FDC INCLUSIVE GROWTH AND DEVELOPMENT PROGRAMS

FDC

THE INCLUSION IMPERATIVE: A CALL TO ACTION

RECOMMENDATIONS FOR POLICY MAKERS AND REGULATORS

FROM FDC'S INCLUSIVE GROWTH AND DEVELOPMENT INITIATIVES

2018

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INTRODUCTION

FDC is an international development organisation which collaborates and partners with the public, private and civil society sectors to improve inclusive growth outcomes in developing economies. Spanning nearly three decades, FDC's work has included policy advocacy, large scale regional programs and ground-breaking research into the challenges of inclusive growth and development. FDC is now part of a group of companies advancing advocacy, implementation and impact in in the arena of inclusive growth.

This report provides a series of recommendations for policy makers and regulators for the purpose of supporting their inclusive growth and development efforts for the Asia-Pacific region. These recommendations have been developed as outcomes of two of FDC's major policy initiatives implemented in 2018; namely the Asia-Pacific Financial Inclusion Forum (Tokyo, 27-28 June) and the Mekong Inclusive Growth Forum (Bangkok, 2-3 October). Both Forums were convened as part of the Financial Inclusion Policy Initiative of the APEC Finance Ministers' Process, which FDC has led since its inception in 2010, under the auspices of the APEC Business Advisory Council (ABAC).

Structured as facilitated dialogues amongst all participants, the Forums provided a unique platform for senior government officials, industry leaders and development specialists to gather and discuss the ongoing challenges and opportunities relative to financial inclusion and inclusive growth. The recommendations in this report are the result of these discussions and the contributions of Forum participants.

A key feature of the 2018 Forums was their broader view of financial inclusion as an enabler of inclusive growth and development in all its manifestations – financial, economic and social – and the particular focus on productive asset accumulation and wealth creation.

Within these themes both Forums sought to identify concrete actions which stakeholders could progress to achieve results.

The outcomes of the Forum discussions cover a range of priority topics including financial inclusion, gender strategies, digital technology, enterprise development and regional integration. While it is recognised that progress in any of these areas will require concerted efforts and cooperation of a wide range of stakeholders including the private sector, the recommendations in this report emphasise opportunities where governments can take a lead role in driving change that will ultimately lead to more inclusive economies and societies across the Asia-Pacific region.

FDC's 2018 policy initiatives were made possible through the support and contributions of our partners including Appui au Développement Autonome (ADA), the Asian Development Bank Institute (ADBI), Banking with the Poor (BWTP), the Thailand Joint Standing Committee on Commerce, Industry and Banking (JSCCIB) and the United Nations Capital Development Fund's SHIFT ASEAN Programme which is supported by the Australian Government. More information about the FDC Group and our partners is available in Annex A.

To provide additional support for its inclusive growth initiatives, FDC has established the Inclusive Growth and Development (IGD) Caucus. The IGD Caucus, which includes senior representatives from various private sector and development agencies, works to ensure consistent alignment with regional trends and priorities. The Caucus also plays an important role in progressing FDC's initiatives by supporting the various activities and assisting with the formation of policy recommendations.

The Inclusive Growth and Development Caucus

ADBInstitute

mandiri

Bloomberg

EY

FDC

LIIN
Lanka Impact Investing Network

MSC
MicroSave Consulting

PayPal

THE INCLUSION IMPERATIVE

Since the 1990's the Asia-Pacific region has shown some confident economic growth trajectories which has contributed to socioeconomic transformation across its economies. While the common aphorism "a rising tide will lift all boats" would suggest that the positive benefits of this economic growth would be equally measurable across all levels of society, the reality of the situation has unfortunately shown that the benefits of economic growth has often excluded those who are most in need resulting in enduring poverty and unemployment. As highlighted in the UNESCAP's 2018 report on inequality in the Asia-Pacific, the rising levels of inequality in the region are leading to larger disparities in income and wealth generation, uneven access to opportunities and basic services and increased severity by which environmental degradation and disasters are impacting the poorest (UNESCAP 2018).

While the challenge of achieving inclusive growth is significant, the benefits are equally substantial and should unquestionably justify the case for economies to adopt a resolute approach towards progress. Research has highlighted the correlation between income inequality and economic growth, with growth rates falling as inequality increases (OECD 2014). Inequality is also often linked to issues such as increased social and political tensions, negative impacts on the environment and increased levels of poverty. From a macroeconomic perspective, inequality weakens consumption spending and also limits innovation and productivity; primarily due to unequal access to, or ability to invest in, education services to increase human capital potential. The cost of poverty is also a major drain on public resources and thus limits opportunities for key infrastructure investments to strengthen the economy.

Policy makers and regulators play a major role in shaping the inclusiveness of their respective societies. Only by understanding the issues which are directly limiting the prospect of equitable growth, and opportunities for wealth creation for <u>all</u> citizens, can governments begin to make meaningful progress toward addressing them. However, inclusive growth and development is a multifaceted issue which requires the participation of a broad range of stakeholders, including public, private and civil society, in order to develop the necessary understanding of its drivers and consequences.

This report represents a "call to action" for stakeholders to combine their knowledge, resources and efforts to achieve equitable and sustainable outcomes through a more concrete dialogue on the institutional and legal reforms needed to make meaningful progress in support of the United Nation's 2030 Agenda on Sustainable Development. Of the multiple themes or aspects of inclusive development which need to be examined, the recommendations in this report focus primarily on issues relating to financial and economic inclusion as key drivers of equitable growth. This includes actions needed to strengthen the capacity of financial institutions and enabling them to expand access of quality products and services to a broader range of unserved or underserved, as well as ways to advance progress towards achieving more productive employment and decent work conditions for all. These recommendations are particularly relevant to the most vulnerable parts of society such as women, youth, elderly or persons with disabilities and owners of nano, micro and small firms.

