

Taking the credit

How financial services liberalisation fails the poor



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About the World Development Movement

The World Development Movement (WDM) campaigns for a world without poverty and injustice. We work in solidarity with activists around the world to tackle the causes of poverty. We research and promote positive alternatives which put the rights of poor communities before the interest of big business. WDM is a democratic membership organisation of individuals and local groups. Please contact WDM for membership information. The World Development Movement is a founder member of the Trade Justice Movement.

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About Centro de Investigación del Consumo y el Consumidor

Centro de Investigación del Consumo y el Consumidor (CICC) is a Mexican non-profit organisation founded in 2006 with the purpose of advancing legal, economic, social and technology research on consumer and consumption issues affecting consumers in Mexico and abroad. CICC has conducted research on access to justice through collective or class actions and in 2007 organised an international congress on class actions and the need for a modern justice system in Mexico. CICC sits on the advisory board of Profeco, the Mexican Consumer Protection Agency and is planning to do research on topics such as best practice in telecommunication services, fair advertising, public policy for a consumer friendly economy, and ethical consumption.

www.alconsumidor.org



About India FDI Watch

India FDI Watch is a campaign to protect retail democracy and to rein in the corporate rise in the retail sector of India by building awareness and facilitating grassroots action. Specifically, India FDI Watch wants to stop multinational retail corporations like Wal-Mart, Tesco, Metro and Carrefour from entering India unless they make satisfactory guarantees that would protect communities; ensure the stability of existing small businesses and traders; guarantee fair wages and working conditions for their own employees and source employees along with union protection and agreements; and ensure that a significant percentage of sourcing derives from the Indian market. India FDI Watch is building joint action committees across India, led by those who will be most affected, mainly small businesses, unions, hawkers organisations, farmers groups and small scale industries.

www.indiafdiwatch.org



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Foreword

“This financial crisis shows all too clearly that the financial industry is incapable of self-regulation.”

Letter to the president of the European Commission from 14 former European leaders

“What is the crime of robbing a bank, compared with the crime of founding one?”

Bertolt Brecht, Happy End

When the World Development Movement first decided to look at the impacts in developing countries of financial services liberalisation through trade deals, we did not appreciate quite how topical the issue was to become. By the time we had finished this report, the banking sector would be dominating the world’s newspaper headlines and a substantial part of the UK banking sector would have been nationalised or part-nationalised. As Martin Wolf of the Financial Times has written, *“No industry has a comparable talent for privatising gains and socialising losses.”*¹

Bank customers here in the UK are in the throes of a credit crunch and British banks are tightening their credit lines. Families are struggling to get new mortgages, while the UK’s Federation of Small Businesses says that almost half of its members have found it increasingly hard to gain access to finance in the last year.²

But this financial crisis, started by reckless and greedy financiers in the US and Western Europe, has been steadily spreading around the world. The Indian central bank has announced an emergency cut in interest rates, the IMF is loaning Pakistan US\$5 billion, while billions more have been pledged by development banks in Latin America.

This report assesses the role that UK, European and US banks play in developing countries, especially following trade deals which locked-in financial services liberalisation. We show how, even before

the credit crunch had kicked in, the loan practices of big foreign banks in India and Mexico were reducing access to credit for small firms or poor households, and shifting credit away from 'productive activities' towards funding personal consumption for those on high and medium incomes. The financial crisis makes it even less likely that vulnerable sectors will be able to access the kind of financial services that we in the UK have traditionally taken for granted.

Meanwhile, the European Union continues to steer an autopilot course towards further global banking disaster, via its international trade negotiations which seek to recreate the same deregulated banking environment in developing countries that has brought the European financial system to its knees. Indeed, it seems beyond belief that multilateral and bilateral free trade deals are being touted as solutions to the current crises.

For too long, officials in Brussels have listened to the financial industry and their lobbyists, allowing unsound banking practices to flourish domestically and destabilising the global economy through the pursuit of trade deals explicitly aimed at allowing European financial institutions the same carte blanche as they have here.

Yet many are now calling for a change in approach. In May 2008, 14 former European leaders wrote to the president of the European Commission, José Manuel Barroso, saying: *"This financial crisis shows all too clearly that the financial industry is incapable of self-regulation. There is a need to improve the supervision and regulatory frameworks for banks"*.³

Meanwhile, WDM has joined a mass call from global justice organisations, trade unions, development charities, environmental agencies and other civil society groups representing millions across Britain, for fundamental reforms in the way our economy is run. These include a demand to *"stop pushing developing countries to liberalise and deregulate their financial services industries, alongside industrial, agricultural and wider service sectors, via the World Trade Organisation and the EU's regional and bilateral trade negotiations"*.⁴

This report calls upon European leaders to change their approach to trade policy and stop demanding greater financial services liberalisation from developing countries. They should instead listen to people like Claudia Ortiz Mateos from Oaxaca in Mexico, or Lakshman Rao from Bangalore in India, whose stories are documented in this report, and who show just how keenly a new, progressive approach from European leaders is required.



Benedict Southworth
Director, World Development Movement

Taking the credit

Executive summary

This report looks at the impacts that the entry and presence of foreign banks in developing countries has on the ability of small businesses and households to access financial services. Financial services – having a bank account and access to credit – are important to businesses and households alike, enabling people to save and make investments in their future. An absence of these services can make it harder to move out of poverty and foster thriving local enterprises, hindering progress towards meeting the Millennium Development Goals.

An important component of financial services liberalisation is to make it easier for foreign banks to offer banking services in the global south. Having reached saturation point in domestic retail banking markets, the liberalisation of overseas markets has been pushed aggressively by the industry's lobbyists via free trade deals, firstly at the World Trade Organisation and more recently at the bilateral level.

Yet for developing countries, the negative impacts of foreign banks on domestic sectors can be significant. There are two key trends. Firstly, the entry

and presence of foreign banks is associated with the 'cherry-picking' of richer customers (both individuals and large businesses) and a decline in services and credit for poorer customers and smaller businesses. Rural communities are especially affected; foreign banks rarely have a meaningful presence outside large urban areas.

Secondly, the entry and presence of foreign banks produces a discernible and negative shift of credit away from productive activities (investment in agriculture, industrial production or local services) which can boost local development, and towards personal consumption, via credit cards and credit for items such as cars and mortgages.

WDM examined these impacts through detailed assessments of the banking sectors in Mexico and India. Working with Centro de Investigación del Consumo y el Consumidor AC (CICC), WDM looked at the ability of rural farmers and artisans to access credit in Oaxaca state, Mexico since the entry of foreign multinational banks was locked-in via several controversial trade deals. The main findings of this were:

- The Mexican banking sector is now one of the most liberalised in the world. It has become highly concentrated and foreign banks control up to 80 per cent of the Mexican banking system.
- Since foreign banks have dominated the market, credit for productive activities has declined as a proportion of the total. Local farmers and artisans in rural Oaxaca state have found it difficult to obtain the credit that they need, holding back the development of an already-poor region.
- The dominance of foreign banks has not made services more affordable. Interest rates and charges across the Mexican banking sector remain very high, with significantly higher rates charged by the foreign banks in Mexico than at home.

The second case study, produced with India FDI Watch, examines access to credit amongst urban consumers and small businesses in India after recent liberalisation of the financial sector. With further liberalisation looming on the horizon, the proposed EU-India trade deal threatens to make it easier for foreign banks to operate in India and to maximise their profits by locking-in such an approach. The main findings from this research include:

- In urban areas where foreign banks are concentrated, low-income householders and small businesses struggle to meet the criteria to open an account, let alone to receive a loan.
- Foreign banks make proportionally larger profits per branch than other financial institutions operating in India. Their increasing presence has distorted the wider sector and caused other financial institutions to target higher-value customers at the expense of the poorer ones.
- Foreign banks and their industry representatives are lobbying hard to gain greater access to the Indian banking sector and to have current operating restrictions lifted.

Strikingly, in both rural Mexico and urban India, the people CICC and India FDI Watch spoke to are very reliant on public banks, local cooperatives and credit unions for provision of basic accounts and small micro-finance loans at reasonable rates.

Cooperatives and credit unions can be highly effective institutions at providing services especially, but not exclusively, to low income communities and must be at the heart of strategies to provide affordable and sustainable financial inclusion.

For those reliant on mainstream commercial banking though, the threat of financial exclusion is likely to get worse as the global recession gathers pace. And the breadth and depth of this exclusion will increase further if proposed trade deals between the EU and various developing economies are left unchallenged. As such, WDM is calling for:

- The European Commission (EC) to stop negotiations on Europe's proposed free trade agreements. As an immediate step, financial services liberalisation demands should be taken out of all proposed trade deals. Instead, the EC must develop progressive trade policies not premised on liberalisation.
- Donors and government agencies to develop a clear agenda for getting affordable and sustainable financial services and productive credit to those who need it. Credit unions, cooperative banks, and other publicly-minded institutions will play a central role in serving financially-excluded firms and communities.
- Governments, including the UK, and international institutions to begin to overhaul the governance of the global financial system so that it supports progressive social and environmental objectives, as the Green New Deal group⁵ has set out.
- The banks to ensure that their investment and lending does not undermine the development of local communities in the global south. The UK government must ensure that banks receiving public funds urgently rethink their overseas expansion strategies and investment criteria.
- The European Commission to carry out an immediate assessment of interest groups' influence on the development and implementation of European trade strategy and a mandatory lobby register to be created.

1. The importance of financial services to poor communities

Access to finance and financial services, especially bank accounts and credit in the form of loans, is an essential component of modern life and can play an important role in improving the life chances of low-income communities.

Access to credit enables people to make small investments in their lives and livelihoods, the cost of which would be prohibitive in the short term, but which is affordable when spread out over a period of time. Sustainable and affordable credit for productive purposes such as setting up a street-side food stall, diversifying into new crop production, or buying new machinery for a factory, is essential for the development of a strong diversified economy.

