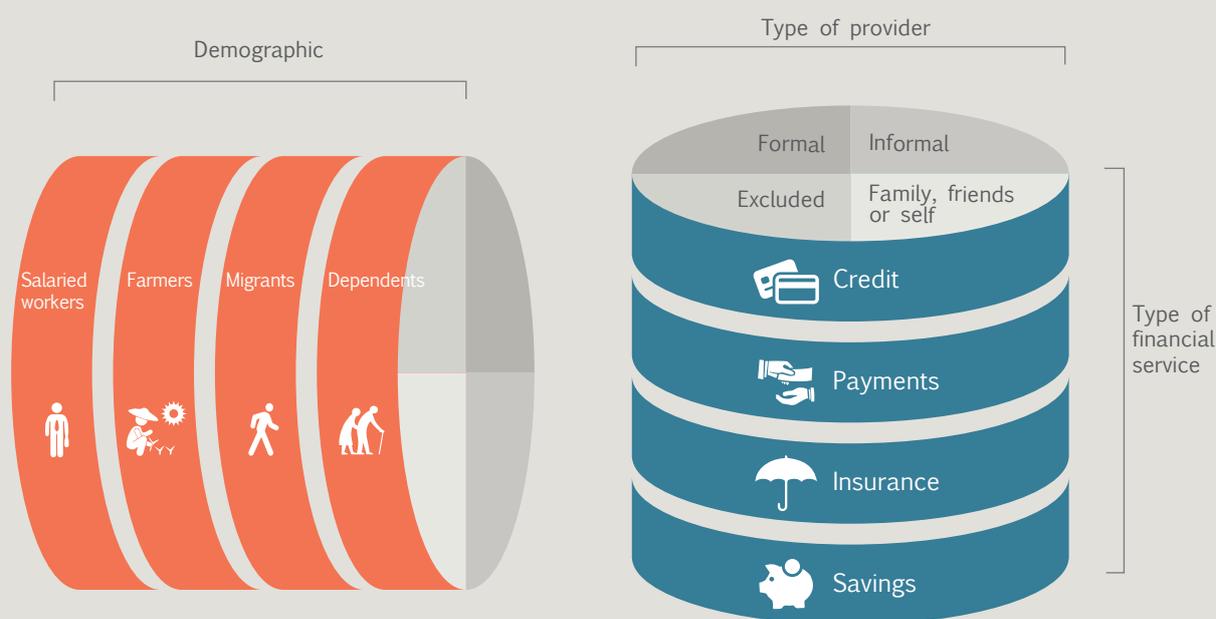
“ A key challenge is how to create the broader interconnected ecosystem of market actors and infrastructure needed for safe and efficient product delivery to the poor.”

(Ehrbeck et al., 2012)

nuanced picture of household behaviour over time. Taken together, these trends and data offer six distinct but often complementary pictures of how financial inclusion can trigger growth and help

address a number of the public policy challenges faced by ASEAN governments in the post-2015 world, especially the least developing and lower-middle-income countries in the region.

Figure 1: UNCDF’s MAP surveys provide data about financial service use disaggregated by market demographic, provider and type of service

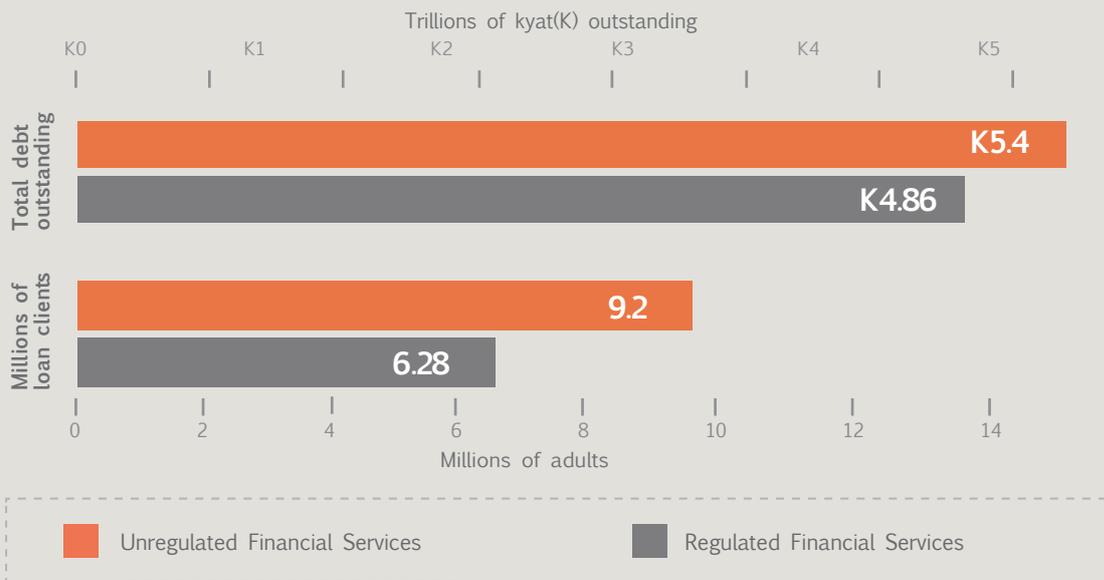


Leveraging the contribution of the smallest economic agents for national saving and investment

Financial inclusion allows even the smallest economic actor to contribute to national savings and investment. For example, in Myanmar the source of just over half of all credit is informal (see Figure 2). These funds are not deposited into the formal financial system, and thus it is difficult to reap the benefits for investment at a national level. In contrast, the Government of Thailand

established Village Funds linked to state financial institutions, which have begun to use low value contributions at the local level for national investment. The Village Funds contribute five percent of national savings (9 billion baht, US\$264 million) from 5.3 million adults, more than half the number of total savings clients in Thailand.

Figure 2: Unregulated credit activity by number of loans and loan debt in Myanmar



Source: MAP Myanmar, FinScope, 2013



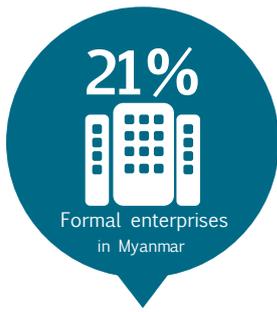
Creating an income and consumption ladder out of vulnerability

Financial inclusion allows poor households and businesses and those hovering just above the poverty level to manage economic risk through the use of savings and investment accounts and health and asset insurance products. These products are cheaper than traditional forms of informal money lending, and they help people to escape poverty or near-poverty.

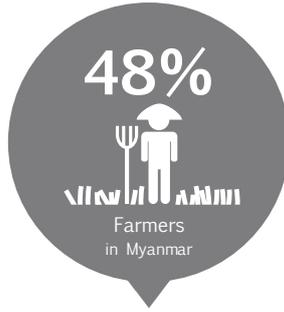
Financial inclusion also allows individuals to use financial products for specific needs, while a limited product offering leads to incorrect use of products

that can hamper progress along the income and consumption ladder. Risk mitigation (savings and insurance) products can be just as important to economic growth and social welfare. In fact, their absence undermines the productivity gains brought about by increased credit.

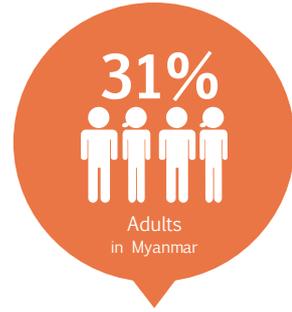
The Making Access Possible (MAP) Myanmar initiative finds that more than three quarters of those who use regulated financial services use only one financial service. This demonstrates that adults in Myanmar have very narrow access to financial services.