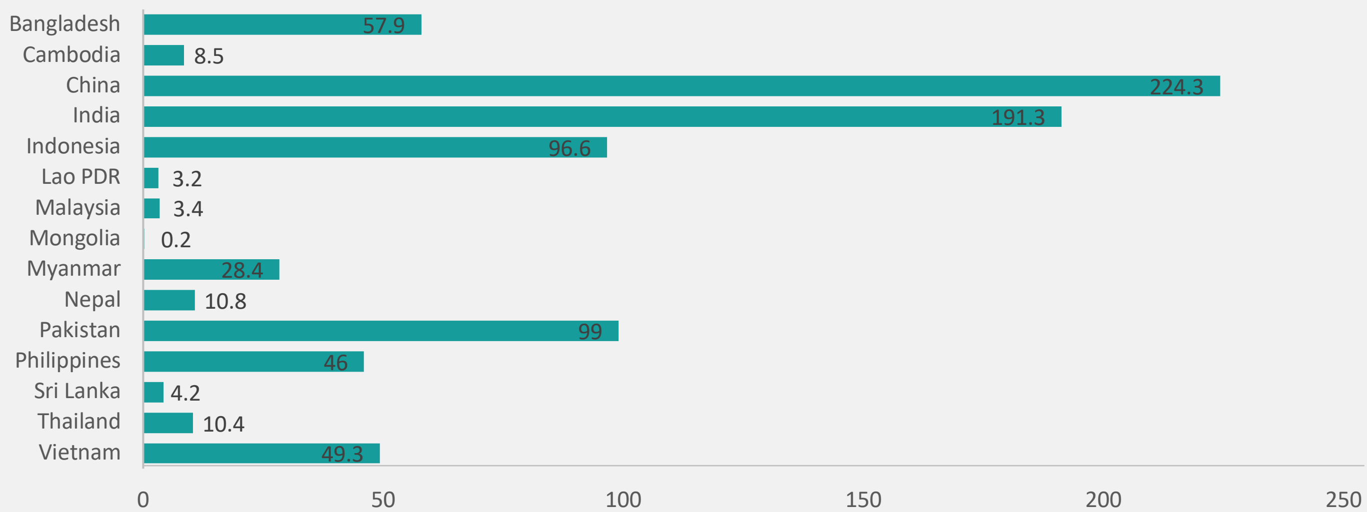
REALISING THE FULL POTENTIAL OF FINANCIAL INCLUSION

As a multidimensional concept, financial inclusion is difficult to define and measure. Most economies apply their own unique definitions or perspectives for financial inclusion based on the characteristics of their financial sector and development priorities. For example, the financial inclusion strategies of some economies put greater emphasis on supporting access to finance for small, medium enterprises (SMEs) while others focus more on the provision of financial products and services for poor or underserved individuals/households. Despite these varying perspectives, financial inclusion has generally been interpreted to comprise three key elements: access, usage and quality.

Access	Usage	Quality
The ability of a person or business to successfully connect with financial products and services.	How a person or business interacts with financial products and services in meaningful ways.	How well a product or service fits the needs of a customer.

According to the World Bank's 2017 Global Findex data 1.7 billion adults remain unbanked[1] globally, with virtually all of these people living in developing economies and over 830 million in Asia's developing economies as depicted in Table 1 below:

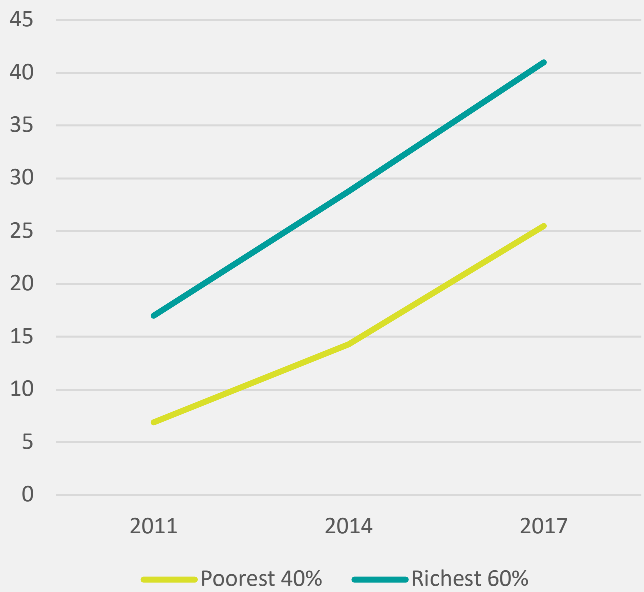
Table 1: Total Unbanked Adults (Millions) – Select Asian Economies



Adapted from: The Global Findex Database 2017, World Bank Group

Propelled by advances in digital technology being applied to the finance sector to lower costs and expand reach through mobile banking services, as well as renewed efforts by governments across the globe to make financial inclusion a priority issue, the rate by which adults globally are gaining access to accounts at banks or other financial institutions has risen significantly in recent years. Between 2011 and 2017 an estimated 1.2 billion adults obtained an account (Demirgüç-Kunt et al. 2018). This increase is particularly evident in low income economies[2] as depicted in Table 2 below:

Table 2: Percentage of Adults with Account Ownership Across Low Income Economies



Adapted from: The Global Findex Database 2017, World Bank Group

[1] The term "unbanked" refers to individuals without an account at a financial institution or through a mobile money provider.

[2] Low-income economies are defined as those in which 2010 GNI per capita was $1,005 or less.

While the increase in access to formal accounts has been significant in recent years, greater scrutiny and focus is needed to understand the usage and quality conditions of financial inclusion to ensure that it can contribute effectively to positive changes in the lives of consumers. Research on the correlation between financial inclusion and poverty alleviation has struggled to settle upon firm conclusions. While access to financial services is generally accepted to be a vital component of achieving sustainable and inclusive economic growth, many proponents of financial inclusion have focused too heavily on promoting the expansion of specific products such as savings or credit. As a consequence of these narrowly focused interventions, several economies are now experiencing unintended negative impacts of financial inclusion such as dormant accounts, over-indebtedness or massive-scale credit blacklisting.

To realise the full positive potential of financial inclusion as a direct driver of increased wellbeing and prosperity among the poor, the definition and work of financial inclusion needs to be broadened to recognise more effectively the role financial services play in broader inclusive growth and development (i.e. financial, economic and social inclusion). With this approach, the real impact of financial inclusion can be realised through policies and practices which are designed to go beyond access, but also focus on the opportunities which become available to those that are financially included such as enabling productive asset accumulation including land title, home ownership, business assets for nano, micro and small enterprises (NMSEs) or access to affordable credit. Ultimately, financial inclusion strategies should lead to the establishment of frameworks which support the development of NMSEs, as crucial assets of the underserved, and create pathways for informal enterprises to participate in the formal economy and become more direct contributors to economic growth.

To achieve this, innovative solutions are needed which enable the unbanked and underserved to access a wider range of products and services that are safe, affordable and tailored to their unique needs. Advancements in digital technology are creating important opportunities for such solutions to be developed. FYXA Global, a global impact enterprise developed by FDC, represents an example of a digital solution which has been designed with a broader view of financial inclusion underpinned by an innovative business model (see Box 1). New technologies such as FYXA Global provide important examples to governments and other stakeholders of how digital solutions can be applied to overcome persistent development challenges, including financial inclusion.

Box 1: Overview of FYXA Global

FYXA GLOBAL

"The proliferation of fintechs offer viable and interesting technology options, but they are not encased in viable business models; they are not solutions in themselves."
Michelle Curry CEO FDC Group

FYXA Global is a cloud-based platform solution offering a suite of new digital financial products and services to individual, retail and institutional customers within a trusted, transparent and compliant ecosystem, through which consumers – specifically low-income consumers - can affordably perform financial transactions digitally. By leveraging FDC's Banking with the Poor initiative, which represents Asia's largest regional association of inclusive finance stakeholders, the FYXA solution is able to reach hundreds of millions of financially underserved prospective financial consumers.