CICC



Mario Martínez Andrés comes from San Andrés, a rural village in the state of Mexico. He is the head of his household and responsible for providing for his wife and three children.

He has a micro-enterprise selling arts, crafts and regional music DVDs.

I once requested a loan at Banamex, but was turned down on account of my low credit profile. I meant to purchase more merchandise, then sell it at a profit and thus repay the bank. Unfortunately I could not do this after they refused to make a loan. I consequently purchased less merchandise, and am on a tight budget.*

*private Mexican bank, now owned by US multinational Citigroup

India FDI Watch



Ramanuj Mishra is originally from Bihar but came to Delhi in 1988 looking for work. He finally became a street grocer and hawker.

I have no bank account. The money which I managed to save was kept either inside my house or with a relative. But last year I lost a good amount of money that I had kept in one relative's house in an incident of burglary. I could not recover the money from my relative because it could have resulted in a loss of faith between us.

The simple act of having a low-cost bank account can enable households and businesses to keep their savings secure and to earn a small return on them. Over time, having a bank account can mean accessing further financial services, and it will be easier for households to access remittances sent by family members overseas.⁶

Conversely, a lack of access to these financial services will constrain the ability of poor communities to be able to participate in the wider economy, increase their incomes and move beyond poverty.⁷ Improved access to affordable financial services could positively impact upon a number of Millennium Development Goals including those which relate to improved health and education,ⁱ those which seek to improve the life opportunities for women,ⁱⁱ and those which contribute towards the overall reduction of hunger and poverty.ⁱⁱⁱ

Access to formal financial services can also mean far less reliance on risky, informal and sometimes unscrupulous money-lenders who can charge exorbitant interest rates for their services and who can be a threatening presence in a local community.

Formal financial services in developing countries are currently provided through a variety of institutions including public and private banks, credit unions, cooperatives and microfinance institutions. Yet there is a huge issue of unmet demand.

Micro, small and medium enterprises need credit to plough into productive purposes to boost local livelihoods and the economy. At an individual level, in India, 41 per cent of the adult population overall and 61 per cent of rural communities lack access to a bank account⁸, while in Mexico only 20 per cent of agricultural producers can access credit⁹. These are not untypical figures in the global south.

The situation is particularly acute in rural areas, away from the big cities where many financial institutions tend to concentrate. In urban areas, there may be a far greater proliferation of bank branches but the poor are still often excluded, lacking the income level, collateral or sometimes the paperwork to fulfil the criteria required to open an account or take out a loan.

CICC



Marisela Ortiz lives in Cuajimalpa, a semi-rural district of Mexico City. She has three children and sells goods in the local market. Last year, she requested 5000 pesos from a local money

lender, to invest in her micro-enterprise. It is a two year loan and was given to her in 24 hours. But the cost of the loan has been very high:

I am currently paying 700 pesos a month [which equates to 16,800 pesos over the whole loan cycle]. Sometimes I have to make late payments, in which case the interest increases to 800 pesos. I still owe 7000 pesos. One needs to be more careful.

- i. MDG 2 – to achieve universal primary education; MDG 4 – to reduce child mortality; MDG 6 – to combat HIV/AIDS, malaria and other diseases; MDG 7 – to ensure environmental sustainability.
- ii. MDG 3 – to promote gender equality and empower women; MDG 5 – to improve maternal health.
- iii. MDG 1 – to eradicate extreme poverty and hunger

2. Liberalising financial services through trade

“In recent years many poor countries have been a laboratory of financial sector reform.”¹⁰

International Monetary Fund Working Paper

“Around the world, countries that have opened up their banking sectors to large international banks have found that those banks prefer to deal with other multinationals like Coca-Cola, IBM and Microsoft. While in the competition between large international banks and local banks the local banks appeared to be the losers, the real losers were the local small businesses that depended on them.”¹⁴

Joseph Stiglitz, former Chief Economist at the World Bank

2.1 Financial services liberalisation - theory vs. reality

2.1.1. Financial liberalisation

Financial reform and liberalisation can take many forms. The privatisation of state-owned or national banks can be one such form. Further financial liberalisation takes place when controls are removed on the movement of capital in and out of the country and on the conversion of money to other currencies. Ultimate financial services liberalisation occurs when foreign banks are allowed to enter the market, and over time, operating restrictions are lifted so that they are treated in the same way as domestic providers.¹¹

There are several ways in which foreign banks can enter the market of an overseas country. Firms can set-up subsidiaries as locally registered companies or take-over existing banks. Alternatively, they can set-up their own branches and representative offices in-country. This latter arrangement only requires the supervision of activities by the home country regulator; subsidiaries require supervision by both the home and host country. This can be beneficial to foreign banks originating in the US and the EU where, over time, domestic regulatory and supervisory regimes have been relaxed in the name of boosting competitiveness, with the disastrous consequences apparent in the present financial crisis.¹²

This report will focus on the entry of, and enhanced access by, foreign banks in the financial markets of developing countries and the progressive elimination of controls on their activity vis a vis domestic providers ie. financial services liberalisation. This report will also specifically concentrate on retail banking: the provision of financial services to households, micro-enterprises, and other companies in developing countries, and how this impacts upon livelihoods. The report will

not look at corporate finance, finance for trade exports, merchant banking or other financial services such as insurance.

2.1.2. The beneficial impacts of the entry of foreign banks – the theory

Advocates of financial services liberalisation argue strongly that the entry and enhanced access for foreign banks to new markets can make a significant contribution to economic growth and poverty eradication in rich and poor countries alike.

In particular, the entry of foreign banks is said to achieve better efficiency through economies of scale and risk-reduction, increased competition and through the introduction of more advanced technology and expertise. Foreign affiliates of international banks may also be perceived as safer than private domestic banks because they have the backing of their parent companies, especially in times of economic difficulties. Finally, so the proponents' theory goes, foreign banks may be less susceptible to domestic political pressures and less inclined to lend solely for political gain.¹³

These arguments around the entry of foreign banks are derived from an economic analysis based on the idea of perfectly competitive markets. But clearly the world is not that simple and greater competition does not always bring positive benefits, especially given the domestic market distortions deeply rooted in many countries around the world.

2.1.3. The entry of foreign banks – the reality

Applying the claim of benefits from the entry of foreign banks to real world situations of imperfect markets creates negative and unforeseen impacts which many proponents rarely mention and which many research projects neglect to look into. Evidence from developing countries which have undertaken financial services reform by allowing the entry of foreign banks shows that the situation is far more complex than the theory implies, and can lead to:

- Active selection or 'cherry-picking' of high-value customers
- Benefits for high-value customers, but a decline in the ability of the wider financial sector to reach low-value customers
- Less credit available to the local private sector (as opposed to public sector or large firms)
- Less credit for productive activities; credit for personal consumption increases
- Distorted behaviour by local banks because of increased competitive pressure
- Overall loss of access to affordable and sustainable financial services for key groups and thus a decline in national welfare

A 2006 working paper produced for the IMF found that *"in poor countries, a stronger foreign bank presence is robustly associated with less credit to the private sector ... In addition, in countries with more foreign bank penetration, credit growth is slower and there is less access to credit."*¹⁵ Indeed, the paper talks of the 'cream-skimming' impact of foreign banks, where foreign banks cream off the high-value customers, leaving the remaining financial institutions to deal with lower-value customers. This increases both the cost of the banking services to those customers and for the banks themselves.¹⁶

The IMF study looks at a number of indicators of access to financial services including the extent of the branch and ATM (cash-point) network, and the number of loans and deposit accounts. The report shows that *"foreign bank presence in poor countries is associated with less access to financial services, as measured by the size of the branch network, number of loans, and number of deposits"*.¹⁷

It concludes that foreign banks are *"better at monitoring high-end customers than domestic banks"* but a high number of foreign banks *"may hurt other customers and worsen welfare."*¹⁸ The analysis includes *"more advanced"* poorer countries such as Brazil, South Africa, Russia, Egypt, India and Indonesia.

One of the reasons for these results from foreign banks, the authors believe, is that when consolidation happens in the banking sector, there is a loss of 'relationship capital'; in particular, when large international foreign banks operate in poor countries, the *"cultural and geographic distance between loan officers and management is maximal"*.¹⁹ This implies that any incoming foreign bank expertise and technology cannot always offset the resulting loss of knowledge and understanding of the local bank sector and customer base.

A study on the impact of foreign banks in Africa confirmed the cream-skimming or 'poaching' of the more profitable customers.²⁰ This survey looked at financial services in the Southern African countries of Botswana, Lesotho, Namibia and Swaziland (BLNS countries).

