MICRO FINANCE FOR POVERTY ALLEVIATION

TOWARDS A PRO-POOR FINANCIAL SECTOR

Keynote address by Max Sisulu, Chairperson of the Economic Transformation Committee of the ANC

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The ANC has declared 2005 the "Year of Popular Mobilisation to Advance the Vision of the Freedom Charter". In our January 8th Statement we said that our task, the task of all progressive and democratic South Africans is to translate the ten clauses of the Charter into solid progress towards the realisation of a better future. We said, "All the structures and cadres of our movement have the duty to honestly re-examine their work in the light of the Charter's political, social, economic and moral vision."

THE PEOPLE SHALL SHARE IN THE COUNTRY'S WEALTH!

With respect to the economy, the Charter demands "The People Shall Share in the Country's Wealth". This is the starting point for the ANCs approach to economic transformation in general, of which micro finance for poverty alleviation forms an important part.

The Charter claimed for all South Africans the restoration of their economic heritage because it rightly equated 300 years of colonialism and apartheid with a systematic campaign of dispossession, expropriation and confiscation of all forms of productive wealth in the hands of Africans in particular and black people in general. The explicit intent of racial domination was to suppress any path to the accumulation of assets in order to consign black people to the status of permanent helots in a land of abundant wealth.

Fifty years have passed since the Congress of the People, but the economic conditions that the Charter calls on us to eradicate have not disappeared. Indeed, for four of those five decades, the campaign of dispossession was brutally intensified. The last remnants of African wealth were systematically expropriated; houses were demolished, families forcibly removed from the few remaining 'black spots' and black entrepreneurial endeavour ruthlessly crushed. Perhaps with foresight, the human engineers of Apartheid also suppressed the accumulation of knowledge, information and education amongst black people. These are the very factors that have become the most important productive assets in the twenty first century economy.

This is the historical basis upon which our economy remains divided into two economies. By this we mean division between a First Economy, globally integrated and fast growing, and a Second Economy, which remains mired in poverty and underdevelopment and which is incapable of self-generating growth.

Inspired by the Freedom Charter, it is the vision of the democratic movement in South Africa to overcome this two-economy divide and create a united and integrated economic system, in which fragmentation and injustice are consigned to history. This, we know, is the only sustainable basis on which we can build a genuinely non-racial, non-sexist, prosperous and democratic South Africa.

MICRO FINANCE DEVELOPMENT

Overcoming the two-economy divide requires us to transfer vast resources into the second economy. These resources must take the form, wherever possible of productive assets that enable our people to empower themselves in order to reverse the legacy of apartheid expropriation. This in turn requires that we transform the institutions of the economy that were constructed on the basis of apartheid fragmentation, and also create new institutions that are capable of meeting the urgent challenges of development.

A central aspect of this programme is the development and transformation of the financial sector. Financial sector development is critical because access to financial services, which includes credit, savings, transaction facilities and insurance, is an essential condition for the accumulation of capital amongst our people.

A large amount of research, and practice, has demonstrated the positive effects of pro-poor financial sector development. The permanent deepening of financial markets in a manner that provides access to the poor can achieve the following outcomes:

- Economic growth and job creation can be stimulated, as small business development and access to housing finance generates new cycles of accumulation and effective demand.
- Poverty can be reduced, as productive assets in the hands of the poor enable them to build a stream of income. Access to finance, in the form of savings, credit or insurance can play a vital role in 'smoothing' the income of the poor, and so reducing their vulnerability to financial shocks. Financial services can also play a key role in building viable communities by contributing to the sustainable livelihood strategies of poor households.
- Social exclusion, of which the apartheid system was a most extreme form, can be overcome as the divide between financial 'insiders' and outsiders is eradicated.

However, the last ten years of financial sector development have had contradictory and complex outcomes. In the dying days of apartheid the state unleashed the genie of the commercial micro-lending sector. In 1992, the last apartheid Minister of Trade and Industry granted an exemption to the Usury Act, which regulates interest rates, to institutions providing loans below R6,000. The following year Persal (the state salary administration) provided codes for the commercial micro-lending industry, enabling them to deduct payments directly from the salaries of public servants.