THE OPPORTUNITY:

1% increase in financial inclusion equals an average.... **❯ 3.6** increase in GDP in growth economies

(Apis Partners 2014)

USD 380B pa revenue opportunity providing financial services to the unbanked

(Accenture 2015)

USD 30T is the projected increase in consumption in growth markets by 2025 through the increase in.... **❯ 1B** people entering the formal 'consumer class'

(Atsmon et al. 2012)

THE FYXA APPROACH:

- Unique customer value proposition: tailored and low-cost relevant products/services, unique features, it is not all about 'supply'
- Effective pricing strategy: reframing the approach to revenue
- Competitive thrust: convenience and ease of access drives acquisition
- Market positioning: changing the business language from disruption to collaboration
- Defined channel and distribution mechanisms: build it with them, not for them
- Management of the enabling ecosystem: key to success

POLICY RECOMMENDATIONS

1 Progress Financial Inclusion within a Broader Inclusive Growth Agenda

Progressing financial inclusion is a crucial component of inclusive growth and development, but to realise its full potential the implementation of financial inclusion strategies needs to include measures which go beyond just promoting access to financial products and services. By understanding the role of financial inclusion as it relates to both economic and social inclusion, and adopting this broader definition in national financial inclusion strategies, greater emphasis can be placed on prioritising structural and regulatory reforms which could contribute to more meaningful development outcomes such as:

- Aiding the poor to accumulate productive assets and build greater long-term wealth and financial security.
- Enabling the poor to participate in the formal economy as represented by employment, wage growth, health insurance and pension schemes.
- Promoting investment in the NMSE sector and providing pathways for informal enterprises to become formalised.
- Increasing the ability of women and other vulnerable populations to participate in economic activity in safe and effective ways.

2 Reforms to Promote the Proliferation of a Broader Suite of Products and Services Available to the Underserved

To translate the outcomes of financial inclusion into meaningful impact on the lives of the poor, greater focus is needed on developing and supplying a broader range of products and services. These products need to be designed based on demand to ensure that they adequately account for the user perspectives and needs. Of particular importance is increased availability of high-quality product which can assist the poor to develop greater financial security such as savings, insurance and pensions. To achieve this, specific reforms might focus on areas such as:

- Promoting financial education, and its role in developing financial health, among the underserved to increase pull from the demand side and creating incentives, or a more enabling regulatory environment, to encourage greater private sector investment into the supply of a broader range of products.
- Targeting the ability for financial institutions to develop and test innovative solutions involving new technology which could assist them to diversify their product offerings.
- Regulators need to consider methods and policies which can be introduced to help encourage the creation and use of savings products that allow people to build assets and resilience. The lack of disposable incomes makes it difficult for the poor to absorb shocks which often makes them more reliant on credit and susceptible to over indebtedness. Products which mix long-term saving with the ability to access in the event of emergencies can be particularly effective in helping the poor develop assets.
- Remittances (both domestic and international) have the potential to be a major driver of inclusive growth. By combining remittance services with other complementary services such as savings, insurance or payments, migrants and their families can increase their opportunities to accumulate assets and build wealth. Governments need to understand this potential and ensure that regulatory frameworks are conducive towards enabling the underserved to access a broader range of products and services through remittance channels.

WOMEN AS DRIVERS OF ECONOMIC GROWTH

Women make up the majority of the world's poorest of the poor and illiterate. They also represent a significant portion of informal employment with over 80% of women in South Asia employed in the informal sector (non-agricultural) (Vanek et al. 2014). The socio-economic benefits of women achieving their economic potential, and having greater economic empowerment, are not only limited to the women themselves, but their successful involvement in economic activity also positively impacts their families, communities and broader aspects of society as a whole. For example, research has highlighted the benefits of increasing women's control over household income and how it impacts spending behaviours in ways which benefit children (World Bank 2011); or how increased access to financial services has the potential to support women's entrepreneurship and its impact on job creation (Fareed et al. 2017).

However, achieving greater equality isn't just a social imperative. The business case for women's economic inclusion is also significant. The more women participate in their economies as entrepreneurs, employees and consumers, the scale and pace of economic growth also increases. Research has found that bridging the current gender gap in economic opportunity could increase global GDP by as much as $28 trillion by 2025 (Woetzel et al. 2015).

Despite the growing evidence to support the benefits of greater economic inclusion of women, significant barriers limiting equal opportunities for women to participate in economic activity remain. In their extensive report on gender inequality, the McKinsey Global Institute identified a number of factors which are commonly blocking the economic potential of women globally. Some of the more significant factors cited in their report are highlighted in Box 2.

Driving the necessary changes to eliminate these barriers cannot be led by a single stakeholder. A range of stakeholders representing both the public and private sectors will need to be actively involved in the development and implementation of plans, policies and programs designed to create more inclusive economies. However, there are a number of specific areas where policy makers and regulators can take a lead role to drive results.

Box 2: Common Factors Limiting the Economic Potential of Women

Cultural expectations that women are primarily responsible for unpaid work (i.e. caring for children or elderly, housework, etc.) – Women spend on average three times as many hours than men in unpaid work, with the number of hours significantly higher in some economies (i.e. nearly ten times in India and Pakistan).

Fewer legal rights (i.e. rights to inherit property or own assets, access to institutions, right to work, right to compensation, etc.) – An estimated 2.5 billion women globally are impacted by legal constraints.

Political underrepresentation to ensure issues which proportionally impact women more than men are appropriately represented – Globally, the number of women in ministerial or parliamentary roles is only 22% of men.

Violence against women (physical and/or sexual) – Nearly 30% of women worldwide have been the victims of violence from an intimate partner.

Access to financial services – On average, women only have about 77% of access to financial services available to men.

Source: Woetzel et al. 2015

POLICY RECOMMENDATIONS

3 Incorporation of Gender Issues Across all National Development Strategies

Despite the significant social and economic imperative for women's economic inclusion, gender issues are commonly not adequately, or not at all, factored into national development strategies, including national financial inclusion strategies. As part of their design and implementation, a "gender lens" should be applied across all components of these strategies. This might involve:

- Including plans to collect and analyse sex-disaggregated data to inform and improve development policies.
- Ensuring that development strategies are truly inclusive of women by engaging with them as part of the design stage and continually throughout implementation – it is important that this engagement is not added on later during implementation (i.e. as an afterthought) but is treated as a core component of the overall strategy from the design phase.
- Identifying and prioritising reforms which reduce inequalities and support the ability of women to actively and meaningfully engage in economic activity. This should include considerations for technology and infrastructure which has the potential to enhance women's access to essential services such as financial services, health care or education.

4 Promoting the Rights and Entitlements of Women

The rights and entitlements of women need to be reemphasised, and in many cases adjusted, to enable equal access to economic opportunity. By promoting the rights of women and elevating their position within society as equal contributors, their role as a key driver of social and economic development can be enhanced and leveraged more effectively to achieve results. However, policies or cultural norms which limit levels of freedom and agency among women can significantly reduce their ability to interact with markets. Governments can take action on this in variety of ways, including:

- Reviewing legal frameworks, infrastructure and economic structures to identify factors which may be creating inequalities and limiting women's access to economic opportunity. It is particularly important to ensure that standards, laws and regulations in place to protect women are clear and enforced.
- Identifying cultural elements which deepen inequalities and work with the private and civil society sectors to promote attitude changes through media campaigns and community-based interventions. Working with the private sector to leverage the influence of businesses on consumers is particularly important.
- Promoting financial literacy and education to increase levels of financial health among women and enhance their economic empowerment.