In particular, the study argued that where the new bank entrant aggressively seeks to establish a higher quality, higher priced, higher margin product that attracts top-end customers, existing banks may be forced to mimic this product in order to compete for the most lucrative part of the market and that this could prevent them from offering lower priced, more basic products to a wider customer base.²¹

The study concludes that the recent experience in BLNS countries and elsewhere in Africa suggests that in economies characterised by extreme levels of inequality, in the absence of strong regulation, short-term losses of access caused by the entry of foreign banks may persist over the long-term.²²

A research review carried out by UNCTAD on financial sector reforms (including foreign bank entry) in eight Least Developed Countries (LDCs) found that increased competition stimulated some improvements in financial services. However, *"with few exceptions the new entrants (both foreign and domestic banks) have avoided the rural areas, hence what benefits that have occurred have been confined to the urban areas"*.²³

The report shows how rural communities and those dependent on agriculture for their livelihood can lose out following financial

services liberalisation. Lending practices are distorted as members of the wider sector find themselves forced to compete with each other and to reallocate credit towards the most 'credit worthy' and those most capable of generating high rates of return – typically not those in rural areas.²⁴

There is further significant evidence showing how large foreign banks (and the wider banking sectors which their presence distorts) are shifting credit away from productive activities and towards funding higher levels of personal consumption instead. This trend has been noticeable in European and North American countries for years and has led to both import booms and property price bubbles. Between 1976 and 2006 in Britain, resident banks' lending to individuals rose from 11.6 per cent of total lending to 40.7 per cent.²⁵

In 2006, HSBC generated 42.9 per cent of its profits from 'personal finance', contrasting with 27.3 per cent and 26.3 per cent from its commercial and investment divisions.²⁶ Part of HSBC's international expansion strategy is targeted at what it calls 'mass affluent customers' in key overseas markets including emerging economies. HSBC has targets to triple its 'Premier' personal customer base to six million by the end of 2011, achieving average revenues per Premier customer of over US\$1000.²⁷

This emphasis on credit for consumption, which started in the West, is now very apparent in certain emerging economies like those in Latin America, including Mexico. Paulo L dos Santos of SOAS writes, *"Evidence suggests that foreign banks have helped significantly reorient the allocation of credit in favour of consumer, credit card and mortgage loans...at least in the Mexican case, this shift has been accompanied by a severe reduction in lending to firms"*. Dos Santos goes on to argue that development strategies based on indigenous industrialisation will thus be hard hit.²⁸

All in all there is substantial evidence to show that financial services liberalisation, and specifically the entry and enhanced access for foreign banks can distort existing financial services provision and weaken the emphasis

on widening sustainable financial inclusion. In particular, while foreign banks make overtures to the high-value personal and wealthy commercial customers, the local private sector and households become a far less appealing customer base for both foreign banks and the wider sector.



3. Europe's trade liberalisation agenda

Europe's comprehensive and wide-ranging trade liberalisation agenda seeks to open up developing countries to the export of European products and services, including in the area of financial services and banking.

Since the start of the Doha round of trade talks in 2001 at the World Trade Organisation (WTO), negotiators have been trying to secure a deal on the General Agreement on Trade in Services (GATS) which covers financial services and banking, as well as other services, such as transport, telecommunications and water.

3.1. Financial services at the WTO

In 2002, via GATS negotiations, the EU requested that 94 countries open up their financial industry. Of these, 20 countries were least developed countries (LDCs) and 30 were low income countries.²⁹ A comprehensive GATS deal is still under negotiation but its finalisation would usher in an era of comprehensive liberalisation of financial services for participating countries – which would be very difficult to reverse. GATS provisions include the dismantling of existing national regulations aimed at protecting local credit providers and consumers.

Key provisions are 'national treatment' clauses (countries cannot treat foreign providers less favourably than their own) and 'most favoured nation' clauses (foreign providers have to be given parity with any other third party that also has a preferential arrangement with a given country).

In practice, a financial services component of GATS would mean that countries commit to:³⁰

- **Undertake not to introduce new conditions that are more restrictive than those already operating.** In practice, this could make it difficult to prohibit risky trading such as 'short-selling' or to introduce measures

designed to boost the stability of the system, such as limiting the numbers of service providers or the number of transactions.³¹

- **Agree to allow all new financial services.** In practice this could allow the liberalisation of exactly the kind of risky financial trading and products that have been so criticised in recent months as leading to the financial and food price crises, including trading in derivatives and securities. GATS seeks the liberalisation of such financial products without requiring that the necessary regulation and supervision be in place.³²
- **Remove any obstacle to foreign financial services.** In practice, full ownership by foreign banks is allowed under GATS. If foreign banks only establish branches, the host country's financial services supervisor will have to depend on information from the bank's home country supervisor to determine whether the bank is stable and meeting its domestic obligations. This will make it hard for the host country's supervisor to monitor the foreign bank's activities and to ensure it is acting in the interests of the host country.³³

While there is provision within GATS to allow members to regulate their domestic financial services sector for 'prudential reasons' to bring stability and integrity to the system, it also stipulates that such measures cannot be introduced to circumvent GATS rules or to avoid the liberalisation commitment outlined above.³⁴

Financial services have been awarded special status at the WTO; GATS has a special Financial Services Annex and financial services are the subject of a specific permanent committee which has focussed on pressuring recalcitrant countries that have not expanded their financial services liberalisation commitments.³⁵ As of July 2007, 121 members of the WTO or 80 per cent of the members had made liberalisation commitments in the area of financial services.³⁶

However, despite seven full years of negotiations, a deal on GATS at the WTO remains elusive. Developing countries have continually rebuffed the strongest demands made by the developed countries and the deal on the table, while still very damaging to developing countries, is not as tough as the EU and US negotiators were originally hoping for. As the talks slid into impasse, European negotiators, urged on by corporate lobbyists, sought an alternative strategy to deliver its liberalisation agenda.

3.2. Global Europe

In 2006, the European Commission published *Global Europe: Competing in the world*. This 20-page strategy drafted by DG-Trade on behalf of then trade commissioner Peter Mandelsonⁱ forms a suite of documents which set out how European trade negotiators would seek to maintain competitive advantage for European big business in a changing, globalised world.ⁱⁱ

Whilst maintaining support for the multilateral WTO approach to trade liberalisation, Global Europe instead sets out a bilateral or regional approach, focussing on a set of countries and regions for trade deals which the EU regards as having the greatest “market potential.”³⁷ The EU is seeking to get “the highest possible degree of trade liberalisation including far-reaching liberalisation of services and investment.”³⁸

These bilateral trade deals will lock-in the provisions being negotiated through GATS, just in case no deal materialises at the WTO, whilst also seeking to go further. As evidence of this, the EU trade deals already signed with Chile and Mexico contain substantial chapters on financial services; while the Caribbean Economic Partnership Agreement with the EU (signed in October 2008) contains some of the most far-reaching elements of GATS.³⁹

The pressure for countries (or blocs of countries) to accept far-reaching financial liberalisation clauses within proposed trade deals with the EU is enormous. However its potential consequences have not been lost on many developing country negotiators, who in many cases have fought hard to retain vital protections to their domestic banking sectors and control over financial markets.

For example, since 2006, the EU has been negotiating with countries in Central Americaⁱⁱⁱ to agree a free trade deal as part of its Global Europe strategy (see box). WDM has not seen the EU’s demands to those countries in the area of financial services. However, WDM has had sight of the responses of three Central American countries to the EU’s demands, dating from March 2008, (summarised in the table opposite⁴⁰), which illustrate the ways in which Central American countries are seeking to defend their financial services.

Global Europe

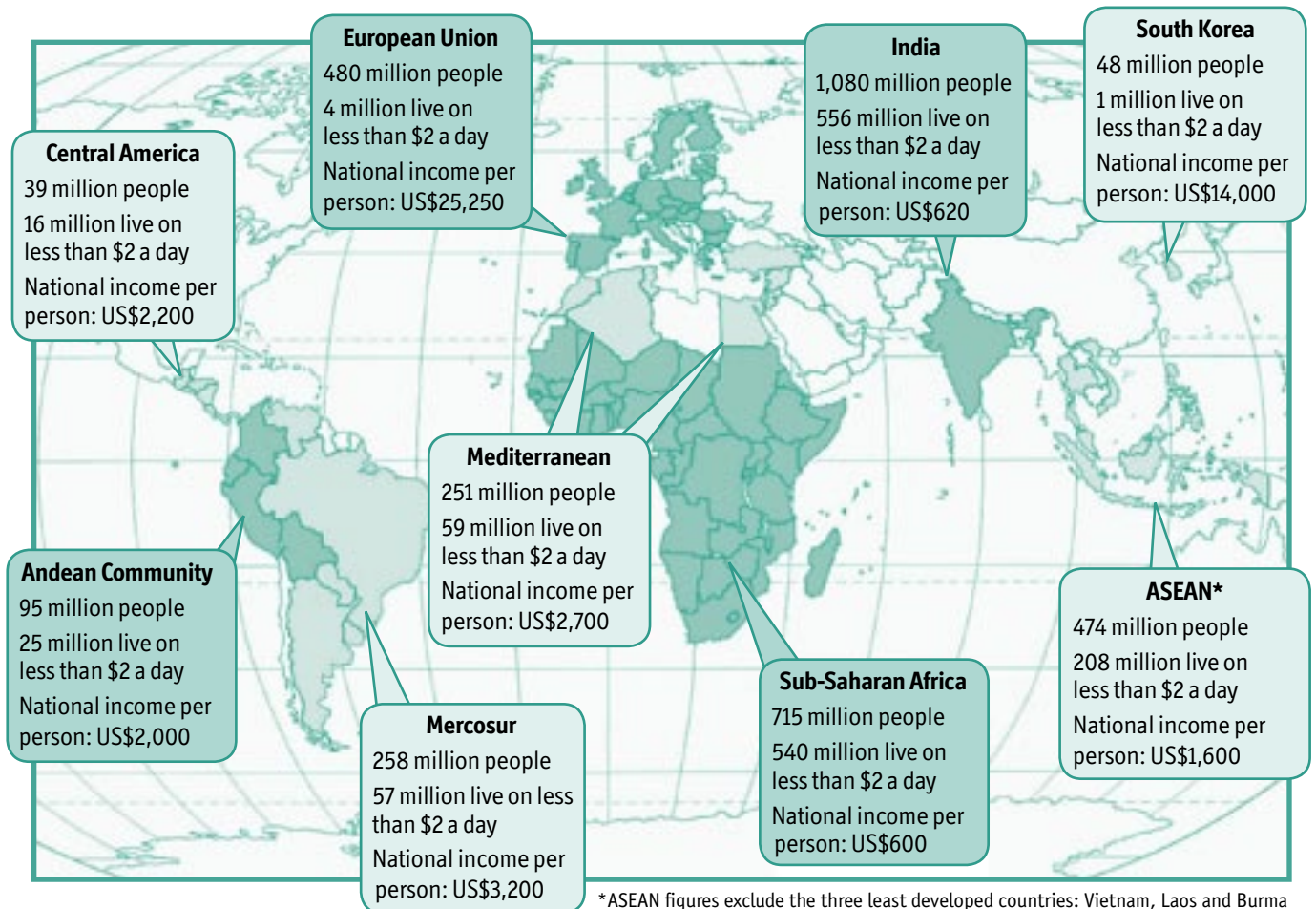
Via its proposed Global Europe strategy to sign bilateral and regional free trade deals, the EU wants developing countries specifically to:

- **Cut import taxes on industrial and agricultural goods**
- **Remove so-called ‘non-tariff barriers’ on imports**
- **Eliminate restrictions on exports, particularly of raw materials**
- **Enforce strict intellectual property rights for European companies**
- **Remove regulations on European service companies, including financial services**
- **Remove regulations on investment by, and products of, European multinational companies**
- **Stop giving preferential treatment to their own companies when awarding government contracts**

In return, the EU promises access to its own markets for developing countries, allowing them to argue that these trade deals are ‘fair’. However, the World Development Movement argues that these trade deals will restrict progress towards poverty eradication, by locking developing countries into a liberalised and deregulated model, and will reduce the scope for governments in these countries to organise and run their economies in the interests of their people.