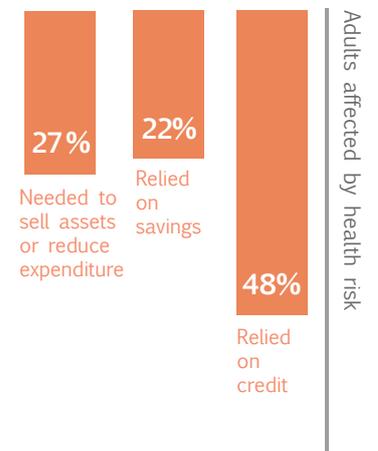
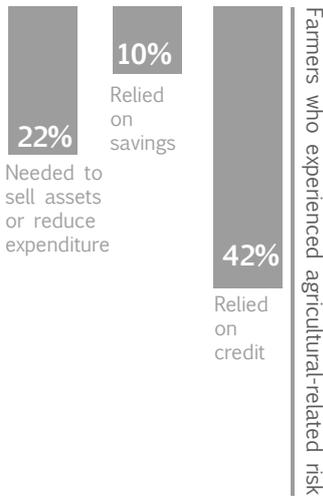
Reported using either savings or credit to mitigate insurable risks.



Experienced crop losses without the safety net of insurance.



Were affected by health risks the previous year and relied on credit, sale of assets or their savings to manage costs.



Extending the reach of the state in building human capital

Financial inclusion can complement public approaches to building human capital. By empowering consumers and reducing vulnerability, financial inclusion can allow even poor households to invest in education and health, which in turn raises skills and productivity. This is different from more familiar forms of poverty alleviation and social protection measures such as cash transfers, commodity subsidies or even

traditional forms of microcredit, which focus on ensuring households move above the national poverty line.

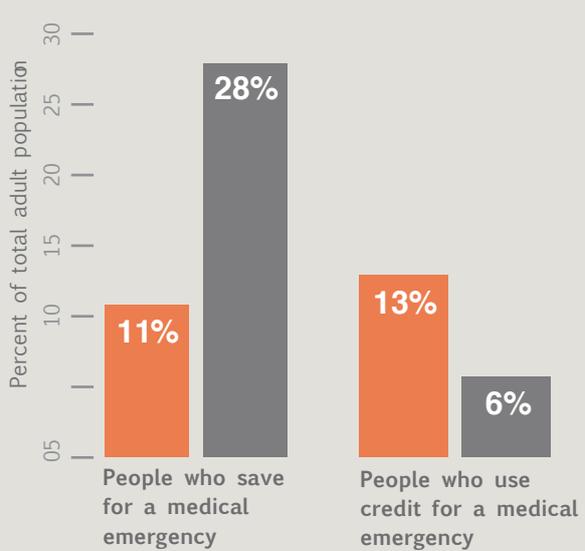
Field data suggest that, given the opportunity, households will use savings, insurance and credit to improve their health and educate their children, thereby improving the human resources of the nation through their individual efforts (see Figure 3).

Figure 3: Percentage of adults in Thailand and Myanmar who use savings or credit for a medical emergency or education expenses



Rich or poor, people invest in their health through a range of financial services

Myanmar
Thailand



Myanmar

In Myanmar, credit is used to manage living expenses. Adults in Myanmar who have no form of public or private health insurance report spending an average of 10 percent of their monthly income on health-related expenses.

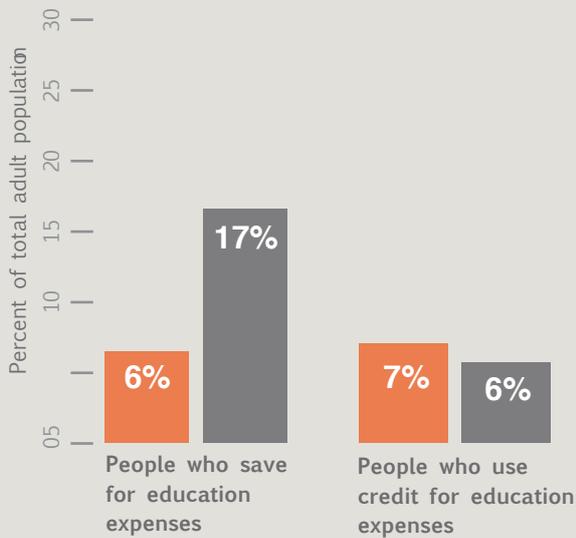
Thailand

In Thailand, where universal health care exists, a significantly higher percentage and more than a quarter of the adult population rely on savings for future medical expenses.



Investments in education are often prioritized in the household budget

Myanmar
Thailand



Myanmar

In Myanmar, respondents who spent money on education reported spending on average 15 to 20 percent of their monthly income on it.

Source: MAP Myanmar, FinScope (2013); MAP Thailand, FinScope (2013)



Enabling social mobility

Financial inclusion can encourage business start-ups and develop micro- and small-sized enterprises. This, in turn, supports the emergence of a domestic entrepreneurial class, one that can provide the ‘missing middle’ common to many developing countries in Asia. Yet not all micro- and small-sized enterprises can be treated alike as shown

by the data collected by MAP Myanmar.¹¹ Disaggregated data enable policymakers to identify where and how different types of enterprises operate, their demographic characteristics and their financial service usage. Governments can then introduce tailored policies to encourage the growth of these businesses.



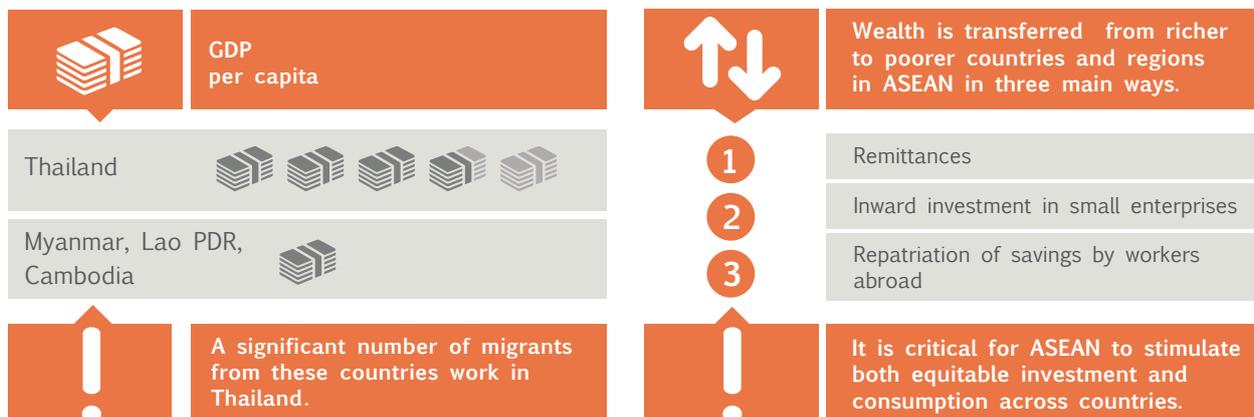
Leveraging remittances for growth, rural development and redistribution of wealth

Most countries within ASEAN, as well as parts of developing Asia, are in the midst of a historic economic and social transformation, spearheaded by the migration of labour out of agriculture and into industry. Moreover, the creation of an international market for labour has led to an expansion of migrant labour overseas. Disaggregating by different demographic markets shows that remittance receivers

or dependents are one of the largest groups of adults in many developing countries, particularly within poorer subnational regions. Thus this group’s consumption, driven by remittances, can be a major driver of growth in these areas. This is clear in countries like the Philippines where remittances have become a major contributor to consumption, investment and government revenue.