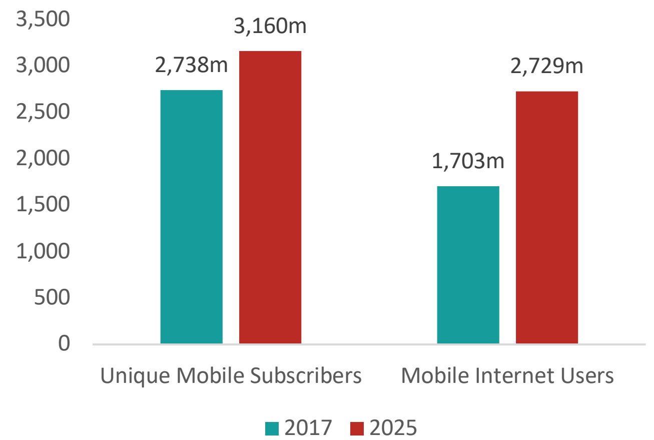
HARNESSING THE POTENTIAL OF THE DIGITAL REVOLUTION

The digital revolution continues to expand opportunities for the poor. With the borderless, instantaneous and low-cost delivery that digital technologies are typically characterised by, digitally-enabled services have the potential to significantly impact the livelihoods and general wellbeing of the poor in a variety of ways such as education, agriculture, health, finance and utilities. The promise of digital finance, or Fintech, has been promoted extensively by experts and world leaders, including the World Bank Group President Jim Yong Kim who made the following statement during an address at a World Bank Forum in 2013:

"Universal access to financial services is within reach – thanks to new technologies, transformative business models and ambitious reforms. As early as 2020, instruments such as e-money cards, along with debit cards and low-cost bank accounts, can significantly increase financial access for those who are now excluded" (World Bank 2013, par. 2).

A key aspect of the digital revolution has been the proliferation of mobile phone technology. Mobile phones enable consumers to connect with the digital world, giving them access to a broad range of digitally-enabled services. As of 2017, over 5 billion people globally were connected to a mobile service and by 2025 the total number of unique mobile subscribers is expected to surpass 70% of the world's population (GSMA 2018). This growth trend is also evident in Asia-Pacific, with developing economies such as India, China, Pakistan, Indonesia and Bangladesh being major contributors. The increased use of mobile phones is also supporting the growth of mobile internet users (Table 3), providing even more possibilities for digital access to services and information.

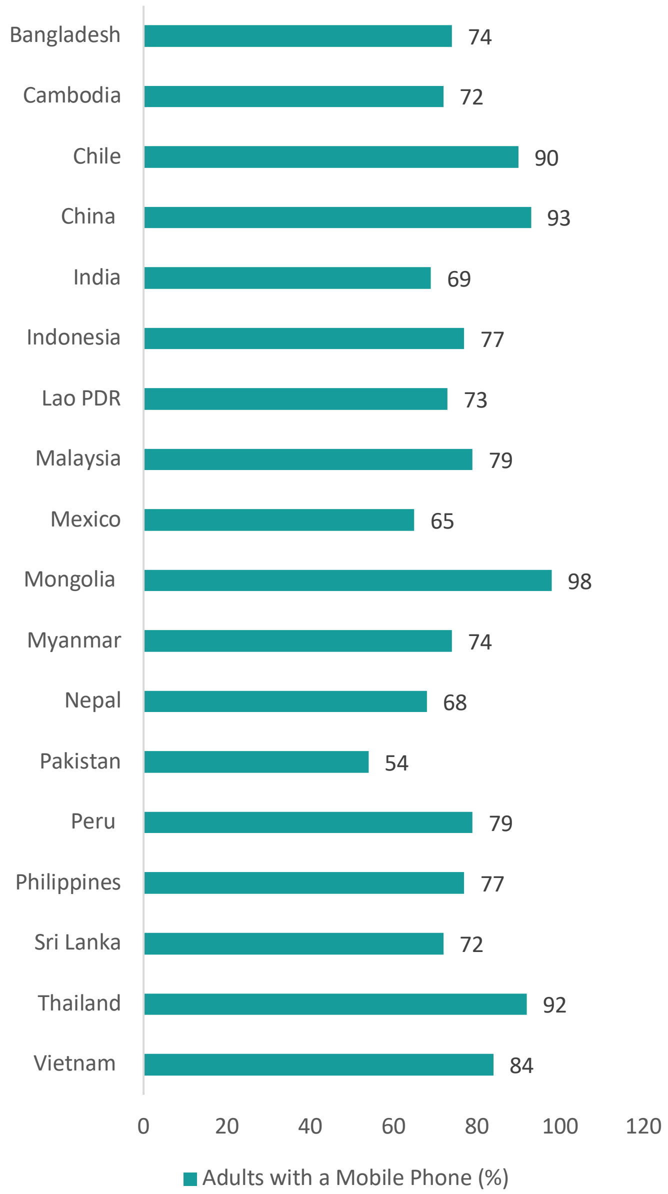
Table 3: Current and Projected Mobile Subscribers and Internet Users in Asia-Pacific (Millions)



Adapted from: GSMA 2018

Importantly, the growing number of mobile phone users is not limited to advanced economies. Usage in emerging and developing markets is also significant (Table 4) and is providing new opportunities for governments, development practitioners and service providers to enhance levels of support for rural and poor communities. These opportunities expand exponentially as smartphones become increasingly available and affordable and users move beyond basic feature phones (i.e. capable of calling, texting and potentially basic internet usage) and can access a much richer suite of software.

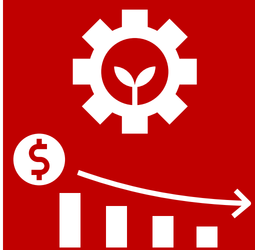
Table 4: Mobile Phone Access in Select Developing Economies



Adapted from: The Global Findex Database 2017, World Bank Group

Aside from the rapid proliferation of mobile phones, other emerging technology such as distributed ledger technology (DLT) and cryptocurrencies are driving significant transformation of the finance sector and may offer unique solutions for development challenges. As these advanced technologies are continually developed and tested in the field, they are expected to play an increasingly important role in development, especially as tools to achieve greater financial inclusion. Some of the potential applications of DLT which could benefit the lives of the underserved or disadvantaged are highlighted in Box 3.

Box 3: The Potential for DLT to Enhance Financial Inclusion



Lowering transaction costs – By cutting out the "middlemen" and automating the transaction process, DLT can make it possible for transactions to have significantly lower transaction costs. This is particularly relevant for remittances, which generally charge an average fee of 7%.

Increased transparency – On public DLTs, all transactions are recorded and tracked on a public ledger. This level of transparency enables greater speeds of purchase along supply chains, meaning that poor entrepreneurs receive payments quicker. DLTs can also be used for creating low-cost collateral registries which can create new opportunities for the unbanked to access credit.

Identification – Lack of adequate identification is a major challenge for financial inclusion since financial institutions are generally required to comply with Know Your Customer (KYC) laws. DLT can potentially aid in solving this problem through the creation of digital identity systems (i.e. eKYC) which are verified with biometrics.

Source: Truiloo 2018

While the proliferation of mobile phones and advanced technology such as DLT is exciting in terms of what these technologies could mean for achieving greater development outcomes, and in particular through the promotion of digital financial services, the introduction of such technologies also carries with it several unique risks and challenges. For example, lack of consumer trust in technology, in particular new digital banking services such as mobile money, is a major constraint which limits the potential transformative impact digital financial services can have for all consumers. Furthermore, increased risks such as privacy issues, security and consumer protection put further strain on governments' ability to provide adequate oversight. Promoting the opportunities while also addressing these issues has been a major challenge for regulators as they have typically struggled to keep up with the fast pace of development within the digital realm.