These interventions led to the explosive growth of the commercial micro-lending sector in a largely unregulated environment. This posed significant dangers to the overall stability of the financial sector. It also unleashed the prospect of financial sector mal-development, with adverse consequence for our developmental objectives.

Rather than promoting asset creation, an unregulated micro lending industry can promote the liquidation of assets to support consumption. Rather than promoting employment and economic security it could promote unemployment and economic

insecurity by thriving on the extension of unsustainable debt burdens amongst low-income workers, thus generating economic disempowerment.

These possibilities for financial mal-development arise, in the first instance, because of unequal power relations between the lender and the borrower. A second and related problem is the lack of knowledge of how to manage finances amongst the borrowers, especially in our context, where the vast majority has been denied access to financial services for so long.

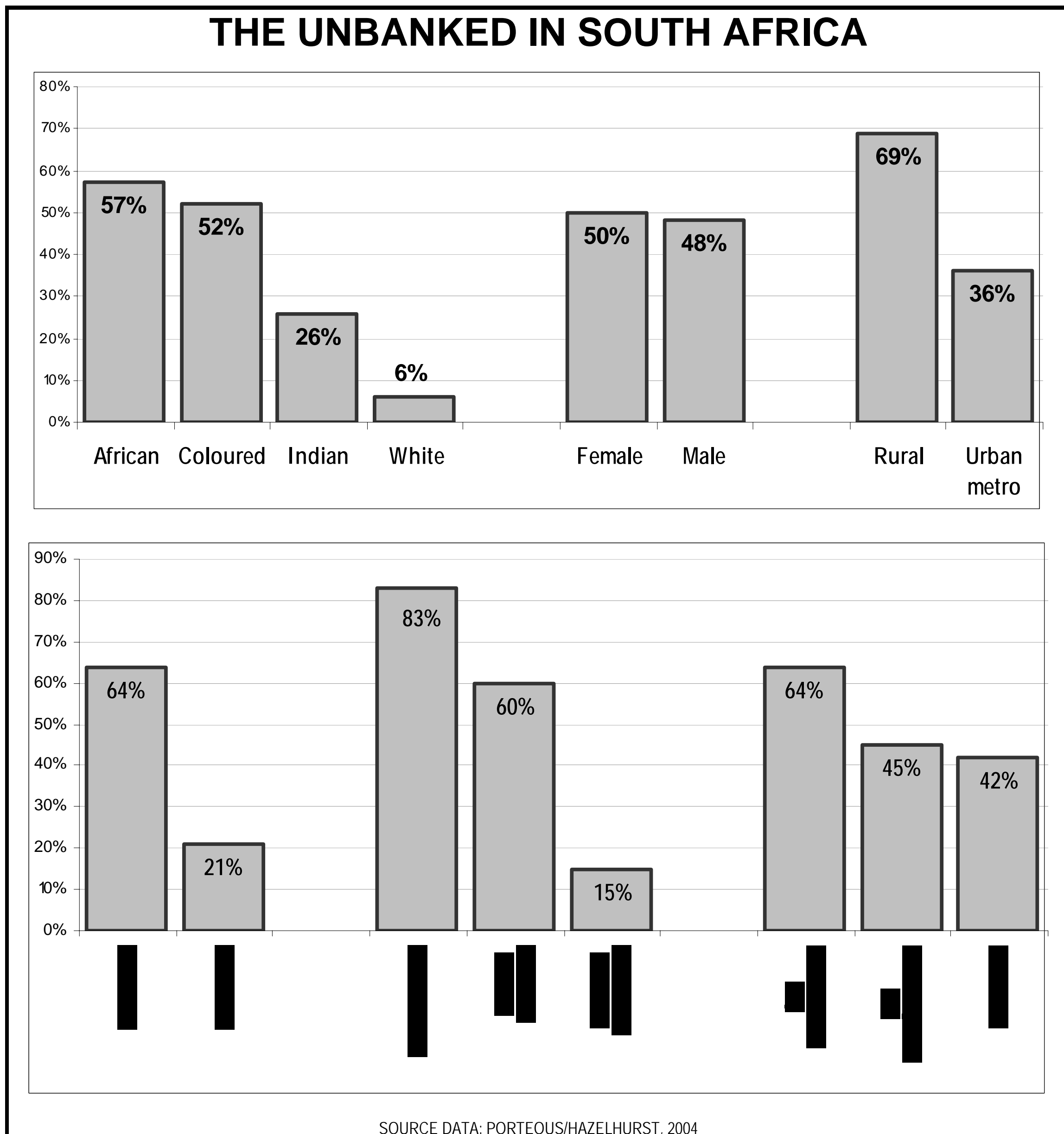
It fell to the democratic state to respond to these dangerous and unpredictable developments. In 1999 a revised exemption to the Usury Act was passed, which established the basis for the regulation of the industry in the form of the Micro Finance Regulatory Council. The revised exemption also outlawed the practice of retaining the ATM card and pin code of clients. The following year the state withdrew access to the Persal system. More recently, the department of Trade and Industry has introduced a Consumer Credit Bill to respond more comprehensively to the dangers of micro financial mal-development.