SNAPSHOT

Remittances are emerging as a powerful mechanism for the redistribution of wealth from higher- to lower-income countries in ASEAN and from urban to rural areas within countries. However, policies that enhance formal access to financial services for undocumented migrants and that introduce innovative cross-border financial products and channels are still missing. When in place, they will positively affect both sending and receiving economies.





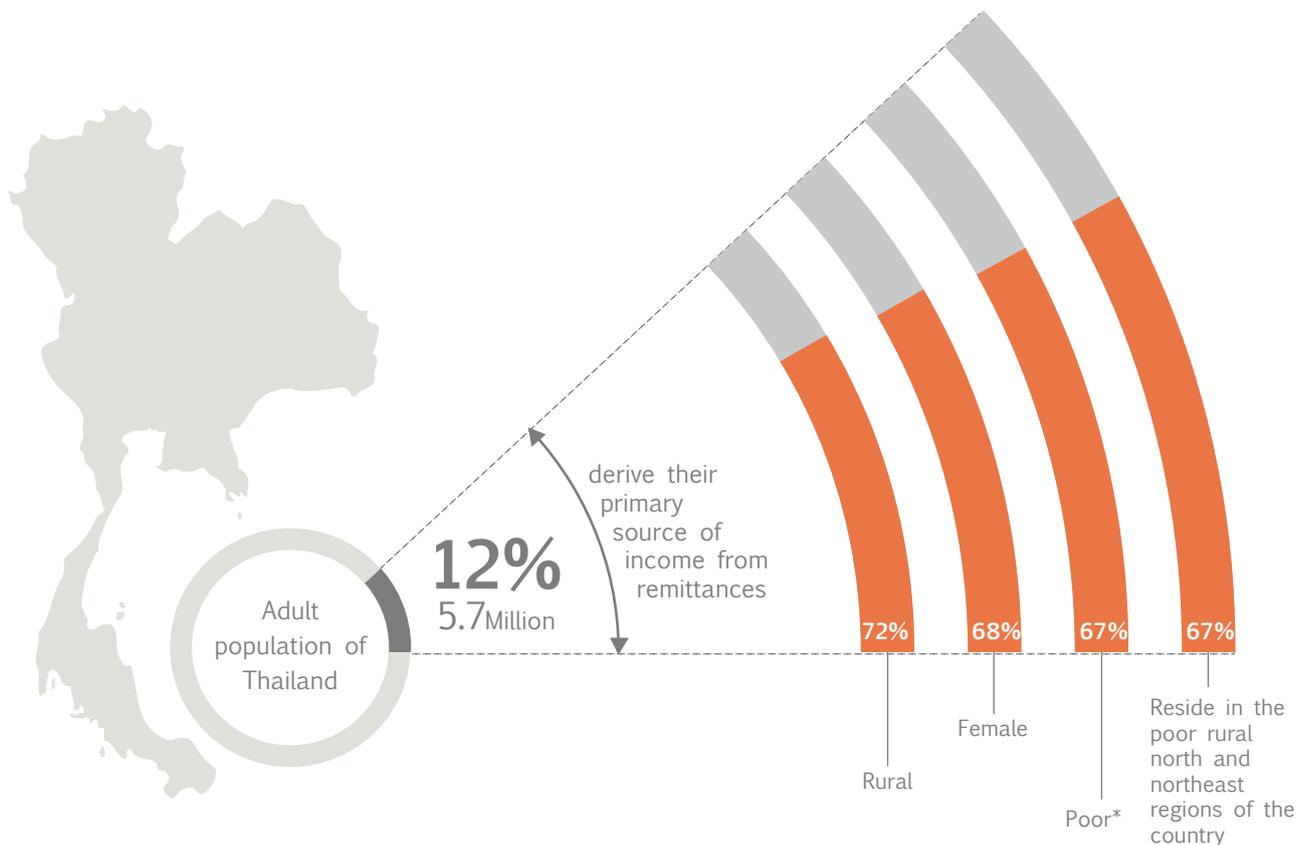
FinScope Myanmar (2014) reports that **2.91 million people from Myanmar** receive remittances from abroad

29% of whom receive their remittances from Thailand

and an estimated **2.5 million** are **undocumented**
(IOM, 2012)

DISCLAIMER: The designations employed and the presentation of material on this map do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations or UNCDF concerning the legal status of any country, territory, city or area or its authorities, or concerning the delimitation of its frontiers or boundaries.

Remittances play a key role in improving the welfare of remittance receivers and help support the consumption economy in these regions.



*(less than US\$175, THB 6,000 per month)



Turning infrastructure corridors into economic corridors

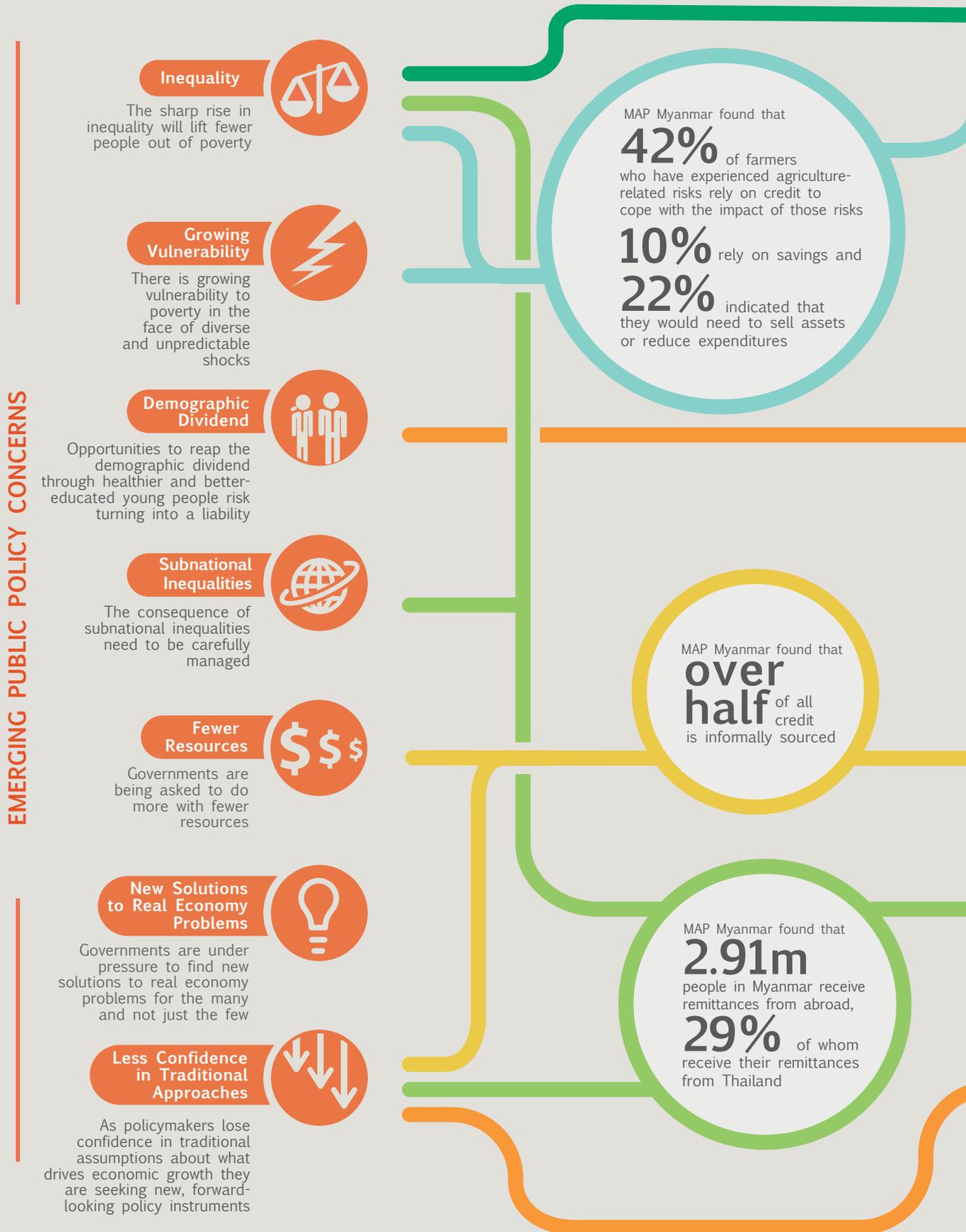
As policymakers begin to place more emphasis on the relationship between geography and economics and the promotion of new urban growth centres and special economic zones (SEZs), a major policy challenge is how to shorten the time between infrastructure investment and complementary economic activity. Since large-scale infrastructure may temporarily increase inequality, infrastructure corridors need to be quickly turned into economic corridors (Ishida and Isono, 2012).¹² In the context of ASEAN connectivity, financial inclusion can reduce the time taken to turn infrastructure corridors into economic ones by allowing micro- and small-sized enterprises to participate in ancillary activities resulting from infrastructural investment and new supply chains. This in turn reduces the risk of a rapid increase in economic inequality that has been a trigger for social conflict in many parts of the world.