- i. Peter Mandelson has since been replaced by Catherine Ashton as European trade commissioner.
- ii. Other documents include: ‘A stronger partnership to deliver market access for European exporters’, and a communication on securing access to raw materials from overseas.
- iii. The Central American region comprises: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama.

Map of Global Europe target countries



Defensive interests in financial services by Central American countries

| Country | March 2008 negotiating position |
|-------------|--|
| Costa Rica | Only Costa Rican nationals can take up key positions in state banks |
| | Maintain key role for commercial state banks in savings and deposits |
| | Foreign banks cannot set up branches, only subsidiaries (this offers more control to host country supervisors) |
| El Salvador | At least 51 per cent of shares of banks set up in El Salvador must be owned by nationals |
| | All employers must have a work force with at least 90 per cent El Salvador nationals |
| | Foreign banks can only set up as a plc (this offers more control to host country authorities) |
| Nicaragua | Maintain 90 per cent Nicaraguan employees in company; a foreign employee allowed if no Nicaraguan available with appropriate skills, but then a Nicaraguan must be trained up |
| | Any private bank must set up as a plc (this offers more control to host country authorities) although foreign banks can operate through branches (which allows the foreign bank and home country supervisor greater control) |

4. The financial services industry – friends in high places

An analysis of the role that banks and their industry representatives play in lobbying trade negotiations shows that these organisations exert a worrying and excessive degree of influence over public policy.

Financial services are big business in the UK. In 2005, the UK was the largest worldwide exporter of financial services.⁴¹ According to the British Bankers' Association, the financial sector contributed £50 billion to the UK economy, or 8.5 per cent of UK gross domestic product (GDP). Of course, the recent financial crisis will mean that, in the future, the scale and profits of the UK sector are somewhat smaller. But even in a recession, the UK banking sector is likely to remain a multi-billion pound industry.

4.1. Financial services lobbying

Considering the size and economic weight of the sector, it is not difficult to understand how the UK financial services sector has friends in high places. There are many organisations which seek to influence international trade negotiations on behalf of the banking industry, as detailed below. Many have developed and articulated aggressive liberalisation demands and have employed a wide variety of techniques to get their agenda adopted. It is clear that the European Union's Global Europe strategy has been actively developed with, and supported by, a range of lobbyists working on behalf of the finance sector.

4.1.1. European Services Forum

In 1998, Leon Brittan, the then EU trade commissioner, approached the chairman of Barclays Bank to create a European lobby group in the areas of services to influence the negotiations at the WTO. The European Services Forum (ESF) was duly set up in 1999 and has since enjoyed generous access to the EU's trade policy-making machinery.⁴²

During the drafting of the Global Europe paper, the European Commission sought views from business lobby groups. In response, the ESF called for the EU to aggressively pursue the removal of regulations such as caps on foreign ownership of service companies, requirements for a company to gain a licence, requirements for a foreign services company to be part of a joint venture with a local company, and limits on the repatriation of profits back to home countries.⁴³

A February 2007 ESF policy paper states, “ESF... welcomes the Commission’s initiative to open new negotiations for bilateral and region-to-region free trade agreements (FTAs), provided ambitious packages on services form the core of any new

agreements. ESF fully supports the negotiations proposed with India, South Korea and the ASEAN countries.”⁴⁴ A number of UK and European banks formally endorsed this letter, including Barclays, Commerzbank, Deutsche Bank, European Association of Cooperative Banks, European Banking Federation, European Savings Banks Group, Goldman Sachs International, Royal Bank of Scotland, and Standard Chartered Bank.⁴⁵

In March 2007, the Commission contacted EU companies and business lobby groups to ask what regulations they should be targeting for removal in trade negotiations.⁴⁶ The ESF made specific demands for each region; the financial services ‘highlights’ are listed below:⁴⁷

Demands by European Services Forum for financial services liberalisation

| FTA Country | ESF Demand |
|-------------------------|---|
| Korea | Accounting Removal of an effective bar on foreign ownership of accountancy firms. |
| | Banking Removal of mandatory lending requirements to small and medium enterprises (SMEs). Removal of limits on credit card rates. Removal of nationality and residence restrictions. |
| India | Banking Removal of 49 per cent equity cap. (Has now been raised to 74 per cent). |
| Malaysia (ASEAN) | Banking Removal of 30 per cent equity cap. Says that “Branching for banking is extremely restricted”. |
| Indonesia (ASEAN) | Banking Removal of 49 per cent equity cap. |
| Thailand (ASEAN) | Banking Removal of 49 per cent equity cap. (Is currently lifted but no international commitments not to reintroduce). |
| The Philippines (ASEAN) | Banking Removal of requirements for at least 70 per cent ownership by Philippines citizens, capital requirements, equity caps, branching restrictions. |
| Vietnam (ASEAN) | Banking Removal of restrictions on the purchase of Vietnamese banks. |

4.1.2. The British Bankers' Association

The British Bankers' Association (BBA) has 219 members and *"is the leading UK banking and financial services trade association"*.⁴⁸ A 2006 report prepared for the BBA states that the UK should, *"continue to enjoy a vigorous and profitable financial sector, unimpeded in its efforts by public policies of one sort or another, but on the contrary encouraged to grow."*⁴⁹

To this end, the BBA has produced two documents analysing the financial services' trade barriers in the ASEAN region and in India which have been submitted to UK decision-makers. For ASEAN, the BBA outlines the equity caps that foreign banks wish to see removed.⁵⁰ For India, the BBA welcomes the recent deregulation that has taken place (see below) and calls for a reduction in the income tax that foreign banks pay, a move to make off-shore banking easier, and the relaxation of the "unappealing" 74 per cent limit of foreign investment in the banking sector.⁵¹

These two reports were released to WDM by the UK government under Freedom of Information along with the information that two meetings had been held between the UK government's Department for Business, Enterprise and Regulatory Reform (DBERR) and the BBA between June 2007 and August 2008 on Global Europe or banking in developing countries.⁵² DBERR has written to WDM that *"We do not hold any minutes or records of these meetings"*⁵³, an indication of the lack of transparency and accountability surrounding corporate lobbying here in the UK.

In a letter to WDM dated June 2008, the BBA's Executive Director Roger Brown wrote:

The BBA will continue to press trade negotiators to seek liberalisation of services such as banking. It is in the interests of both the economies concerned and our members that poorer countries achieve the higher rates of economic growth and prosperity that flow from greater efficiency and competition.⁵⁴

4.1.3. European Banking Federation

The BBA is the UK delegate to the European Banking Federation (EBF). Roger Brown, Executive Director of the BBA, chairs the EBF's committee for international affairs which has specific responsibility for work on EU bilateral trade agreements.⁵⁵ One of the EBF's guiding principles is to *"lobby at EU and international level in support of the free market and to ensure that European banks face a level playing field on EU and global markets, operating free of unfair distortions of competition"*.⁵⁶

In 2007 the EBF asked the European Commission *"to conclude meaningful Free Trade Agreements with selected jurisdictions to achieve the elimination of national legislation and standards regarded as discriminatory against EU banks; and to deepen existing financial regulatory dialogues."*⁵⁷ It submitted a detailed note covering India, ASEAN countries, South Korea and Ukraine.

In a request to the European Commission, information was released to WDM regarding a meeting between staff from the EBF and officials from DG-Trade in January 2008, regarding trade barriers affecting financial services and market access, and the possibility of setting up an *"EU-based working group on financial services barriers"*.⁵⁸ According to the Commission, reports of this meeting were not made.⁵⁹

4.1.4. International Financial Services London and LOTIS group

Not only did the former EU trade commissioner Leon Brittan prompt the creation of the ESF, he then went on to chair a sister lobbying organisation called the 'High-level LOTIS' group which is part of International Financial Services London (IFSL).⁶⁰

LOTIS stands for the Liberalisation of Trade in Services and according to its own web page it is, *"the key voice of the UK financial services sector on global trade policy issues."*⁶¹ It works to *"bring together senior representatives from across the industry to work for the liberalisation of trade in financial services."* It has also apparently *"played a key role in influencing the successful conclusion of the WTO Agreement on Financial Services in December 1997"*.⁶²

It's 'success' is perhaps not surprising considering that it appears to enjoy a significant level of access to UK government decision-makers. The LOTIS web page states, *"Senior government representatives are also invited to attend [IFSL quarterly meetings] as observers; officials from the Foreign and Commonwealth Office, UK Trade & Investment, HM Treasury, and the Department for Business, Enterprise & Regulatory Reform are often present."*⁶³

4.1.5. Direct bank lobbying

Aside from the lobbying that may be undertaken by industry lobby groups, some UK banks speak directly to government officials regarding their overseas expansion plans. Information has been released to WDM under Freedom of Information rules regarding two meetings held between Barclays and officials at the Department for Business, Enterprise and Regulatory Reform in October 2007 and August 2008.⁶⁴ The first meeting also included minister Gareth Thomas.