Also in response to the burgeoning micro lending industry, the mass movement in our country, most notably at the initiative of the SACP, led a series of popular mobilisations designed to deepen the financial sector in favour of the poor and combat negative tendencies on the part of micro lenders. As a result of these efforts, the NEDLAC declaration on the financial sector was signed in 2002. This in turn gave birth to the financial services charter, which promises to significantly extend access to financial services amongst our people.

In terms of the charter, the financial sector has committed itself to "substantially increase effective access to first-order retail financial services to a greater segment of the population, within LSM 1-5." Amongst other important the targets, this means that 80% of those within LSM 1- 5 should have access to transaction banking within 20 kilometres of their home by the year 2008.

This is a major victory for us as a democratic movement, and must be welcomed by all those interested in pro-poor financial sector development. But we should not underestimate the awesome nature of the challenges posed by this victory.

Of the 27 million adults in our country, more than 13 million do not have basic transaction facilities. Of this 13 million unbanked South Africans, 11 million are Africans who fall within the bottom half of the distribution of income, reflecting the continuing realities of apartheid's legacy. Amongst the unemployed, 83% do not have a bank account, while 60% of those who work in the informal sector remain unbanked.



BANKING FOR THE SECOND ECONOMY

Despite the chaotic nature of its emergence, and the potential negative effects of financial mal-development that we have described, a commercial micro lending sector can make an important and positive contribution to our economic vision. Millions of black people who could not access loans and other financial services before can now do so, providing them with the opportunity to accumulate income-generating assets.

The challenge we face is to effectively regulate this sector in order to prevent over-indebtedness, and to redress the power imbalances between lenders and borrowers through regulation and education. The recent Policy Framework for Consumer Credit Law and the Consumer Credit Bill seek to do just this. They are on the table and require input from all of us.

However, the commercial micro lending sector has reached the limit of its expansion. The nature of its business model is such that it can only extend financial services to the salaried workforce. As we have said, the vast majority of the ‘unbanked’ fall outside this category.

The challenge we now face, and the main focus of our discussion today, must be how we approach the problem creating sustainable financial services for those who fall within the second economy.

Financial Services for the Poor

Arguably, the most important component of such services is savings. With savings facilities available to them, the poor are able to accumulate cash surpluses, which could be turned into productive assets. Savings can make a significant contribution to household livelihood strategies, and cash surpluses can also create a barrier for the foreseen and unforeseen expenses of the future, thus reducing vulnerability to the debt traps.

The second part of it is transaction services. Given the historic legacy of the migrant labour system, this is an especially important issue in South Africa. As we have already noted, the programme outlined in the financial services charter takes us some way forward in addressing the access to transaction banking, and the recently launched Mzansi account is a major leap forward in this regard.

A third component is credit. In the right circumstances credit can, like savings, assist the poor in building income-generating assets and ‘smoothing’ the up-and-down nature of their income.

A fourth component is insurance. Already our people have organised themselves into popular insurance enterprises in the form of burial societies.