Taken together, insights from new data offer a powerful case for the potential of financial inclusion to address some key policy concerns for governments, especially in least developed and lower-middle-income countries. Figure 4 illustrates the value of financial inclusion as a public policy choice as it relates to each of the emerging public policy concerns within ASEAN as set out in Section 1.

Women have the potential to assume multiple economic roles but not without targeted support and interventions

Women increasingly play a role as consumers and tend to spend more on their children's education and health, which improves the social mobility of their family. Anticipated trends such as a growing demand for labour as well as labour mobility create new opportunities for women's empowerment as employees in enterprises or as entrepreneurs in their own right. However, social and cultural barriers and a lack of legal protection hinder women from gaining equal access to these opportunities. Where and when they do manage to participate, women usually occupy more vulnerable positions that result in greater personal insecurities as well as economic ones. Policymakers must pay special attention to these challenges if they hope to financially include women.

Figure 4: Links between emerging public policy concerns and the value of financial inclusion as a public policy choice



MAP Myanmar found that

2.5m adults
finance their business from
their savings and revenue,
undermining their potential
productivity

MAP Thailand found that
for adults living in Thailand,
spending on education
accounts for

14% of credit usage
and consumes
25% of personal
savings

MAP Thailand found that

5.3m adults
save via government Village
Funds, contributing to
5% of national
savings



Income and Consumption Ladder

Creating an income
and consumption
ladder out of
vulnerability



Building Human Capital

Extending the reach
of the state in
building human
capital



Social Mobility

Enabling social
mobility



National Saving and Investment

Tapping into the
national savings and
investment potential
of households and
small businesses



Remittances

Leveraging
remittances for
growth, rural
development and
redistribution



Economic Corridors

Turning infrastruc-
ture corridors into
economic
corridors

FINANCIAL INCLUSION AS A POLICY CHOICE

Box 1: Addressing emerging public concerns through financial inclusion in Myanmar

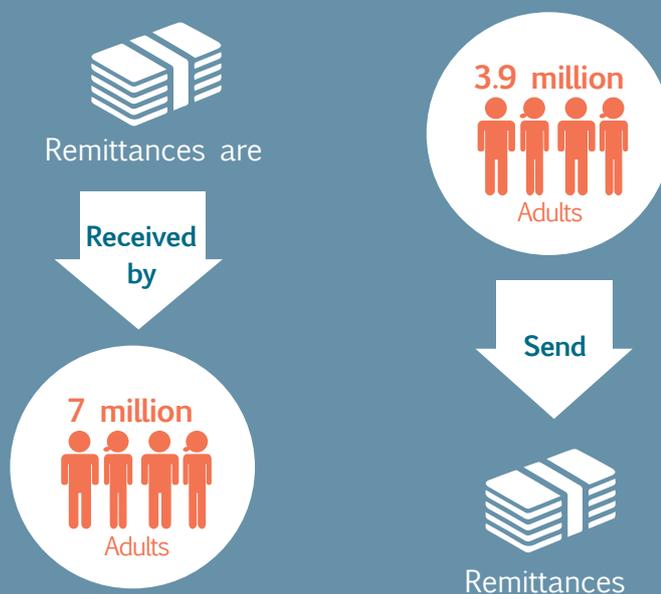
Historically, Myanmar has lacked accurate data on its development progress. Macroeconomic data have significant gaps and household data have not been collected since the last official census in March 1983.¹³ The lack of accurate data creates uncertainty around the current economic environment and what the government's priority policy concerns should be. In 2013, a FinScope Consumer Survey was conducted in Myanmar as part of the MAP programme, interviewing 5,100 adults across all regions and states. These data were able to fill in some of the gaps on the current economic environment and provide insights into how financial inclusion can address some of Myanmar's emerging public policy concerns. Key insights include:

○ A more inclusive financial system can address the shortage of capital in Myanmar.

At the time of the FinScope survey, more than half of all credit was provided informally from adults in Myanmar to other adults in Myanmar. Qualitative research confirmed that this was surplus savings that was being on-lent at higher rates of interest than was offered from a savings account at a bank. The low level of bank deposits, coupled with restrictions on foreign capital and fluctuating exchange rates, has resulted in a shortage of domestic capital. Myanmar can increase domestic investment and growth if it can bring informal lending into the formal sector through appropriate financial inclusion policies.

○ Financial inclusion can help mitigate regional inequalities.

Myanmar has a large migrant population that remits money locally between urban and rural areas.

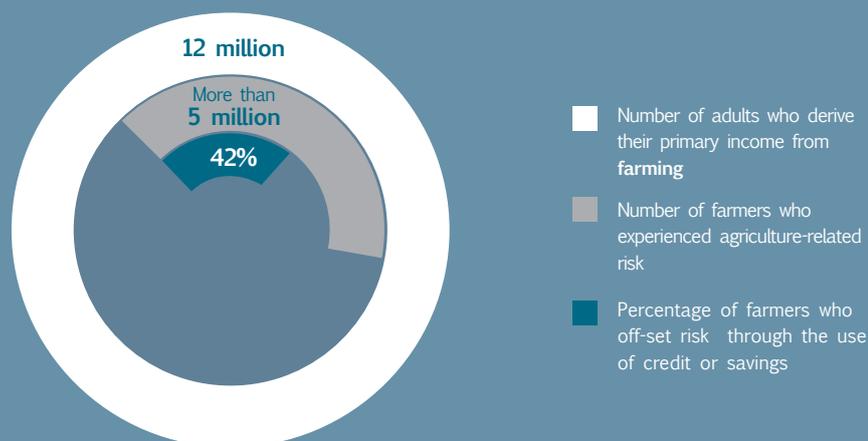


These transfers were traditionally conducted through unregulated networks but are increasingly occurring through regulated banking channels. However, rural adults still remain largely underserved by these channels, with only 12 percent of rural adults living within 30 minutes of a bank branch. Regulated channels provide a more efficient option for transferring wealth between rural and urban areas and can be used to provide a broader portfolio of financial services to adults living in rural areas.