POLICY RECOMMENDATIONS

5 Align National Development Strategies with National Digital Strategies

To keep up with new technology developments and rapidly changing markets a continuous dialogue between regulators and market players is necessary to understand and take advantage of the opportunities these advances provide as well as manage new risks which they create. To support these efforts, governments can examine ways to align their development strategies, including national financial inclusion strategies, with their national digital strategies. Examples of ways this could be achieved include:

- Acquiring relevant talent to enhance internal capabilities (i.e. technology experts within central banks or other government ministries).
- Cross-ministry/agency coordination to enhance cooperation on common goals and objectives.
- Engagement with the private sector and civil society representatives to help inform strategies and identify strategy alignment opportunities.
- Explore opportunities for data analytics and data supervision platforms to enhance the effectiveness of regulation and enable more focused inclusive development interventions.

6 Establish Regulatory Sandboxes to Enable Innovations to be Tested

Regulatory sandboxes are an effective way for governments to keep up with the fast pace of innovation while limiting risk-exposure to the market place. They provide an important mechanism for the private sector to test innovative solutions in the real market while also enabling governments to develop appropriate regulatory frameworks more effectively.

Regulatory sandboxes do not need to be confined within a single economy, however. By applying the concept to cross-border issues such as trade or remittances, multi-economy regulatory sandboxes can be an effective method for governments to cooperate on the development and testing of technology solutions. Through this approach, governments can also potentially leverage the infrastructure of another economy to explore solutions and help to prioritise their own infrastructure development needs.

7 Prioritise Investments to Achieve Maximum Impact

There is a lot of hype and excitement around the promise of the digital revolution and what technology can offer as part of new solutions to development; however, much of this technology is still not readily available to the poor, at least not in a way which can drive many of the promised benefits. Issues such as consumer trust in technology, literacy, or infrastructure constraints often pose significant barriers for many developing economies. With this being the case, it is important for governments to consider their investments into technology carefully to ensure that these actions lead to the maximum impact. Some examples of areas where governments could focus their efforts to realise the benefits of technology for inclusive development include:

- Developing and testing digital finance, or FinTech, solutions which enable the underserved to access to a broader range of digitally-enabled products/services (i.e. insurance, pensions, savings, remittances, payments, etc). The creation of regulatory sandboxes is an important method of testing and developing such innovations with the involvement of a broad range of stakeholders.
- Social transfers represent one of the most important opportunities for digital financial services, including payments and ID systems, to directly impact the lives of the poor. In many cases, social transfers are the only way to reach the poorest of the poor (lower 30%) and provide them with access to formal financial systems. By digitising social transfer accounts governments can create an effective entry point for the poorest to gain access to other beneficial digital financial services.
- Regulation which allows for the creation of digital identification systems that are secure and reliable can have a significant impact on the lives of the underserved. By extending regulatory frameworks to also enable the recognition of IDs from other economies will particularly impact the lives of migrant workers across the region by creating the ability for them to access financial services while abroad. Governments should explore potential technology and coordinated legal solutions to this issue which may include the use of internationally recognised digital IDs.
- As digitisation of the finance sector continues to increase, poor and less educated population segments will potentially be left behind. Governments need to consider both the infrastructure needs (hard and soft) to bring digital financial services to rural communities as well as capacity building methods which the government could support to ensure that these consumers will be able to use digital financial products effectively.

DRIVING GROWTH THROUGH N-M-S-ENTERPRISES AND CROSS-BORDER TRADE

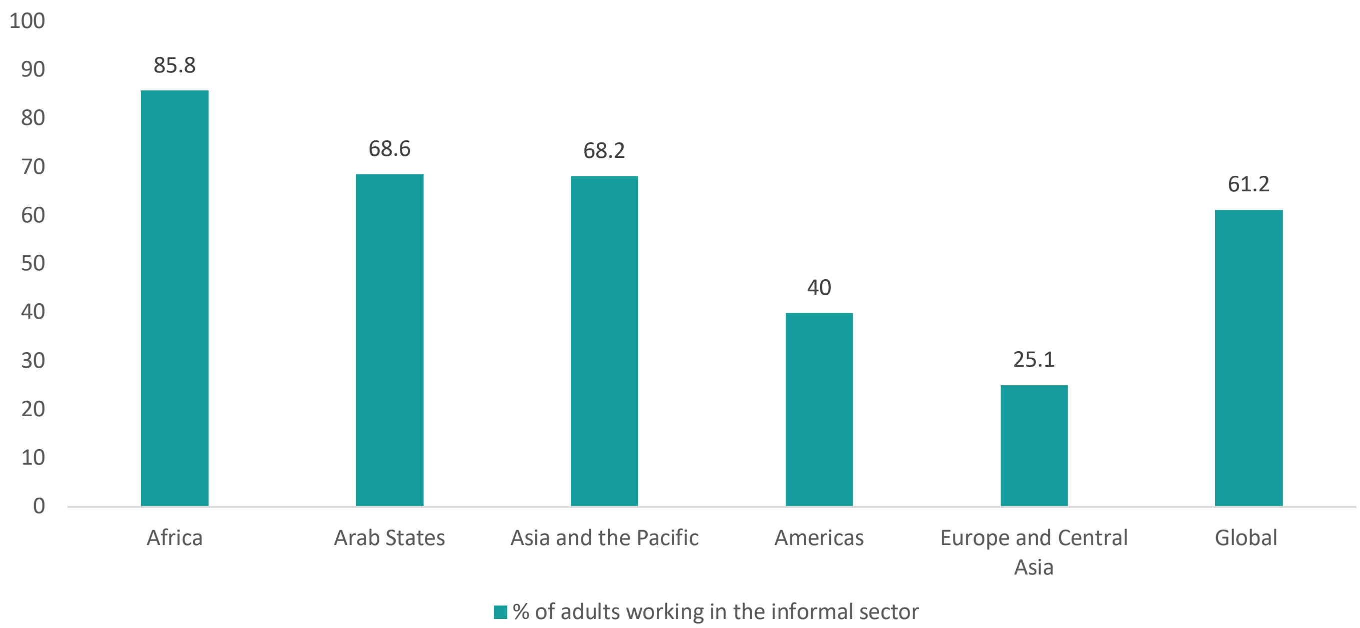
Nano, micro and small enterprises (NMSEs) are a major contributor to economic growth and are the primary source of livelihoods in many economies. However, most of these enterprises; particularly those at the nano (survival) and micro (specialised) levels (see Annex B), are operating within the informal economy which limits their potential for growth and sustainability. The International Labour Organisation (ILO) defines the Informal Economy as "*all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements*" (ILO 2015 pg. 8). As depicted in Table 5, the latest statistics from the ILO indicate that over half of the world's adults (61.2 %) work informally, or nearly 70% in Asia-Pacific, and are thus largely deprived of decent working conditions and broader economic participation opportunities.