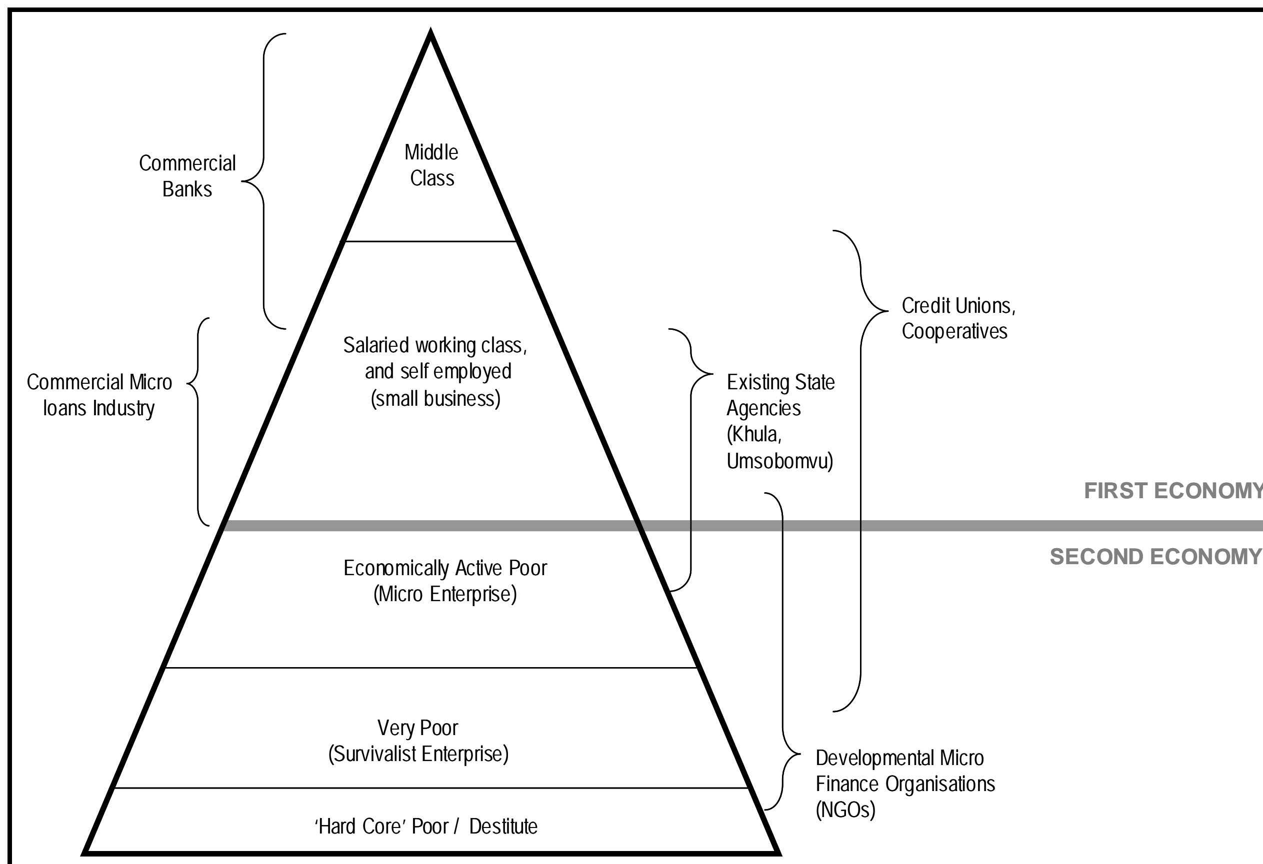
The current state of financial services, particularly savings and credit, can be thought of in terms of a pyramid. At the top the middle class is fully serviced by the big four banks. The salaried working class, and people earning a regular income from self-employment and small business are able to access savings and loans through the commercial banks and the micro lending industry.

At the bottom of the pyramid are the millions who unemployed and live without any steady income stream, except for social grants and remittances from family members in full time employment. These millions lack any form of income-generating asset and are forced to adopt a range of livelihood strategies to secure their own survival.