○ Enabling farmers to reach their true productive potential as drivers of growth in Myanmar.

Farming sustains the livelihoods of 23 million adults in Myanmar. Agriculture contributes up to 60 percent of GDP and 30 percent of exports. However, the role of agriculture has been diminishing. The Government has made agriculture productivity a priority by providing low-cost credit through the state agricultural bank, but the productivity of this credit is being undermined due to the lack of appropriate risk mitigation mechanisms.

This diverts the intended state-provided credit away from productive purposes toward risk management. Thus the development of the insurance market will be critical in supporting agricultural growth.



Source: Adapted from Chamberlain et al. (2014)



03

Financial inclusion policies are essential to ensure equitable growth across the ASEAN region

Financial integration that does not include the poor risks not only future growth prospects but also the creation of an artificially protected silo, similar to a luxury gated housing community. Enabling those who are financially excluded to save, invest and better manage their financial resources may prove to be an important trigger for growth and transmission of welfare. Seen in this light, financial inclusion can help achieve the goals laid out under the third pillar of the ASEAN Economic Community Blueprint on Equitable Economic Development.

Reconciling financial integration with financial inclusion priorities

Financial integration remains the overriding policy orientation in ASEAN, driven on the one hand by the fear of financial instability and, on the other, by more conventional views about what drives growth, such as trade, investment and the establishment of large enterprises and multinational companies. This approach may not fully hold in the post-2015 world. The integration of a range of financial services, from banking to insurance and capital market development, is a way to reduce the risk of financial instability and improve the regulatory effectiveness of central banks. The result is a focus on the internal consistency and viability of the regulated financial sector, rather than on the extension of formal regulated channels of financial services to those currently excluded.

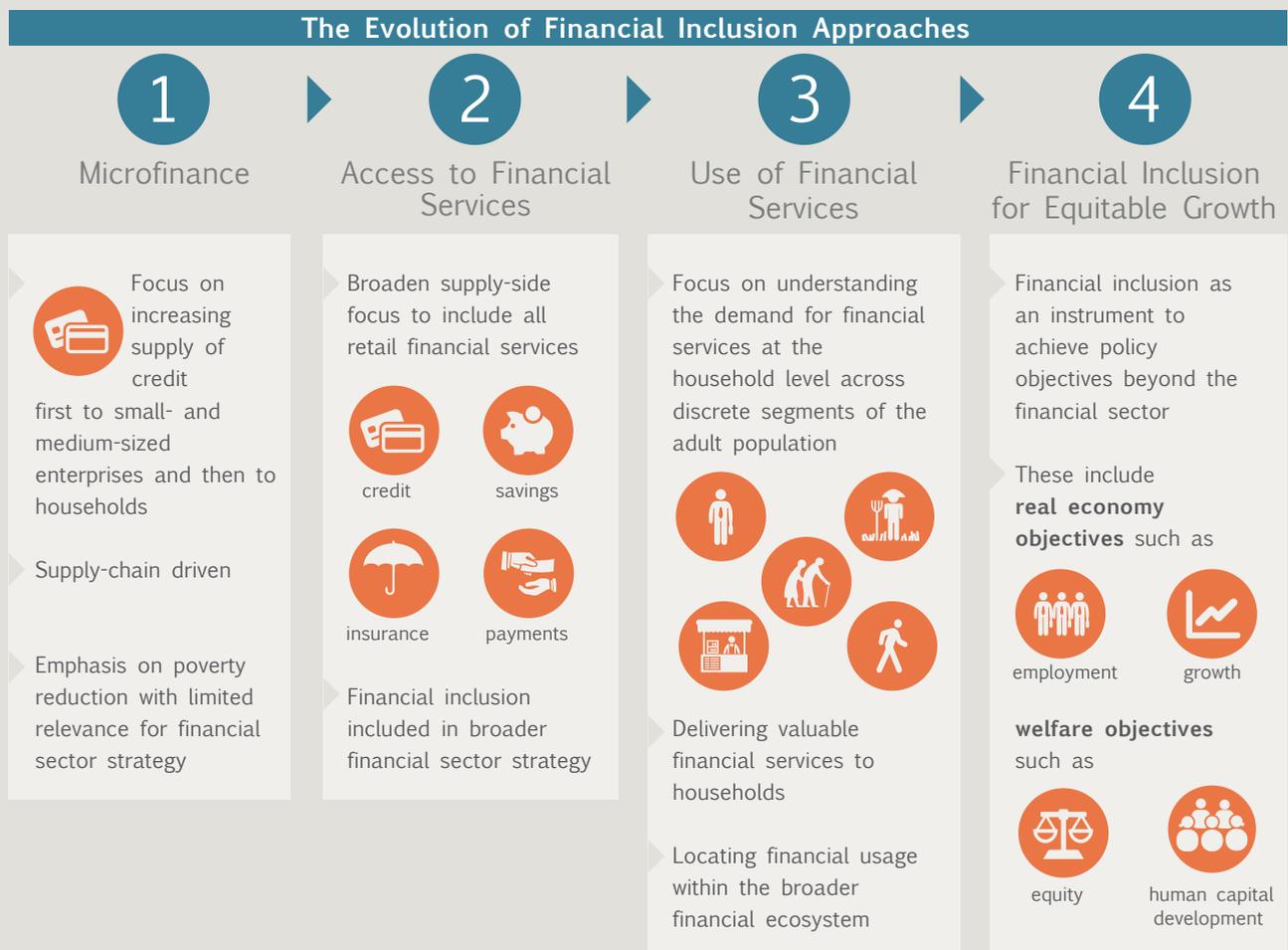
An ASEAN-wide approach toward achieving rapid

financial inclusion beyond its small- and medium-sized enterprise promotion window has yet to be developed. This section lays out the necessary steps towards mainstreaming financial inclusion policies into ASEAN's financial integration agenda.

Evolving the thinking and practice on financial inclusion

There is a need to think beyond financial inclusion as purely microfinance—with its exclusive supply-side credit and savings focus—and to recognize the importance of placing consumers and their financial needs within the larger financial system in which both financial service clients and suppliers operate. Policymakers should also consider the many different methods of financial inclusion and how they can help achieve critical national economic and social objectives. Figure 5 illustrates the evolution in financial inclusion thinking and practice.

Figure 5: The evolution of financial inclusion approaches



Appreciating differences in inclusion and stages of market development

The approach to financial inclusion will be country and region specific. Although ASEAN is one region in terms of its aspirations, as captured in the ASEAN Economic Community Blueprint and Road Map, it is also a group of countries that, in terms of size and structure of national financial systems, is more diverse than the European Union (Menon, 2012).