Research on the informal economy has also shown that the majority of people working informally do not do so by choice, but rather as a consequence of lack of opportunities in the formal sector. Economies with high levels of informal employment are generally characterised as having lower levels of economic development, lower Human Development Index (HDI), and higher levels of poverty. These characteristics are reaffirmed by the fact that the highest rates of informality are found within emerging and developing economies as depicted in Table 6.

Supporting the NMSE sector, including building their capacity and providing pathways for formalisation, can lead to major development gains such as local economic growth, employment, wealth creation and increased government revenue. As regional/global connectivity increases, coupled with the impact of the digital revolution, new and important opportunities are also emerging for NSMEs to be part of cross-border value chains (including through ecommerce platforms) as a way to expand their markets. To maximise this potential, producers, manufacturers and traders need access to financial products and services that facilitate international trade.

Achieving this is difficult as it requires navigating varying conditions between economies such as laws, regulations and physical/financial infrastructure which often create barriers for the movement of goods, people and capital across borders. The key to success will likely be the establishment of effective cross-border partnerships and the ability of stakeholders to harness digital technology to support international market functions.

Table 5: Informal Employment by Region



Adapted from ILO 2018

Table 6: Share of Employment in Select Economies (%)

Adapted from ILO 2018

POLICY RECOMMENDATIONS

8 Develop Effective Policy Frameworks Which Address the Needs of the Informal Economy

The informal economy is often treated by governments as a social welfare issue rather than an economic opportunity. The informal economy employs significantly more people than the formal economy, and by officially recognising it, governments can develop more effective policies to drive greater economic results. To achieve this, it must be understood that enterprises operating within the informal economy; particularly the nano and micro enterprises operated by the poorest population segments, face unique challenges that need to be addressed by a broad stakeholder ecosystem represented by the public, private and civil society sectors. Governments, however, can play an important role by formulating policy frameworks which address some of the more critical challenges NMSEs face such as:

- Lack of credit history or formal identification which limits access to formal financial services – A potential solution may include the use of unstructured data to make credit decisions.
- Lack of customised financial products and services which meet the unique needs of the informal sector – Attempts to serve the NMSE markets often incorrectly assume that products and services designed for formal enterprises will also address the needs of informal enterprises. Products and services designed for the informal economy also need to have a particular focus on women who make up the majority of nano and micro entrepreneurs.
- The need for access to non-financial services such as micro-medical insurance, school fee savings products, financial literacy or vocational training – Access to finance should be complimented with access to appropriate non-financial services to help translate financial inclusion into economic opportunity.
- The need for more diverse financing resources for smallholders – Examples may include specialised community-owned finance companies or co-operatives which can provide financing services to those unable to access credit from commercial banks.

9 Support the Facilitation of Cross-border Trade and Finance for NMSEs

Effective management of cross-border trade services between economies is a very important aspect of economic growth and stability. To achieve more inclusive development and fully leverage the economic potential of the NMSE sector, governments should consider ways to enable and encourage their engagement in international markets. Some specific priority issues which governments should aim to address in this regard include:

- Establishing, where possible, common protocols on a regional or global level to make it easier to achieve consistent cross-border management practices and procedures while also further enabling and improving trade conditions.
- Governments should make a concerted effort to identify local commodities which have the potential for cross-border movement, and also identify who the major suppliers of these commodities are within their respective economies. To enhance trade, infrastructure development, including pricing stabilising mechanisms, can then be prioritised to support the supply chains of certain commodities resulting in more stable income for many NMSEs including farmers.
- Policies should be formed which enable NMSEs to settle cross-border payments in local currency. The ability to settle foreign trade payments in local currency is crucial to enabling NMSEs to develop and thrive. As an example, Thailand's government allows cross-border trade and investment to be done in any currency. However, some economies do not allow local currency to be used for cross-border trade; thus creating a major barrier for many NMSEs across the region. Such regulations need to be relaxed to increase the opportunities for these enterprises.

REGIONAL INTEGRATION AND COOPERATION

Integration and connectivity represents an essential component of regional economic cooperation and has been recognised as a priority issue by several governments and international organisations as part of their inclusive growth and development strategies. As production networks and value chains are increasingly interlinked across the region, governments are actively seeking ways to successfully unlock their potential to drive greater economic benefits across a range of sectors including trade, transport, energy, technology and finance.

Throughout Asia-Pacific, financial markets have continually become more interconnected both regionally and globally. This trend has been particularly evident since the Asian financial crisis (AFC) in the late 1990's, and further following the global financial crisis (GFC) in 2008-2009, which exposed several weaknesses in the region's financial infrastructure. Both crisis episodes triggered a wide range of policy reforms resulting in more integrated and resilient financial systems across the region. In their analysis of the progress of Asia's financial market integration, the Asian Development Bank (ADB) finds that Asia's financial markets have become more interconnected over the past two decades (both regionally and globally) as depicted in Figure 1 below.

This deepening and broadening of regional financial markets and financial systems has become an essential component to support both financial efficiency and resilience on a regional level. An important outcome of this is the potential for a more developed and regionally integrated banking and financial market to improve efficiency in channelling regional savings into real, productive investment. The ADB estimates that Asia's developing economies will need to invest at least $1.7 trillion per year in infrastructure until 2030 in order to maintain current growth momentum; however, the region is currently only investing $881 billion annually (ADB 2017b). The improved mobilisation and allocation of financial resources as a result of greater integration is of critical importance to meet the region's vast infrastructure financing needs. Ensuring the continued development of these infrastructure needs is critical to achieving inclusive growth and development for the region.

As economies and markets continue to experience greater levels of integration, the importance of cross-border cooperation also increases. Regional connectivity and integration is creating new opportunities for enhancing the economic impact gained from cross-border functions such as trade, supply chains and financial systems.

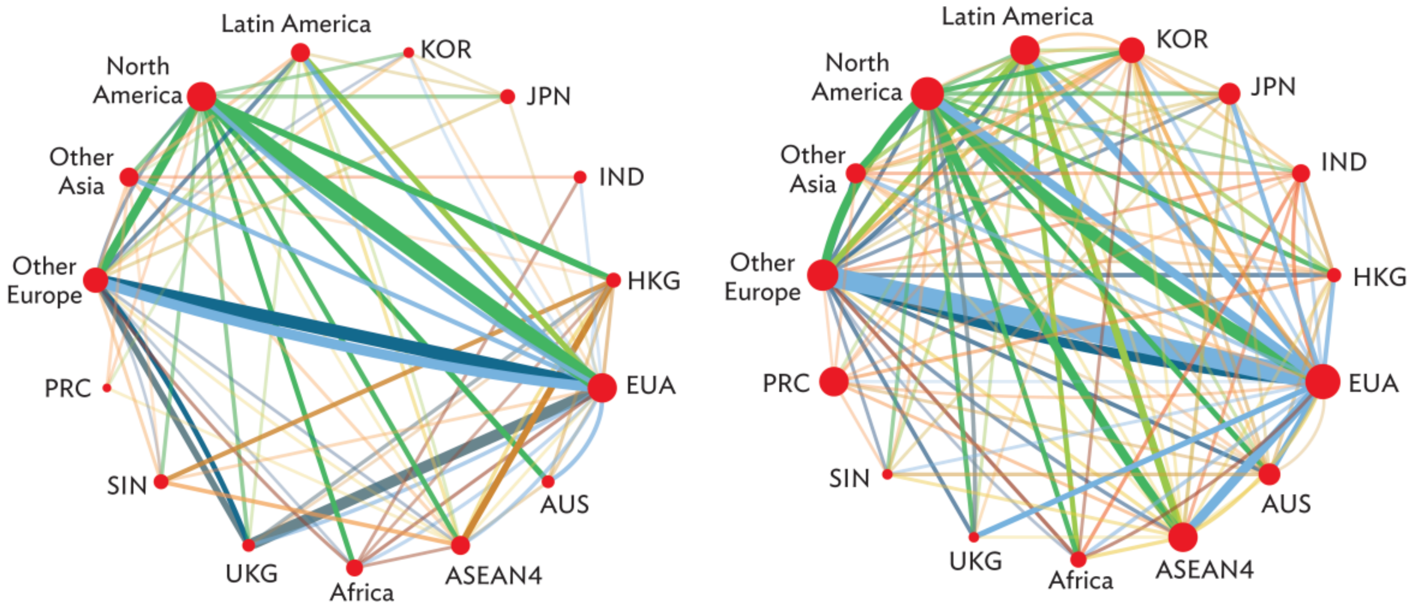
Figure 1: Evolution of Asia's Financial Network