An email from an unnamed DBERR official to Barclays which was sent on 7 August 2008 said:

It was great to catch up with you and your team yesterday ... I'd like to explore further Barclays trade policy priorities (key markets/ barriers). I'm pleased to note that a lot of what you said yesterday reaffirmed my understanding. However, its always good to have more examples/ background to ensure that the UK is well placed to continue to argue that financial services should remain at the top of the Commission's priority list in terms of negotiating trade agreements ... I also hope that Barclays can begin to raise its profile in fora such as the BBA, IFSL and the ESF.⁶⁵

The tone and content of this email (and related emails seen by WDM) implies a real 'meeting of minds' between UK government officials and Barclays, so much so that the official actively encourages Barclays to support further lobbying activities via the industry groups described above. This is of great concern, not least because the official is doing so at a time, Summer 2008, when the activities of the global financial services sector were about to bring the world economy to its knees.

In conclusion, it is clear that the financial services lobby, in all its guises, is working hard to create new and enhanced opportunities to work overseas in countries like India – notwithstanding the impacts on the accessibility of financial services for households and small businesses on the ground.

5. The impacts of financial services liberalisation on the ground

5.1. Mexico

Produced with Centro de Investigación del Consumo y el Consumidor AC (CICC), Mexico

Mexico is the 14th largest economy in the world, but the country still suffers from widespread poverty and inequality. One-fifth of Mexico's population ie. 21 million people are estimated by the World Bank to live on less than US\$2 a day.⁶⁶ Life expectancy is 74 years, compared to 80 years in the EU, while infant mortality is almost five times higher at 23 for every 1,000 births.⁶⁷ National income per person is US\$11,990, compared to US\$31,181 in the EU, and this income is distributed far more unequally in Mexico than in the EU.⁶⁸

5.1.1. Financial services liberalisation through trade deals

Mexico has signed several free trade deals which have locked-in financial services liberalisation. These include both the North American Free Trade Agreement (signed in 1994 between Canada, Mexico and the US) and the EU-Mexico free trade deal which came into force in 2000.

By 1999, Mexico had lifted all restrictions on bank ownership by foreign companies, leaving it as a near-perfect 'experiment' in pure financial services liberalisation. The EU-Mexico trade agreement and its follow-up agreements lock the country into this liberalised model and indicate that Mexico cannot put limits on the proportion of foreign shareholdings in a bank, or limit the total value of foreign ownership within the banking sector.⁶⁹ Neither the EU or Mexico can adopt new measures which might discriminate against Mexican or European providers, and the agreement adopts both 'national treatment' and 'most favoured nation' clauses for financial services.⁷⁰

Today, Mexico has a banking sector where the assets are 80 per cent controlled by foreign banks.⁷¹ According to Standard and Poor's, the Mexican banking sector is now highly concentrated which has led to higher interest rates.⁷² The four largest banks are part of multinational financial groups: BBVA-Bancomer (Spain), Banamex-Citigroup (US), Santander-Serfin (Spain) and HSBC (UK). They account for at least 65 per cent of the market share and 69 per cent of net profits, which total 21 billion pesos.^{i 73}

5.1.2. The impacts of foreign bank dominance

There is strong evidence that dominance of the Mexican retail bank sector by a few multinational banks has reduced lending for production and for small and medium sized companies. A paper for the UN-Economic Commission for Latin America and the Caribbean says that banking credits to productive activities in Mexico shrank by more than 15 per cent as a proportion of GDP between 1996 and 2005.⁷⁴ Another study shows mortgage and consumption lending rose with the entry of foreign banks, from 15 to 45 per cent of all lending between 1999 and 2007.⁷⁵

This has exacerbated the dual economy where multinational firms producing for export to the US and EU can access credit, but domestic small and medium-sized companies cannot.⁷⁶ The IMF has found that total bank lending in Mexico fell between 2000 and 2003. It rose between 2003 and 2005, but this was through an increase in loans to consumers, not because of loans for production. Overall, lending by commercial banks to private business, as a proportion of their total lending, fell from 60 per cent to 48 per cent.⁷⁷ Paulo L dos Santos reports that while banking credit to firms in 2006 went through a mild recovery, it was still less than 72 per cent of what it had been a decade before, and that it was well below banking credit to households.⁷⁸

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Violeta Cruz Ramírez is a young farmer cultivating nopal (edible cactus) in Santa María Ayoquezco, Oaxaca state, Mexico. She is currently the treasurer for MENA – the Mujeres

Envasadoras del Nopal de Ayoquezco – a cooperative of women nopal growers.

There are no commercial banks in Ayoquezco. There is just a local cooperative, a couple of places where they receive remittances, and a public savings bank called Bansefi. As a cooperative we don't have a loan through any commercial bank. The paperwork is very bureaucratic and the interest rates are very high. As MENA, we have sought out lending institutions with more of a social focus, like us, rather than going to a commercial bank.

i. As of February 2009, £1 was equivalent to 21 Mexican pesos.

Furthermore, loans that are made to companies have increasingly been concentrated in larger corporations, whilst small and medium-sized companies have struggled to get loans from commercial banks.⁷⁹ This is despite the fact that according to the 1999 census, 99.7 per cent of all Mexican firms are classified as micro, small or medium enterprises, supporting 70 per cent of employees and contributing almost half of Mexico's GDP.⁸⁰ Another study found that after the liberalisation of foreign bank entry, the presence of foreign banks grew, but lending, particularly to the private sector, declined. The fall in private lending was more pronounced in foreign than in domestic banks.⁸¹

Of the top five banks operating in Mexico in the first quarter of 2007, Banorte (Mexican-owned) allocated 31.1 per cent of total assets as loans to firms. The foreign banks allocated significantly smaller proportions: Bancomer allocated 22.7 per cent; Banamex, 16.7 per cent; HSBC, 19.9 per cent; and Santander, 20.0 per cent.⁸²

Poorer households have also struggled to access credit from foreign banks. *"Foreign banks in Mexico charge up to nine times more for its financial products than they charge in the countries where such banks are headquartered"* was the opening statement of a report prepared by members of the Mexican Senate in July 2008.⁸³ Indeed, credit card charges in Mexico are reported to be the highest in the western world with the total annual cost of a credit card ranging between 40 and 113 per cent.⁸⁴ The senators reported that HSBC was charging Mexican consumers the equivalent of 77 per cent (interest rates plus fees) for a credit card, while in the UK it can be as low as 16 per cent.⁸⁵ According to Raúl Anibal, an analyst at the Centre of Economic Investigation and Teaching (CIDE) the banks charge such rates, *"because they can"*, due to their concentrated power in the sector.⁸⁶

HSBC was criticised by the Mexican Central Bank in November 2008 for its charge of 19.95 pesos to customers using non-HSBC ATMs. Simply checking your balance in a non-HSBC ATM costs ten pesos. Yet the scarcity of bank branches in rural areas

may mean that customers are forced to rely on ATMs from other providers in order to be able to access their funds. HSBC's charges are amongst the highest in Mexico, and not surprisingly, its profits have been high too.⁸⁷ In 2006, HSBC's pre-tax profits from Mexico were over one billion dollars. In 2008, pre-tax profits were down to US\$714 million, as the global financial crisis started to bite. Nonetheless, HSBC notes that the use of debit and credit cards has grown in Mexico, which drove up commissions from cash withdrawals and point of sale billing. Stricter guidelines on the imposition of late payment fees also led to higher income.⁸⁸

You would think that high fees would deter people from using their credit cards. However, aware that in the present financial situation existing customers may be using their credit card less, newspapers report that HSBC is now re-instating a fee which will be charged where there is a *"lack of use of the plastic"*, which will be around 54 pesos per month.⁸⁹

5.1.3. The impacts in rural areas - Oaxaca state

Oaxaca state is in southwest Mexico, approximately 450 kilometres from Mexico City. Oaxaca is one of the poorest states in Mexico, with the lowest wages averaging only 49 pesos a day.

| | Percentage of Oaxacans |
|---|------------------------|
| Live in homes with dirt floors | 42 |
| Live without piped water | 27 |
| Are over 15 years old and have not completed primary school | 46 |
| Are illiterate | 21 |
| Live in communities of 5,000 people or less | 64 |

Oaxaca has a large population of indigenous Mexicans as well as many people from other ethnic groups. It is a predominantly rural state, with the majority of people living in small communities away from the handful of cities in the state. Fifty one per cent of people work in agriculture, growing coffee, corn, sugar cane, and nopal (a type of edible cactus).

Poverty and a lack of work means that Oaxaca experiences high levels of migration; 46 per cent of households have at least one family member who has migrated to seek work in either northern Mexico or the US. The extent of migration is such that for some communities, the majority of able-bodied men of working age have left the area. This is a major concern for the local community. As one Oaxacan resident, Francisca Cruz Sanchez said, *"I want a source of employment in our community. I don't want my countrymen, the people in my state, to migrate. I don't want this anymore."*

According to figures from AMUCSS - a federation of credit unions and savings cooperatives - only 20 per cent of agricultural producers can

access credit in Mexico. Seventy seven per cent of agricultural producers have plots of land of less than five hectares and only five to ten per cent of these small producers are able to access financial services.⁹⁰ Meanwhile, two per cent of agricultural producers can be classed as large-scale and they enjoy full access to financial services. There is thus a very significant issue for small and low-income farming households and communities regarding access to financial services in Mexico.

The financial needs of these communities include simple bank accounts and the supply of credit for the storage, processing and exporting of agricultural products, the building of warehouses, marketing, and the purchase of machinery, seeds and other supplies.⁹¹ At least 60 per cent of existing rural financing needs are met by cooperatives.

In Oaxaca, the coverage of foreign banks is extremely limited and their branches are concentrated in the urban centres. According to CICC, in a state with a population of 3.5 million people, Santander has 22 branches and HSBC only seven. Oaxaca, along with Chiapas and other rural states, has one of the lowest ratios of bank branches per thousand habitants in Mexico.⁹² As a result, rural Oaxacans appear to have limited interactions with foreign banks.