Navigating through the political economy

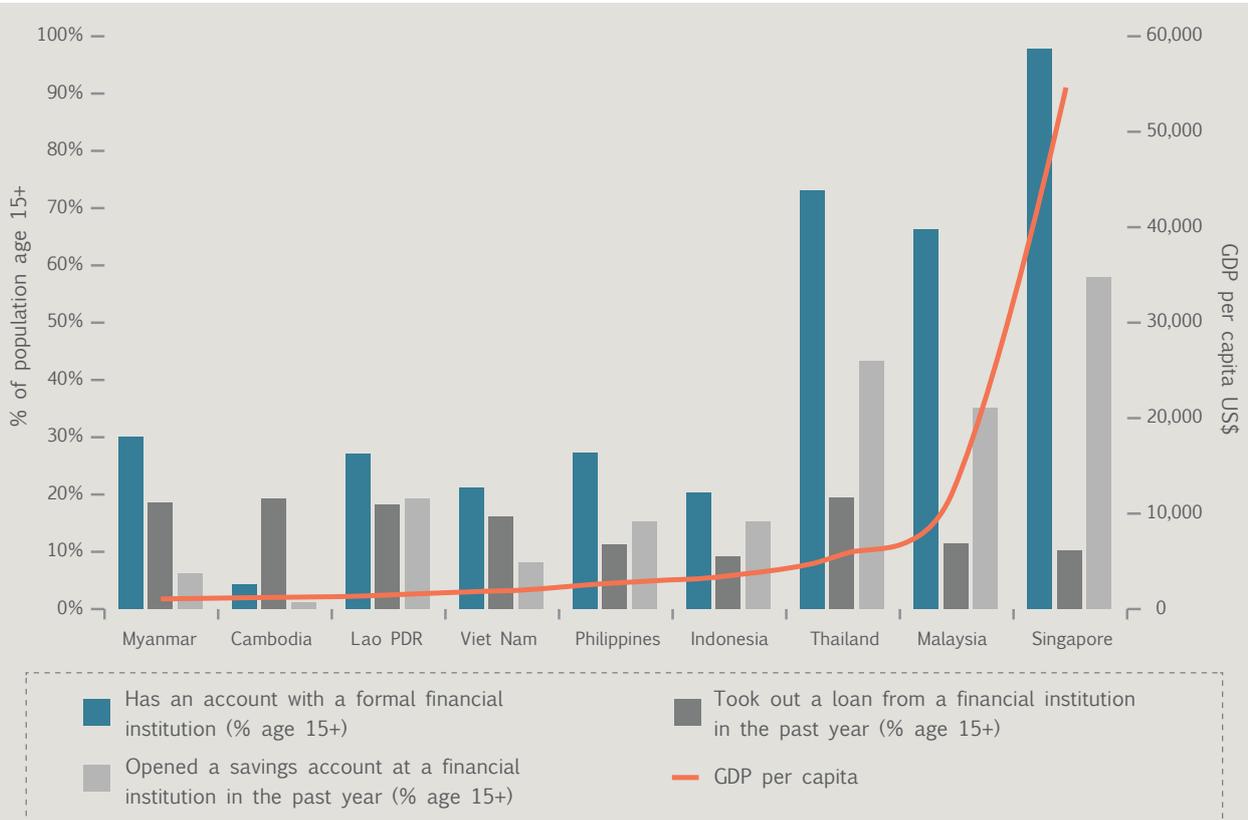
Singapore is one of the richest countries in the world while Myanmar is one of its poorest. Indonesia is the fourth most populous country in the world and an archipelago of over 17,000 islands, whereas Lao PDR is a landlocked country with just over six million people. Some countries have experienced the trauma of prolonged civil war and social conflict, whereas

others have enjoyed relative political and social stability. Some are very open market economies while others are still heavily controlled by the state and a central planning apparatus. And all operate within a contested space where interests, priorities and resources have to be negotiated and shared. All these differences present both opportunities and constraints to the rapid expansion of financial inclusion across the region.

Moving from best practice and generic templates to tailored solutions based on evidence and national visions

If financial inclusion is to be the policy choice for developing Asia and ASEAN in the 21st Century, then the formulation of a financial inclusion strategy will need to be tailored to each country's location, community, national development orientation and stage of market development.

Figure 6: Percentage of adult population using financial services versus GDP per capita in selected ASEAN countries



Source: MAP Myanmar, FinScope (2013)

Differences in financial inclusion rates

Figure 6 illustrates the different levels of financial inclusion across ASEAN countries. Rates of financial inclusion vary significantly, from Singapore, where virtually 100 percent of the adult population has an account at a formal financial institution, to Cambodia, where formal penetration is less than 5 percent.

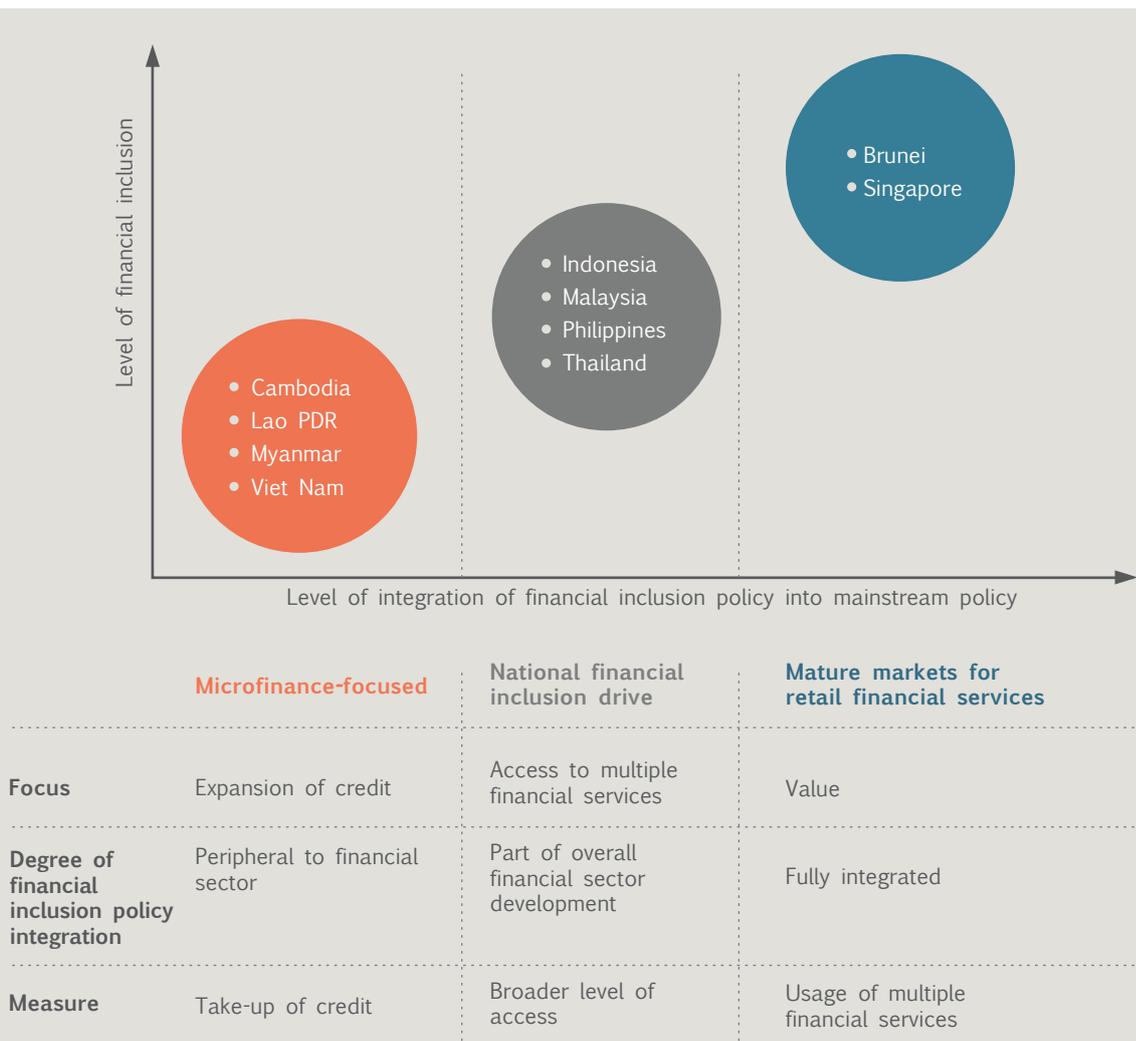
Differences in policy orientation and stages of market development

The differences between the various countries in terms of financial inclusion, and financial sector development more broadly, suggests policy

approaches to encourage financial inclusion and garner the resulting economic and social benefits need to be tailored to each country's specific circumstances. This is already seen in practice, with different groups of countries at different levels of development following different approaches to financial inclusion. In terms of financial inclusion, the ASEAN region can be split into three distinct groups of countries, possibly the result of particular policy approaches.