Recent research shows that the vast extension of social security has had a radical impact on the levels of poverty in the second economy. What is more, state transfers, which will continue to expand over the coming years, contributes to creating effective demand amongst the poor. But remittances, grants and survival strategies do not necessarily lead to the accumulation of income generating assets, and it is this that we must focus on today.

In terms of facilities for savings and loans there are few institutions available to the poor. The existing state agencies, such as Khula and Umsobomvu, do not reach deeply into the second economy. Certainly, the promotion of small business finance and entrepreneurial development amongst the relatively more affluent of our people is a vital programme, and we must continue to broaden the base of our economy through such institutions.

But the deficit in our interventions is amongst the economically active poor (who engage in micro-enterprise in the informal economy) the very poor (many of whom supplement remittances and grants with survivalist, or household based micro-enterprises) and the ‘hard core’ poor, or destitute.



Although a number of NGOs provide developmental micro-finance to these masses, at present the scale of their activities is not sufficient to make a significant contribution to our programme of poverty eradication.

Our determination to provide banking services to the second economy raises a number of important issues, which require more debate, but which we will mention briefly here.

Target Groups

The first is the target group that we should prioritise. Those within the second economy are not a homogenous group. Would our resources be best directed at the more affluent and educated; those already engaged in some form of micro-enterprise, with the hope that these will eventually ‘graduate’ into fully-fledged formal businesses, and thus contribute to broader goals of economic development and job creation? Or, as others believe, should the focus of our activity start right at the bottom of the pyramid, targeting the ‘hard core poor’ directly, in order to alleviate poverty and build assets that can minimise vulnerability and exclusion?

Another way of putting this question is to ask: should micro finance be aimed primarily at supporting sustainable livelihoods, or should it seek to augment productive investment for job creation?

We do not mean to imply that one target group should be chosen and others ignored. The point is that when we design our interventions we should all be very clear about which target group a particular intervention is intended to reach.

The Institutional Challenge

The second question, related to the first, is the appropriate type of institutions that we should strive to create and nurture. Different types of institutions may be best suited to providing services to different categories of people. The real challenge here is not the creation of an apex institution, or wholesale financing. The experience of Khula and a host of other apex type institutions that have come and gone over the last ten years shows that the real challenge is not wholesale, but retail.

There are four institutional types that we could broadly conceive of as providing retail financial services to the poor. The first is a commercial, profit driven model. However, it seems clear from our own and international experience that 'market failure' would preclude the extension of micro financial services beyond the salaried working class, at least without some form of direct subsidy.

The second type of institution is a Developmental Micro Finance Organisation (MFO). Various models of MFO have been development internationally, the most famous of which is the Grameen Bank in Bangladesh. Over the last ten years many of these models have been adapted to the South African context. However, few have yet attained a scale of operation that is required and even fewer have succeeded in becoming financially sustainable. While there may have been regulatory impediments to achieving these ends, there are also some who argue that such institutions are inappropriate to the South African context.

Another type institution is the Savings and Credit Cooperative, also known as credit unions. An advantage of the cooperative approach is that it builds upon our traditions of democratic and popular organisation, since they are often built around existing structures such as unions or residents groups. However, there are questions about whether financial cooperatives are appropriate for reaching the poorest people.

Finally, we could consider a retail agency linked directly to the state. This could be an entirely new state retail agency, or could work through existing state institutions, for example the post bank.

Sustainability, Subsidies and Time Lines

At the centre of this institutional challenge is the question of sustainability. What type of institution can provide finance in a manner that builds wealth amongst the poor? What type of institution would do so most efficiently, so that the savings on the high cost of proving services for small amounts of savings or credit can be passed onto the poor in the form of low finance charges? What type of institution can reach out to the millions of our people that require savings and credit for poverty alleviation, but can also sustain itself financially, at least in the long run?

In the short run, however, any of these institutions would require some form of subsidy, and this is the third issue that requires further interrogation. For some believers in 'market fundamentalism' any form of subsidy is regarded as bad in and of itself. Rather than entertain this debate, it may be more useful for us to ask what form of subsidy we deploy in the short to medium term in order to generate dynamic efficiencies in the long run that would otherwise not emerge.