Claudia's journey

Claudia Ortiz Mateos lives in the community of San Bartolo Coyotepec, Oaxaca with her ten-year old daughter plus her mother and grandmother. She and four other women run a small crafts business, producing black pottery ('barro negro') and selling it in their shop, Artesanías Juanita. They need a loan to be able to expand their micro-enterprise, to expand the number of markets they sell at and to be able to transport their fragile products more safely.

At the moment, Claudia gets financial services by participating in a 'colmena' (beehive) group at a local microfinance institution called Centeotl, A.C. which specialises in supporting small cooperatives of women with microfinance loans as well as capacity-building training. Loan interest rates are reasonable at 1.5 per cent per month. However, the maximum loan that she can take out is 10,000 pesos; Claudia's estimate is that she and her colleagues need a loan of 50-80,000 pesos. Together with a representative of CICC, in October and November 2008, Claudia travelled to Oaxaca de Juárez, the state's capital city, to visit **Santander** (Spanish), **Banorte** (Mexican) and **HSBC** (UK) to discuss her loan requirements to see if they could help her.

The Santander representative tells Claudia that to qualify for credit she will require annual sales of 300,000 pesos with monthly deposits of 30,000 pesos. *"In fact we have never had loans for small businesses. We only offer services for the medium businesses and the big companies, but not for the small businesses, we have never offered those services, not even when the economy was in a less risky time,"* she tells Claudia.⁹³

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These sums are way above Claudia's expectations, but to receive a loan, Claudia must also show a banking history, either with this bank or another bank, for at least 18 months. Her credit record from the cooperative, while good, is not acceptable as a banking history. To open a checking (or current) account, Santander requires a deposit and minimum balance of 5,000 pesos. For a savings account, the monthly bank charge is 13.80 pesos, additional to the required minimum balance of 1,100 pesos per month. Interest is only earned on balances over 10,000 pesos.

Claudia was told by Santander that, *"It would be a good idea for you to open a bank account, start building a banking history and applying for credit cards"*. Interest rates on credits cards start at 56 per cent. Claudia wants a loan to invest in her business, yet to qualify she appears to have to take out personal credit first. Personal credit appears to be much easier to obtain over credit for a small business, perhaps because it is easier to chase up and demand repayment. This echoes a wider trend in the Mexican bank sector, as discussed earlier.

Banorte is also very unhelpful. They tell Claudia that their minimum loan is for 100,000 pesos (although she is only asking for 50-80,000).⁹⁴ But Banorte is unable to countenance a loan to Claudia because her business needs to be legally constituted; while it is registered with the government for tax purposes, this is not sufficient for the bank. Banorte also requires that she has an accountant's statement to cover all financial transactions for this year and last year.

Meanwhile, a new regulation has recently come in (due to the wider financial crisis) so that Banorte now requires property to be put up as loan collateral. Claudia lives with her family and has paperwork to show that she is legally entitled to live in her house. However, the property is communally owned (over 90 per cent of land in Oaxaca is thought to be communally owned⁹⁵), and the bank will not accept such properties as collateral.

In fact the Banorte representative tells Claudia that, *"Really small loans are typically accessed through the credit unions and microfinance institutions. Loans less than 100,000 pesos are only in the credit unions and such, because the banks really only work with amounts over 100,000 pesos for businesses."*

Claudia moves on to visit HSBC bank. HSBC tells Claudia that to access 50-80,000 pesos of credit, she must have a minimum average monthly balance of 15,000 pesos.⁹⁶ The total annual cost of this loan including interest and any fees payable, would be 47 per cent. In fact this would not be a small business loan per se, but a 'flexible account for business persons'.

"When you have enough income, doors are open, but when you do not have enough revenue we do not exist"

While HSBC is the only bank where Claudia and her colleagues are likely to be able to get a loan to support their business, the requirements for the monthly balance are still too high for them, while the charges are also steep. Besides, the scarcity of HSBC branches would mean that Claudia has to travel to the city every time she needed to make a transaction, or she would have to incur charges by using other banks' ATMs.

Overall, it seems as if Claudia is stuck between a rock and a hard place. The local financial cooperative has supported her well, but the women are now looking to take on a larger loan than the cooperative can support, but none of the large commercial banks offer help on terms which Claudia and her colleagues would be able to meet. So how did she sum up her experiences with the three banks? *"When you have enough income, doors are open, but when you do not have enough revenue we do not exist for them and if we do not exist that means that we are not worthy or valuable for them. I do dream to have a loan. But one thing is dreaming, the other is putting feet down to earth."*

PANO: Procesadora de Alimentos Nostálgicos de Oaxaca

MENA, the Mujeres Envasadoras del Nopal de Ayoquezco, is a cooperative of local women producing nopal cactus. In 2001, according to Francisca Cruz Sanchez, *“We began by getting together the women in the village and going around and gathering other women, slowly there were ten, 15 until we had enough support to move forward with our vision”*. Today the cooperative has 170 members, six of whom are men. Their vision was to construct a local factory to process the nopal cactus into pickles and jams, and to produce other goods such as mole (a local speciality sauce) and different teas, with the hope of providing employment opportunities in their community, and eventually reducing the outflow migration of men to the United States.

Seven years on, the factory is built and operational as PANO, the Procesadora de Alimentos Nostálgicos de Oaxaca, funded by their own contributions, a charitable grant and remittances from migrants from the community now living in the US. No funding for this project came in the form of a loan from the banking sector. However, the MENA women would still like to invest further in the factory and their local production, to produce a better quality product and to increase the factory’s turnover.

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Fabiola Velasco Gutiel, the factory production manager, takes up the story: *“Now we have a bank account in Bancomer [a Spanish-owned bank operating in Mexico]. We have the account because it is necessary for accounting and the administration of the company. We were trying to get a loan for production ie. for working capital. We didn’t have enough saved in our account; they told us we couldn’t get a loan. They didn’t even tell us the requirements, they just told us we wouldn’t qualify.”*

Now the women have agreed a loan with AMUCSS (a federation of credit unions and savings cooperatives) that has a two per cent monthly interest rate with two years to repay. As Violeta Cruz Ramírez says, *“The dream to create this project was a dream of many women in the community. Some women have become disillusioned because the work at the plant has been slow to begin with, but now the women are becoming more inspired again, little by little”*.

Overall, financial services liberalisation in Mexico has led to a decline in access to credit for small businesses and for productive purposes. The absence of banks from many rural communities, the strict demands and criteria set by the banks, plus the high fees and demands for minimum balances, leave many excluded from the formal banking system. As the case studies from rural Oaxaca state have shown, this situation has made life very difficult. Small cooperatives and enterprises struggle to expand and to build the sustainable livelihoods required to stop migration out of the community and to tackle the high levels of poverty experienced.

CICC’s co-founder and Director, Adriana Labardini says of her experiences in talking to the women of Oaxaca:

It is heartbreaking to witness in the 21st century, a community of hardworking, honest and productive Mexican women that have proven to be credit worthy and committed entrepreneurs, being excluded by the commercial banks. In Mexico we all had high expectations from competition in the financial services, specifically from foreign banks. We thought the local, established ones would modernise their practices and learn competitive skills from firms operating in developed countries, but we were wrong. Instead, there is little competition, and there are little differences among the large banks in terms of rates, fees and practices.

Meeting the needs of the financially excluded in rural Mexico

Microfinance, the lending of very small amounts to low-income people, in Mexico as in many countries around the world has been touted as a solution to reducing poverty and boosting financial inclusion. In Mexico the microfinance market, comprising loans between 500 and 40,000 pesos, has been especially focussed on rural areas where the bulk of unserved communities lie.

As Alder Phillips has written in a report for WDM, *“While large commercial banks, both national and international, have continued to grow in Mexico under NAFTA, their services do not extend to remote areas of the country, nor do they serve the large population of poor.”*⁹⁷ That combined with the decline of state funding, has gradually opened up space for the microfinance sector to enter rural areas.

There have been some notable successes for microfinance. In Oaxaca as in other rural states in Mexico, cooperative microfinance institutions are getting small loans to households and micro-businesses to enable people, especially women, to make necessary investments in their lives.

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Catalina Modesta Sánchez Jiménez is a nopal grower, affiliated with MENA, the women’s cooperative. She champions a local finance cooperative

called La Cooperativa Ayoquezco, established by a catholic priest to fill a need in the community.

I prefer to apply for loans at the cooperative because I can make payments when I want, at the time that works for me. In other banking establishments, I feel they are much stricter and charge fees. At the cooperative they charge a two per cent monthly interest rate. The loans that I receive have been used for expanding individual plots for cultivating nopal or for fertilising plots once or twice a year.

Yet there is also growing concern about the commercialisation of the microfinance sector in Mexico. Alder Phillips points to Compartamos. Last year it became a fully-fledged commercial bank having started as a not-for-profit organisation; now interest rates from Compartamos average 79 per cent and its net profit is 249 million pesos.⁹⁸ According to another survey, the average annual interest rate amongst microfinance institutions in Mexico is 64 per cent.⁹⁹

One cause of the mixed reputation of the Mexican microfinance sector could be the poor level of regulation. Most remain outside the regulatory framework and thus not subject to transparency requirements regarding reporting and interest rate setting.¹⁰⁰ Without a more aggressive approach to regulation, it is hard to see how competition alone will push microfinance institutions to improve the services they offer to Mexico’s rural poor.

Meanwhile, despite the foreign banks talking up microfinance programmes in poorer countries in their corporate social responsibility reports to their western shareholders, there is little evidence that they are running microfinance schemes in rural Oaxaca.

WDM wrote to HSBC and to Santander to set out our findings about their activities in Mexico. At the time of writing, neither company had replied to our letter.