Pre-AFC

(1 Mar 1995-1Jul 1997)

Post-GFC

(1 Apr 2010 – 30 Dec 2016)



Source: ADB 2017a, chpt. 8

Cooperation among governments on issues such as setting regional standards can have a major impact on enabling their integrated markets to drive inclusive growth outcomes. Cross-border capital flows (such as remittances) and data standards to address cyber security are examples of areas where regional standards are required to unlock the full benefits of regional integration and connectivity.

While increased financial integration yields potential benefits for the region—such as a more efficient allocation of financial capital resources or enhanced international risk sharing—it does, however, also entail some potential risks—such as increased risk of financial contagion and financial market volatilities. Consequently, it is important for policy makers to address these risks and safeguard financial stability and resilience amid increasingly interconnected financial markets.

POLICY RECOMMENDATIONS

10 Prioritise Reforms to Support Financing Mechanisms for the Region's Infrastructure Needs

Asia's infrastructure needs are considerable and these needs have a significant impact on the region's inclusive growth potential. While actions to narrow this gap will require the cooperation of several actors, governments can explore a number of options to potentially increase the quantity and quality of investment. Some examples of actions policy makers might consider include:

- Improving the foreign direct investment (FDI) landscape by ensuring that regulation and legislation is clear and promotes greater transparency, including disclosure of the true identity of the investor. Investors should also be required to clearly identify the beneficiaries of their investment, as well as any potential social impacts.
- Developing local currency bond markets to strengthen the region's financial market infrastructure and financial resilience. Since the AFC, many governments in the region have put greater emphasis on developing bond markets to increase financial sector resilience. Bond markets also provide an important financing mechanism for local infrastructure investments. To increase the effectiveness of these investments and further enhance resiliency, governments should encourage the development and deepening of long-term local currency bond markets to reduce currency and maturity mismatches.
- With the infrastructure finance needs greatly outweighing the general resources in most developing economies, governments need to explore alternative methods of funding which function at a regional level. Recognising the benefits of increasing regional integration and connectivity, governments might consider cooperating on the creation of a regional fund which could be used to finance specific infrastructure needs that would result in greater regional connectivity.
- Financial innovation is critical to bridging the region's considerable infrastructure financing needs. Policy makers can consider several innovative options for infrastructure finance. These include (i) the mobilisation of additional public revenues through focused and efficient revenue generating mechanisms (e.g. "user pays" principle) (ii) financial support by governments to encourage further private sector investment in infrastructure (e.g. through funding of the viability gap, direct government payments and/or guarantees), and (iii) blending of concessional and non-concessional finance for infrastructure investment. Such practice could make an infrastructure project sufficiently profitable to attract private sector interest, while maximising the use of limited concessional resources.

11 Promote and Engage in Regional Cooperation Efforts to Enhance Cross-border Functions

Regional connectivity and integration can create many important opportunities for economies to accelerate economic growth while also achieving greater inclusiveness. In order to maximise this potential, enhanced levels of regional cooperation are also needed to ensure that governments and other stakeholders are working together towards shared development objectives. While there are several issues which policy makers and regulators are currently seeking to address through regional collaboration efforts, some specific areas related to the region's financial market integration which would benefit from greater cooperation efforts include:

- Establishing regional KYC/eKYC standards to enable access to formal remittance channels. The use of formal remittance channels represents a major opportunity both in terms of the benefits they provide to the poor as well as broader economic growth. Current KYC/e-KYC regulations are overly restrictive and are limiting this potential. Government agencies across the region should work together to establish a level of standardisation for Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) controls and develop a tiered or proportional regulatory approach which will enable marginalised population segments to gain access to formal channels. Consideration should be given to establishing a remittance working group among policymakers across the region to ensure concerted action on this topic as there are significant inter-regional flows.

- Establishing regional standards for data security. Central banks globally often site cyber security as their number one priority. The standards and regulatory frameworks for data protection differ across the region's economies. Central banks and other relevant government ministries should work together to develop a common set of data protection standards. Such an accomplishment would also potentially increase the viability of sharing consumer data across borders which could have major implications for the financial and economic inclusion of migrant workers.
- Amid expanding intraregional trade, there is a need to further enhance and integrate the region's financial market infrastructure to facilitate local currency transactions across economies. Increasing the links between payment systems in the region could encourage the use of local currencies thereby reducing reliance on foreign currencies, including the US dollar. Agreements on local currency settlement frameworks across central banks could also incorporate digital payment platforms.
- More generally, increasing financial integration and the rise in regional banking activities and institutions—possibly of systemic importance—heighten the region's vulnerability to external shocks. In order to stem this, policy makers need to review and strengthen the financial safety nets in place. In particular, strengthening the Chiang Mai Initiative Multilateralisation and its regional macroeconomic surveillance unit, the ASEAN+3 Macroeconomic Research Office, can simultaneously aid in the monitoring of potential financial disruptions and contain the spread of shocks across Asian financial markets. In addition, discussions of the resolution mechanisms for interconnected regional banks and regional regulatory cooperation, more broadly, can promote financial stability.

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ANNEX A: ABOUT THE FDC GROUP AND OUR PARTNERS

FDC

The FDC Group

FDC is an international development organisation established in 1990. It has worked for circa 30 years in various areas of international development, with a primary focus on economic development.

- It has seeded, incubated and managed region-wide initiatives, some of which remain in operation.
- It has established strong regional brand assets, such as Banking with the Poor (www.bwtp.org) and Microfinance Pasifika Network (www.microfinance-pasifika.org) which are networks of Asia-Pacific region-wide actors in the microfinance industry who serve millions of people who are unbanked or underserved.
- Since 2010, FDC has led the financial inclusion agenda of the APEC Finance Ministers. Each year FDC runs programs within the Finance Ministers Process, culminating in annual policy recommendations provided to Finance Ministers and Central Bank Governors and their deputies which address Financial Inclusion concerns.
- In 2017, FDC redefined and expanded its work to focus on an inclusive growth and development agenda, addressing issues that go beyond traditional financial inclusion, in areas such as asset accumulation, economic inclusion, digital and social inclusion.