Figure 7 plots the level of financial inclusion in each cluster of countries against the extent to which financial inclusion policy is integrated into the mainstream policy agenda. The policy approaches applied in the three clusters differ in a number of ways.

Figure 7: Profiles of financial inclusion levels and policy in the ASEAN region¹⁴



● A focus on microfinance

In contrast to other ASEAN countries, Figure 7 shows that Cambodia, Myanmar and Viet Nam have much higher levels of credit than savings (Lao PDR has almost equivalent levels of savings and credit). The fact that financial inclusion policies in these countries focus mainly on microfinance and expanding credit to the poor may explain this pattern.

- Viet Nam has focused on the restructuring of the People's Credit Fund (PCF), launching new PCFs in rural areas, and building a sustainable microfinance system targeted at low-income households and micro- and small-sized businesses.
- The Government of Cambodia, based on the rapid growth of the microfinance sector since the early 1990s, has a microfinance strategy.
- In 2011, the Government of Myanmar appointed a Microfinance Supervisor and passed the Microfinance Business Law.
- The Government of Lao PDR is pushing for financial sector reform, especially of microfinance suppliers, through its National Growth and Poverty Eradication Strategy.

● A national financial inclusion drive

In contrast, the policy approach in Indonesia, Malaysia, the Philippines and Thailand encompasses a broader focus on financial inclusion across multiple financial services.

- Thailand's Financial Inclusion Master Plan consists of three parts: improve the range of service providers for payments, credit, savings and insurance, in order to expand supply; raise demand through financial education; and improve the quality of financial regulatory infrastructure, based on improved data and regulatory reform.

- Indonesia has developed a National Financial Inclusion Strategy to achieve the three goals of equitable development, poverty reduction and financial system stability. The country has also committed to expanding the culture of savings as part of their Maya Declaration.¹⁵
- The Philippines might not have an explicit overarching financial inclusion plan, but it has developed both a microfinance and micro-insurance regulatory framework and is one of the leading countries in the provision of mobile payments plans in that it offers at least one physical financial services access point in 90 percent of the country's subdistricts; it also aims to connect 95 percent of the adult population to the formal banking sector.
- Financial inclusion is included within Malaysia's Financial Sector Blueprint 2011-2012. As part of its Maya Declaration commitment, Bank Negara Malaysia has enabled 95 percent of the adult population to have access to the formal banking sector.

● Mature markets for retail financial services

Singapore and possibly Brunei, on which no data is available, constitute a third category of mature markets where most households use multiple financial services.

Box 2: How financial integration and financial inclusion connect in the post-2015 world

Both financial integration and financial inclusion are frequently cited as important policy challenges to the ASEAN Economic Community, although most of the attention has centered on integration alone. However, financial inclusion is set to receive increased attention from both policy researchers and policymakers in the ASEAN region. While theoretically related, financial integration and inclusion address very different policy concerns and propose very different solutions to the issues of slower economic growth and rising rates of inequality.

- Interest in financial integration grew sharply with the emergence of global financial markets from the mid-1990s.

As trade and investment flows increasingly connected the globe, investment and trade by transnational corporations came to be financed by international banks. An important argument in favour of financial integration in the context of such globalization was the need to enable surplus savings from some countries and regions to flow to others with attractive investment opportunities. An integrated financial market where savings could be mobilized for cross-border trade and investment could increase the overall amount of global investment. In theory, this would boost the supply of both international credit as well as investment into developing countries as they were increasingly integrated into the economic and financial markets of this new globalized world.

- The advent of the Asian Financial Crisis and the 2008-09 global financial crisis has led to another worry altogether: That the trend toward financial globalization and integration is in reverse.

Financial integration is now getting policy attention in a very different, and less optimistic, context than was the case in the heady early years of globalization. The McKinsey Global Institute (2013) points out that cross-border capital flows are still only 60 percent of their pre-crisis peak. Today, economists worry about the financial fragmentation of the ASEAN region as emphasis is increasingly placed on domestic capital mobilization as opposed to international capital mobilization. While this might reduce the risk of future contagion from unstable international financial markets, it will also restrict the flow of private investment and finance at a time when other forms of finance, including bank credit and official development assistance, may be diminishing. This in turn will reduce rates of growth and poverty reduction since many developing countries will not get the investment resources they need to accelerate economic growth. This logic would also apply to economic and financial integration within the ASEAN Economic Community. Financial integration would in theory allow savings to flow freely across borders to encourage investment opportunities.

- This is where financial inclusion comes in.

Financial inclusion addresses another problem in the process of development and globalization. Often, when countries or regions develop quickly, some people or even countries remain excluded from the benefits of development and are increasingly marginalized. Concentrating on financial integration alone can easily create islands or enclaves of modern, inter-linked financial services while excluding the majority of the population from access to such services altogether, much like the kinds of economic enclaves that grow around natural resources, special economic zones or prized urban real estate in developing countries.

- Increasing financial inclusion will ensure more equitable growth since it allows poor households to manage consumption and production risks through access to formal financial services.

Financial integration that focuses on the integration of cross-border financial services or to the connections between different types of financial services such as insurance and credit will do little for growth and equity if large segments of the population are mere spectators rather than participants in national or regional economic development efforts.

- In the best of all worlds, financial integration would be against the backdrop of universal financial inclusion.

Only then will financial integration be able to provide market participants with equal opportunities for economic participation. For the first time the new data revolution and the rising policy attention to curbing inequality and exclusion might well allow financial integration and inclusion to play a symbiotic role in the post-2015 ASEAN region. In turn, a similar symbiosis can be created between ASEAN's richer and poorer countries.



04

The way forward

A number of ASEAN countries have already made great strides towards increasing financial inclusion while several others would benefit from accelerating their existing efforts through more focused policy frameworks. A last group has barely moved beyond the promotion of credit through state-owned financial institutions.

The diversity across ASEAN countries provides an opportunity to design more coordinated and regionally integrated financial inclusion policies that connect more developed financial sectors to less developed ones within the ASEAN region. Such an approach is in line with the core objectives of the

ASEAN Economic Community and it draws upon the latest thinking, decades of policy experience and comprehensive new field data to design and monitor a policy instrument that could combine high growth with equity and sustained poverty reduction.

At a national level, ASEAN countries could benefit from the following initiatives:

Integrating financial inclusion as a central pillar of their overall development policy

In the face of mounting development challenges, countries can no longer afford to treat financial inclusion as a tool of financial sector development only. Its ability to enlist the smallest actors in the economy in the pursuit of key growth and development objectives, and to distribute income and opportunity across borders and regions, should make it a central pillar of post-2015 development policy.