Also important would be to assess the opportunity cost of a subsidy. For example, if the poor had bank accounts, government could transfer welfare payments directly. The money saved in terms of welfare administration costs could be used to subsidize these banking facilities.

A final question is the time frame that we define. When we say we expect a retail institution to become financially sustainable in the long run, what time frame do we have in mind? Should it be one year, or five years, or ten years? What is the cut-off point where we say, clearly we are barking up the wrong tree and we need to divert our resources in to more useful pursuits?

THE NEW REGULATORY AND INSTITUTIONAL ENVIRONMENT

Ultimately it is the test of practice that will decide what is the most appropriate institutional form for South Africa. Those institutions that are able to sustainably provide financial services to the poor in South African conditions must be given every opportunity to test their ability to do so. Our regulatory environment, and the institutions we create to support micro finance for the poor, must create the conditions for a thousand flowers to bloom, in the knowledge that those which are not adapted to our climate will whither away.

Arising from the resolutions of the ANCs Stellenbosch conference, the government is in the process of a fundamental re-engineering of the legislation and institutions that can contribute towards these objectives. We have already mentioned the Consumer Credit Bill. Two other important pieces of legislation that we must consider are the Dedicated Banks Bill and the Cooperative Banks Bill.

- The Dedicated Banks Bill creates the space for Savings and Loans Banks, as well as dedicated Savings banks. It does so by lowering the entry requirements currently prescribed by the Banks Act of 1990. In particular, the new 'Dedicated Banks' will have lower initial capital requirements. Apart from new banks being established, it is also likely that retail groups will also apply for banking licenses and offer savings accounts through extensive retail networks.
- The Cooperative Banks Bill aims to create an enabling environment for Savings and Loans Cooperatives. It is hoped that this will facilitate the development of credit unions and financial cooperatives, which currently form the largest component of the developmental micro finance sector.

In addition to this legislation, we must also consider the implications and direction of the South African Micro Finance Apex Fund (SAMAF). SAMAF too arises from the ANCs resolutions at Stellenbosch, which called for "the establishment of an apex fund that can on-lend to the very poor through developmental micro-lenders and community banking institutions".

It is likely that neither the legislation on the table nor the plans for SAMAF are yet in a state of perfection. It is our task to enrich and develop these ideas in a manner that will contribute toward fulfilling our objectives.

UNITY IN ACTION FOR PRO-POOR BANKING

The Economic Transformation Committee of the ANC has convened this workshop for two important reasons. The first is that we are convinced that the people gathered here today can make an invaluable contribution to the development of our economic programme. The second is that we are convinced that only by uniting in action, and acting in unity, will South Africa be able to address the awesome challenge of realising the vision of the Freedom Charter. If we work together there is no reason why we should not succeed.

All of us are agents for change. All of us seek to transform our society. All of us are acting to decisively defeat poverty and underdevelopment.

In conclusion allow me to spell out the questions we have posed to you today:

1. What do we understand by pro-poor, developmental micro finance?
2. How do we define the target group for developmental micro finance?
3. What is the most appropriate institutional form, at the retail level, for the delivery of pro-poor micro-finance
4. What are the objective constraints to the creation of a pro-poor developmental micro-finance movement in South Africa?
5. What can government do to create a regulatory environment to enable the emergence of a developmental micro-finance sector and a financial cooperatives movement?
6. What can government do to directly support the emergence of a developmental micro-finance sector and a financial cooperatives movement? In particular, what is the role of government in capacity building and providing start up finance or other forms of subsidy?
7. What are the strengths and weaknesses of current policy initiatives, such as the Apex Fund, the Dedicated Banks Bill, Consumer Credit Bill and the Cooperative Banks Bill?
8. Building on the initiatives already in motion, what are the key policy recommendations that need to be taken on board to upscale developmental micro-finance?
9. Building on the Financial Sector Charter what broader interventions are required around Financial Sector Development towards the goal of a pro-poor financial sector.

None of us have the answers individually. But acting together South Africans have shown time and time again that there is no problem that cannot be resolved.