In 2017, FDC recognised that it can and should play a role in harnessing the value that lies at the intersection of the development agenda and the private sector, in particular technology innovations that can accelerate development outcomes. As part of its new strategy, FDC established a new business called Deventures. Simply, the mission of Deventures is to commercialise development initiatives, creating the right ecosystems and go to market solutions and models that can create winning outcomes for all actors in the value chain and, in particular, deliver positive development outcomes for the economies involved. FYXA Global is the first investment of Deventures creating a digital financial services marketplace for the region's poor.

The opportunity landscape is limitless, and the role of Deventures, which can be enabled by leveraging FDC's decades of work in building networks and channels to the poor, is focussed in three pivotal areas:

1. Translating technology and business model innovations into meaningful responses or solutions that meet the real needs of the poor.
2. Providing commercial pathways and returns for viable innovations whilst they deliver development outcomes.
3. Creating new investment pathways for investors into currently unavailable or untapped investment markets in the region.

In doing so, we disrupt traditional development paradigms, and align the interests of multiple coalitions towards shared objectives.

FDC and Deventures – the FDC Group - are mutually reinforcing and create significant leverage for the entities to achieve impactful development outcomes in this unique context. www.fdc.org.au

ABAC

APEC Business Advisory Council (ABAC)

The Asia-Pacific Economic Cooperation (APEC) Business Advisory Council (ABAC) was created by the APEC leaders in 1995 to advise APEC on the implementation of its agenda and to provide the business perspective on specific areas of cooperation. ABAC is comprised of up to three members from each of APEC's 21 member economies, representing a range of business sectors. ABAC holds an annual dialogue with the APEC leaders and engages in regular discussions with APEC ministers in charge of trade, finance, and other economic matters. www.abaconline.org

ada LUXEMBOURG AID & DEVELOPMENT

Appui au Développement Autonome (ADA)

For 24 years, ADA has been committed to developing microfinance services to populations excluded from traditional banking channels. Our aim is to strengthen the autonomy and capacity of microfinance institutions (MFIs), professional associations and networks. In South-East Asia, ADA supports technically and financially the national microfinance networks of Cambodia, Laos and Vietnam. ADA also provides support to governments to reinforce and structure the microfinance industry on regional and national levels. We develop and offer specific and innovative microfinance products to MFIs, trainings to microfinance professionals acting in and for the south, and support MFIs in their search for funds. In addition, we have chosen to be present in the field of research to anticipate the future needs of the world of microfinance and to measure the social impact of our actions. ADA, whose headquarters are in Luxembourg, pursues its goals with the support of the Directorate for Development Cooperation and Humanitarian Affairs. ADA benefits from the patronage of HRH Grand Duchess Maria Teresa of Luxembourg. www.ada-microfinance.org

ADBInstitute

Asian Development Bank Institute (ADBI)

The Asian Development Bank Institute (ADBI), located in Tokyo, is a subsidiary of the Asian Development Bank. It was established in December 1997 to respond to two needs of developing member economies: identification of effective development strategies and improvement of the capacity for sound development management of agencies and organisations in developing member economies. As a provider of knowledge for development and a training center, ADBI serves a region stretching from the Caucasus to the Pacific islands. www.adbi.org

Banking with the Poor (BWTP)

The BWTP network is a unique platform comprised of a variety of inclusive growth stakeholders across 17 Asian economies including some of the region's most prominent financial inclusion practitioners and thought leaders. Working in close partnership with its members, BWTP's work consists of exploring, demonstrating and publicising the scope for increased access to financial services for the poor on a sound commercial basis. This includes conducting research and facilitating peer learning to improve practice and policy in the region. Through its membership, BWTP also represents an unparalleled channel to poor and underserved households and communities across Asia. www.bwtp.org

The Thailand Joint Standing Committee on Commerce, Industry and Banking (JSCCIB)

JSCCIB was established in 1977 as an apex body of the three core private sector organizations, namely the Board of Trade of Thailand (BOT), the Federation of Thai Industries (FTI) and the Thai Bankers' Association (TBA). JSCCIB serves as the central coordinating body in providing private sector recommendations and advice to the Joint Public-Private Consultative Committee (JPPCC), Chaired by the Prime Minister. It also coordinates for finding common position of the private sector on relevant issues being raised in both bilateral and multilateral forum. JSCCIB's major activities include promoting international economic, trade and investment relations by appointing its representatives to various sub-regional and regional forum; identifying trade and investment obstacles in order to improve economic conditions and investment climate in Thailand; and promoting bilateral economic, trade and investment cooperation by forming business council with its counterpart in various countries. www.jsccib.org

United Nations Capital Development Fund (UNCDF) - SHIFT ASEAN Programme

UNCDF makes public and private finance work for the poor in the world's 47 least developed countries. With its capital mandate and instruments, UNCDF offers "last mile" finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development. UNCDF's financing models work through two channels: financial inclusion that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and by showing how localised investments — through fiscal decentralisation, innovative municipal finance, and structured project finance — can drive public and private funding that underpins local economic expansion and sustainable development. By strengthening how finance works for poor people at the household, small enterprise, and local infrastructure levels, UNCDF contributes to SDG 1 on eradicating poverty and SDG 17 on the means of implementation. By identifying those market segments where innovative financing models can have transformational impact in helping to reach the last mile and address exclusion and inequalities of access, UNCDF contributes to a number of different SDGs. www.uncdf.org

About UNCDF SHIFT

UNCDF's Shaping Inclusive Finance Transformations (SHIFT) programme aims to expand women's economic empowerment through financial inclusion. SHIFT advances financial markets by changing the behaviour of market actors to stimulate investment, business innovations and regulatory reform in growing inclusive enterprises. SHIFT catalyses innovative partnerships to accelerate financial inclusion and women's economic participation in the least developed countries of the ASEAN and SAARC regions. UNCDF's SHIFT ASEAN programme is supported by the Australian Government.

ANNEX B: UNDERSTANDING NANO AND MICRO ENTERPRISES

While much work has been done to develop policy environments which enable access to finance to micro, small and medium enterprises (MSMEs) and support the growth of the sector, much of this work focuses on enterprises within the formal economy and falls short of addressing the various needs of the multitude of enterprises operating within the informal sector.

In response, FDC has established the following characteristics of nano and micro enterprises to provide clearer distinctions and highlight important features which can help to deepen understanding of the unique challenges they face for development. It should be noted that measures of size have intentionally been excluded from the definitions as such measures are unlikely to reflect whether it qualifies as a nano or micro enterprise.

Nano Enterprise (survival approach):

- Establishment of the enterprise was made possible by receiving a micro loan.
- The enterprise has no employees other than immediate family members (i.e. spouse, children).
- The enterprise does not produce sufficient income to meet the daily needs of the individual or household, and so it is necessary to take up more than one income generating activity to provide sufficient income.

Micro Enterprise (specialised approach):

- Establishment of the enterprise was made possible by receiving a micro loan.
- The enterprise employs other people outside of immediate family members.
- The enterprise is able to generate sufficient income to support the daily needs of the individual or household from a single enterprise. (Note: The individual/household may still participate in multiple income generating activities for extra income, but if necessary they would be able to rely on just a single enterprise to support daily needs