Developing comprehensive financial inclusion policies

The transformative power of financial inclusion lies in its ability to deliver a full spectrum of tailored financial services by a diversity of service providers to households, including payments, savings, insurance and credit. Simply focusing on the provision of a certain type of credit to a small fraction of the population cannot possibly realize the full benefits of this policy instrument.

- *Policies need to also address the development of the financial sector infrastructure and distribution networks, such as electronic payments and branchless or agent banking options that enhance physical access for the majority.*
- *These policies could be guided by regulations that preserve responsibility and transparency on the part of financial service providers and protect the interests of consumers.*

Tailoring financial inclusion initiatives based on a sound understanding of the market

The new data-based evidence shows that different kinds of consumers within a country require very different financial services delivered by different kinds of financial service providers. Countries would benefit from developing a thorough understanding of their populations to tailor policies to the particular needs of each market, with a particular focus on addressing barriers that exclude women, youth and other potentially marginalized groups. This is likely to deliver better results with fewer resources.

At a regional level, ASEAN could encourage financial inclusion through the following interventions:

Understanding and facilitating cross-border financial flows at a household level

The power of cross-border remittances to boost household consumption should be maximized across the region to reduce regional income disparities. Greater equity between countries also serves to improve regional stability and growth. Such policies should not only deal with financial services, but should also provide access to formal financial services to undocumented migrants. This would require coordinated regulation and supervision to facilitate cross-border remittances, perhaps initially through bilateral agreements.

Understanding and facilitating cross-border financial and knowledge flows at the financial institution and real-economy enterprise levels

ASEAN can provide for the flow of non-traditional forms of finance (such as remittances) into financial institutions and real economy enterprises. The ASEAN landscape also provides a critical mass of financial institutions and enterprises, allowing the opportunity for cross-border collaboration or testing of innovative products and services outside the market of origin. A regional funding facility could strengthen financial partnerships between countries. Along with financial flows, such collaborations also result in transfers of knowledge and competencies and contribute to capacity building, boosting the transition of countries from one stage of market development to the next.

Establishing common standards of measurement and indicators

As financial inclusion strategies develop rapidly across the region, governments will benefit from comparative analyses of their outcomes. This can be facilitated by developing common approaches to the measurement of financial access, as well as the formulation of indicators and goals that are adopted regionwide.

Creating a platform for peer-to-peer learning and mutual support

Some countries in ASEAN have more experience with, and expertise in, financial inclusion than others. The ASEAN platform already offers a mechanism for coordination within other relevant thematic areas such as enterprise development. Implementation of the above recommended priority actions will also benefit from the newly-established ASEAN working committee tasked with coordinating efforts to improve financial inclusion in the region. Such a peer network is also well placed to play a capacity building role in specific areas of need for policymakers from less developed member states.

End notes

- 1 ASEAN countries include Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.
- 2 The 'middle-income trap' is a term used to describe the current economic situation in several developing countries, such as Brazil, China, Indonesia and others that, despite high economic growth and per capita incomes, are unable to move into the category of developed, high-income countries. One important reason is that while rising real wages—such as those produced in the manufacturing sector—reduce the competitive advantage gained from cheap labour, these middle-income countries are unable to make the technological leap into highly-productive industries, largely due to insufficient investment in research and technology. A contributing factor is the inability to create a dynamic innovation architecture in which the government, research organizations and the private sector combine to generate new technologies and products.
- 3 The 'real economy' broadly refers to the non-financial sectors of the economy where physical output rather than financial products drive growth and income.
- 4 The title of Alice Amsden's 2001 book, who uses it to describe the changing global situation in which the share of world income and trade is reverting back to the historical norms of the pre-industrial era when the combined share of India and China was around half of global output. Seen in this light the current global economic rebalancing towards large developing economies, especially in Asia, signals not so much the "decline of the West" but instead "the rise of the Rest" as late industrializing countries increase their share of global trade and output.
- 5 Kanbur, Rhee and Zhuang (2014) summarize developing Asia's remarkable economic performance as follows: "During 1990-2010 the region's average per capita GDP in 2005 terms increased from US\$1,602 to US\$4,982. The proportion of the population living on or below the poverty line fell from 54 percent in 1990 to 22 percent in 2008. Taking the US\$2 per day poverty line the poverty rate declined from close to 80 percent to about 45 percent." Yet this impressive growth performance has been accompanied by exceptional increases in inequality. As Kanbur et al. point out, "12 countries in developing Asia accounting for around 82 percent of the population in 2010 faced rising inequality of per capita expenditure or income measured coefficient." This trend is worrying because the region has been historically marked by low levels of inequality compared to most other parts of the world. Yet in recent years Latin American inequality has declined while developing Asia's has risen sharply.
- 6 Martin Ravallion from the World Bank (2012) summarized the situation as follows: "The developing world as a whole has made considerable progress in fighting extreme poverty but the 663 million people who move above the poverty lines are still poor by the standards of the middle and high income countries. This bunching up just above the extreme poverty line is indicative of the vulnerability facing a great many people in the World. And at the current rate of progress around 1 billion people would live in extreme poverty in 2015." This is a grim message for developing Asia where the largest numbers of the absolute poor live.
- 7 Refers to the possible economic advantage gained from a demographic age structure skewed towards younger age groups, usually below 25, due to declining fertility rates and a reduction in infant mortality rates. The presence of such a young population allows countries to raise productivity and incomes by training and providing employment for their youth such as to sustain rising levels of employment to population ratios. However, such a dividend is only a potential source of economic growth since failure to provide new skills and jobs can simply lead to rising youth unemployment, turning the dividend into a burden.

- 8 ASEAN-6 refers to Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand.
- 9 Thomas et al. (2000) from *The Quality of Growth*, published by the World Bank. Also see a whole generation of UNDP's *Human Development Reports* and the recent controversy in India following the publication of Amartya Sen and Jean Dreze's 2013 book, *An Uncertain Glory: India and its Contradictions*.
- 10 Infrastructure refers to buildings and networks, but also underlying national financial sector infrastructure to enable payments and credit bureaus.
- 11 For example, MAP Myanmar distinguishes between formal and informal and small- and medium-sized businesses and shows that formal and informal and small- and medium-sized businesses have different characteristics and exhibit different types of financial behaviour. In all, 2.5 million adults run their own small- or micro-sized formal businesses, and reported nearly twice the average income of the 4.7 million people who ran informal businesses (\$224 versus \$133). Formal enterprise owners were also more likely to live in urban areas (75 percent versus 48 percent) and to have higher levels of tertiary education (27 percent versus 1.5 percent). Given different profiles, financial needs differ substantially between these two groups of clients. For example, the average loan size taken out by formal enterprises is substantially higher than those taken out by farmers and informal enterprises in Myanmar and monthly repayments make up a smaller proportion of their monthly income. This indicates a greater capacity for credit and, it would seem, growth.
- 12 For the problems of establishing economic corridors see Masami Ishida and Ikumo Isono (2012) as well as several papers on the subject by ERIA.
- 13 The Government conducted a new census in 2014, after the MAP Myanmar programme was completed.
- 14 Figure 7 is a stylistic representation based on opinions of individuals at the Ministries of Finance and Central Banks in the ASEAN region.
- 15 The Maya Declaration is part of the Alliance for Financial Inclusion member commitment to financial inclusion. Learn more at www.afi-global.org/maya-declaration-afi-member-commitment-financial-inclusion.

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