5.2. India

Produced with India FDI Watch

India is the world's tenth largest economy but much of its population face incredible economic hardship. The average Indian earns just US\$2,460 compared to an average income of US\$33,650 for an individual in the UK. Infant mortality in India stands at 56 for every 1,000 births, twelve times higher than the UK.¹⁰¹ Furthermore life expectancy in India is 64 years; in the UK it stands at 79 years.¹⁰² The EU represents India's largest trading bloc and for the EU, the proposed free trade deal with India represents perhaps the 'jewel in the crown' of the Global Europe strategy.

5.2.1. Scale of financial challenge

Despite India's recent period of rapid economic growth, over half of its 1.13 billion people live on less than US\$2 a day.¹⁰³ The vast majority of Indians living in poverty are unserved by financial services. According to the Reserve Bank of India (RBI), 59 per cent of the adult population in the country have bank accounts, leaving 41 per cent of the population as 'unbanked'. In rural areas the 'banked' coverage is 39 per cent with 60 per cent in urban areas. The financially-unserved include farmers, landless labourers, informal enterprises, urban slum dwellers, migrants, senior citizens and women.¹⁰⁴

The scale of the financial services challenge in India cannot be overestimated. Similarly, it is hard to overestimate the attraction of the Indian market to the large foreign-owned banks. While 200 million people have a mobile phone, only ten per cent of this number has a credit card. Meanwhile, by 2017, India is expected to be eighth on the list of nations of wealthy individuals with 411,000 millionaires. Increasingly the Indian super-rich and middle classes represent an attractive market for financial retail products, wealth management and financial advisory services.¹⁰⁵

5.2.2. Background to financial liberalisation

From 1969 to the 1990s, India went through a period of nationalisation of the bank sector, a policy which Indian bank expert Kavaljit Singh says was an attempt to change the orientation

of the system from "class banking' to 'mass banking'".¹⁰⁶ During this time, foreign banks were present in India (their presence pre-dates the nationalisation of 1969) but they did not undertake real expansion.

While far from a perfect system, the nationalised bank sector had policies in place to extend services to rural areas and small borrowers.¹⁰⁷ An innovative tool, later abolished, was a branch licensing policy which determined that for every branch opened in a 'banked' area, four branches had to be opened in an 'under-banked' area. This led to rural branches increasing from 23 per cent of the total to 58.5 per cent in 20 years.¹⁰⁸ The UK's Department for International Development reports that during this time, a one per cent increase in the number of rural banked locations reduced rural poverty by 0.34 per cent.¹⁰⁹

However, since the 1990s, the government of India has embarked upon the liberalisation of the financial services sector, including policies of both privatisation and the opening up of the sector to greater numbers of foreign banks.

| | Before WTO liberalisation 1994 | Post liberalisation 2001-02 |
|--|--------------------------------|-----------------------------|
| Foreign bank-owned branches | 156 | 212 |
| Districts with foreign banks | 18 | 26 |
| Foreign bank share of long-term loans | 5% | 10% |

All figures from Gormley.¹¹⁰

Today India has 88 commercial banks, 31 of which are foreign-owned, amounting to 6.5 per cent of total bank assets in India.¹¹¹ Foreign banks in India include ABN AMRO, Barclays, Deutsche Bank, HSBC and Standard Chartered. Since 2005, a further wave of liberalisation has been taking place and more is anticipated in the future - even before an EU-India trade deal has been finalised.

5.2.3. Impacts of financial services liberalisation and foreign banks

The impacts of existing financial services liberalisation have been many. In the post-liberalisation period the following trends have been documented:¹¹²

- The share of the market for cooperative banks has fallen by almost half from 62 per cent to 33 per cent.
- Rural banks have declined from a high of 58.5 per cent of the total in 1991 to 42.7 per cent in 2006-07. Meanwhile, the proportion of urban bank branches has been rising.
- Uttar Pradesh, Bihar, and states in the north-eastern region ie. poorer states, have seen a major decline in the numbers of bank branches. Delhi, meanwhile, has seen its number of bank branches grow by 30 per cent from 1,256 to 1,639 in seven years.
- Funding for smaller businesses has fallen from 15 per cent in 1991 to 11 per cent in 2003. Market surveys have shown that both foreign and Indian private banks have been reluctant to lend money to small and medium businesses, preferring to serve big businesses perceived as being less risky.
- Funding for small borrowers has declined from 95 per cent in 1992 to 90.3 per cent in 2006.

For foreign banks' entry specifically, a study demonstrates that they have shown a marked preference for lending to only the most profitable firms. The study concludes that *"the entrance of new foreign banks to India is associated with a reallocation of loans that is not necessarily a boon to the lion's share of domestic firms"*.¹¹³ While the most profitable ten per cent of firms located near a foreign bank branch received larger loans, on average firms were 7.6 per cent less likely to have a long-term loan of any size following the entry of a foreign bank. And in order to remain competitive with the new foreign entrants, non-foreign banks were also reducing the level of credit available for long-term loans to local businesses.¹¹⁴

In the area of personal loans, the eligibility criteria which HSBC in India sets out on its website requires that applicants be salaried or self-employed.

Those self-employed people listed as being eligible for a personal loan are doctors, accountants, company secretaries, architects, engineers and management graduates – clearly all well-paid professions. In October 2008, the minimum net annual income required by HSBC was 75,000 rupees, about £1,056.¹¹⁵ But by January 2009, the requirement appeared to have risen to 250,000 rupees per annum or £3,521.¹¹⁶ However, in India 51 per cent of people live on less than US\$2 a day or £515 per year.¹¹⁷

HSBC India's website talks of how customers can open a "no-frills" savings account with no requirement to maintain a quarterly balance.¹¹⁸ Yet those people interviewed by India FDI Watch who had visited HSBC to open an account and were turned down, do not appear to have been offered such an account. Meanwhile, India FDI Watch did not find evidence of any HSBC programmes for microfinance. WDM wrote to HSBC to set out our findings about their activities in India. At the time of writing, they had not replied to our letter.

i. As of February 2009, £1 is equivalent to approximately 71 rupees.

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Suresh Dhahrak is a 21-year old final year student living in Worli, Mumbai. He is the youngest of four brothers, all of whom work to support the

family. He applied to some banks for a loan to pay for a vocational course but with no luck; he was told that he needed to show his earnings. At HSBC, he was turned down; he was not clear if this was because of the current credit crisis or because he did not qualify. If he decided to open an account, he was told he would have to maintain a minimum quarterly balance of 25,000 rupees, a figure way beyond his reach. So for now, he says, his career will have to take a back seat until his family can come up with the required amount by saving a little every month.

Barclays India have four different savings accounts: a 'no-frills' savings account with a requirement to maintain an average quarterly balance of 350 rupees; a 'zero-balance' account with no minimum or quarterly balance requirements; an Advantage/Advantage plus account which requires an average quarterly balance of 20,000 rupees; and the Kutumb savings account (for a family of four) which also requires an average quarterly balance of 20,000 rupees. Barclays have told us that in India, as of 31 December 2008, they have opened 40,726 zero-balance bank accounts and 3935 no frills accounts, which make up the vast majority of their customer accounts.¹¹⁹

Dharmendra Kumar of India FDI Watch says:

During my personal visit to a branch of Barclays in December 2008, a senior sales relationship officer informed me that two types of saving accounts are available. I was told either to opt for Kutumb account or zero balance account. I was excited to learn about the zero balance account but was told that there is a service charge of 500 rupees per quarter. I don't think even middle class people would like to give 2,000 rupees per annum to the bank for a zero balance account. The executive told me that she would visit my residence to verify my identity and other details before opening the account.

It appears that Barclays does have bank accounts aimed at lower-income Indians; however, it is not clear that these are being consistently offered across Barclays India branches. Besides, requirements to maintain quarterly balances or to pay service charges are likely to put off many on low incomes.

According to Barclays India's website, to receive a personal loan you must be salaried, with a minimum gross monthly income of 10,000 rupees per month or £1,690 per year. Otherwise, self-employed people need an average annual salary of 100,000 rupees or £1,408 for a loan.¹²⁰ As with the HSBC criteria discussed above, such criteria presumably would put a loan out of reach for many Indians.

In correspondence with WDM, Barclays says that it offers loans to people earning less than 120,000 rupees "on a case-by-case basis".¹²¹

Barclays does not offer microfinance programmes in these cities. However, it has told WDM that it has a three-year loan line of credit of £342,000 to SKS Microfinance in India which offers micro-finance to local poor labourers and farmers in Andhra Pradesh.¹²²



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Thirty-two year old **Shashibhushan Pandit** hails from a Dalit family in Bihar. He came to Delhi in the 1990s but still supports his parents and younger brother living in his home village. Now he works for a private company in the city and he went to HSBC asking to open an account.

Shashibhushan says, "**Maintaining 100,000 rupees every quarter was near impossible for me and therefore I decided to move to another bank**". He believes that the big globalised banks are beneficial only for big businessmen, elites, and 'movers and shakers' of big deals: "**The creamy layers of metros and big cities are the potential clients of foreign banks.**"

Balicharan from Delhi had a similar experience. He owns a machine which makes bottle tops and he works 15 hours a day to meet his clients' orders. He tried to open his first bank account with Barclays. Balicharan laughs:

I had gone there to open my first bank account but the bank told me to provide required security money through a cheque of another bank!



India FDI Watch

India FDI Watch



Lakshman Rao lives in Nelamangala, Bangalore and he runs the Manjunatha Paper Mart newspaper shop in K.R.Puram market. The shop is

very small, so to develop his business in October 2008 he applied for a loan of 50,000 rupees from Barclays. He says:

I have submitted all the documents. But the bank people are asking me for a phone bill. They called me several times asking for evidence of a post-paid mobile connection bill, which I didn't have; I am using a prepaid connection. Very recently they called me and said they need a salaried employee as surety. I asked my friends first, but it was difficult. My parents were asking me to rethink the loan because of the heavy interest rate. But due to unavoidable circumstances I applied. Finally Barclays refused to give the loan.

A number of the people that India FDI Watch interviewed reported that, aside from the unmeetable criteria to obtain an account or a loan, the way in which they were treated by the banks had caused them distress.

Madanlal Gupta who is a credit card holder with a foreign bank and was initially offered and then rejected for a loan in Delhi says, *"they behave with affluent clients with much courtesy, but, when it comes to deal with lower or middle income earning people, they change their colours and become impersonal and rude"*.

Anil Arora is a successful and well-off businessman in Delhi, running an advertising agency and he has been able to secure a big loan from Barclays. Yet he too recognises that he is amongst one of the lucky ones. *"The reach of foreign banks is very limited. They are beneficial to those whose turnover*

amounts to millions. The number of banks has increased in recent times, but they do not cater to all sections of society. These banks have no place for lower income people. To be sure, European private banks are not meant for the poor."

Venkatesh, a fruit vendor from Bangalore says that when he went to European banks they did not provide information in Hindi or other local languages: *"I don't know what there is in the document. Without knowing things, how can I sign an agreement? At least local banks will give the information in local language."*

In response, Barclays wrote to WDM that it translates forms and brochures into seven languages including Hindi and local languages which are *"available with the front office staff in the reception area of these branches"*.¹²³

However, Dharmendra Kumar says that when he visited Barclays in Delhi, *"I specifically asked for literature in Hindi and they said it was not available. I also went to ABN AMRO (a Dutch bank, part-owned by the Royal Bank of Scotland and Santander) and nothing was available either"*.

Overall, it appears from the academic and the anecdotal evidence, that financial services liberalisation in India has led many financial services providers, including the foreign banks, to focus their efforts on reaching those populations in India that are already in secure jobs, have a high, regular income or are larger businesses. Such a focus excludes huge swathes of the Indian population and would presumably put off many from even bothering to apply.

This strategy helps to maximise profits, so perhaps it is not surprising that foreign bank profits in India are substantially higher than for other banks. In 2005-06, the net profit per branch for foreign banks was 120 million rupees, against 3.3 million rupees for Indian state-owned banks. In 2007, the net profits of foreign banks in India increased by 49 per cent, a substantially higher average than that for the entire banking sector in India (27 per cent).¹²⁴ In 2008, HSBC India's pre-tax profits jumped by nearly 26 per cent to US\$666 million.¹²⁵

5.2.4. EU-India Free Trade Agreement

The EU and India agreed to negotiate a free trade agreement in October 2006. The EU-India FTA 'mandate', which authorises the European Commission to conduct these negotiations says that it "shall provide for the progressive and reciprocal liberalisation of establishment and of trade in services with the aim to ensure a high level of market access opportunities".¹²⁶

Despite the existing level of liberalisation within the Indian bank sector, the European Banking Federation highlights the following regulations on foreign banks which they consider unfairly restrict their operations in India and which they wish to see removed:¹²⁷

- Foreign banks can only operate as branches, wholly-owned subsidiaries or as subsidiaries with total foreign investment up to 74 per cent (as of 2009) in Indian private banks
- Foreign banks are limited to opening 20 branches (across all foreign banks) per year
- Foreign banks are unable to engage in other activities e.g. insurance

It is clear the foreign bank lobby considers the EU-India FTA as an opportunity to remove these regulations permanently.

Yet Indian domestic banks argue that foreign banks unfairly gain from the current system. Foreign banks only have to loan 32 per cent of their net bank credit to priority sectors (students, retail, small business, export industries etc), as opposed to 40 per cent for Indian banks. Foreign banks have no requirements to lend to either the agricultural sector or other more vulnerable sections of society, unlike the domestic Indian banks. More generally, foreign banks appear to have been able to meet their priority sector credit targets through a disproportionate reliance upon credit for export activities, an area likely to be increasingly lucrative.¹²⁸

Foreign banks are currently prohibited by the regulatory authorities from opening branches in rural areas of India. Despite complaints about this policy from the industry lobby,¹²⁹ such regulations arguably work in the interests of

foreign banks as rural branches tend to generate less profit than their urban counterparts, so leaving the 'burden' of rural bank provision to the Indian banks.¹³⁰ As Kavaljit Singh says, "the lopsided regulatory framework in India has ensured that foreign banks can remain insensitive to the requirements of the agricultural sector and the weaker sections of society."¹³¹

So what will be the impacts of further liberalisation if the proposed EU-India free trade deal goes ahead?

If the European Commission and EU banking lobby get their way, the policy space of the Indian banking regulatory authorities will be significantly reduced. In particular, it will be harder, if not impossible, to regulate foreign banks in a way which would ensure that they were required to serve increased levels of rural and poor communities.

The Trade Sustainability Impact Assessment conducted on the proposed FTA, on behalf of the European Commission, would appear to support this assertion. It says: "Further opening up and liberalisation of the banking and financial sector as a result of EU-India FTA are not going to help the rural sector ... as a result of increased competition from foreign banks, domestic banks too would concentrate more on profitable segment of urban and semi-urban markets".¹³²

Considering the impacts of foreign bank presence in India so far, the challenge for Indian trade negotiators would be to negotiate a trade deal which eliminated the existing benefits that foreign banks receive from the current regulatory regime, and impose on them additional requirements to reach unserved communities. However, a differential regulatory regime for domestic and foreign banks would not be allowed under an EU-India trade deal; foreign banks could challenge it as discrimination under 'national treatment' rules.¹³³ The only hope would be if India was able to negotiate exemptions on financial services within the deal.

Indian banking unions AIBOA and AIBEA (the All India Bank Officers' Association and the All India Bank Employees' Association respectively) have launched a nationwide campaign to oppose the further liberalisation of the sector. Their campaigning has included strikes and mass petitions of over 10 million signatures submitted to the prime minister and the speaker of the Indian parliament. Their policy recommendations include: no privatisation of public sector banks; no unrestricted entry of foreign direct investment in the banking sector; no de-licencing of branch opening – open more branches in unbanked rural areas; increase credit for agriculture sector and rural development; and revitalise cooperative banks.¹³⁴

In the view of Kavaljit Singh, the Indian bank regulatory regime needs to be revised to bring back the old rule that demands that for every branch opened in an urban or banked area, at least one branch (if not more) is opened in an 'underserved' area.¹³⁵ Because of the historical legacy that sees foreign banks disproportionately serving rich, urban customers in India, increased regulatory requirements should be imposed on foreign banks.

India FDI Watch's Dharmendra Kumar agrees, and adds:

There are several problems with the current lending regime in India. One is that it is almost impossible to get a loan. The second is that the interest rates are frequently phenomenal and at predatory rates. The aggressive penetration of European banks is going to further deteriorate the scenario. During my personal visits to branches of European banks operating in India including Barclays, HSBC and ABN AMRO, it was obvious to me that they are only hunting for rich people and have fool proof mechanisms to ensure that poor and low income people do not become their clients.

A number of the people India FDI Watch spoke to in the cities of Delhi, Mumbai and Bangalore, who were rejected for a bank account or a loan by a foreign bank, were later able to secure what they needed from an Indian financial institution – private, public or cooperative. The academic evidence presented earlier shows that over time, the presence of foreign banks distorts the wider market and is likely to force the wider sector to

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Rahul is originally from a Dalit community in Madhya Pradesh but moved to Delhi six years ago and now works in a computer repair shop. He was turned down for a loan by both Barclays

and HSBC but later approached an Indian bank called Syndicate where he was able to obtain what he needed. Today he denounces the government policy of encouraging foreign banking in India. He asserts:

The entire structure and procedure of lending of foreign banks goes against the interests of a larger section of Indian society. They mock the people who have small savings.

compete for high-value customers, at the expense of low-income communities.

The proposed EU-India free trade deal threatens to make this situation worse. By further liberalising the sector and signing the proposed trade deal with the EU, the Indian authorities run the risk of losing the ability to regulate foreign banks differentially from other Indian banks, and to specifically remedy the built-in advantages that the foreign banks have derived from the present far-from-perfect regulation of the sector. If the FTA goes ahead, the Indian government will be locked-in to a permanently deregulated banking sector, with limited policy tools to tackle the huge problem of financial exclusion.

6. Promoting sustainable financial inclusion

This report has argued that financial services liberalisation and the entrance of, and enhanced access by, foreign banks in developing countries can reduce rather than improve sustainable financial inclusion for firms and households alike. Locking-in such liberalisation via bilateral and multilateral trade deals would exacerbate this trend by removing the policy space required by governments to fully regulate such banks, as well as substantially limiting their opportunities to explore and experiment with alternative strategies for achieving financial inclusion.

In this case, how can we tackle the huge issue of financial exclusion in developing countries and enable poor communities and small businesses to be able to securely save and access credit so that they can move out of poverty and have confidence in the future?

6.1. Effective finance institutions for development

The evidence presented here shows that a strong and healthy scepticism is required when assessing the benefits claimed by foreign banks to justify their presence in developing countries. It is clear that the entry of foreign banks is far from being a panacea for affordable and productive financial services and governments may understandably conclude that the risks are not worth it. It is vital that governments retain the full policy flexibility to reject the entry of foreign banks entirely, or at least to be able to strongly regulate foreign banks, if they are not convinced that they will bring sustainable financial inclusion benefits to their domestic economy.

Microfinance can play an important role in tackling poverty, although it does not challenge the other reasons that keep people around the world in poverty (e.g. unfair trade rules, absence of land reform, expensive or inaccessible public

services, environmental degradation). Instead it has to work within the existing economic and political reality of a country.¹³⁶ Overall the microfinance sector needs to be far better regulated than at present, to ensure that interest rates, loaning and collection practices are fair and appropriate, and to ensure that microfinance is really reaching those who need it most.

Many institutions can and do offer financial services. Significantly under-valued are cooperative banking and credit unions which play an important role in tackling financial exclusion. Generally owned by their members, credit unions and cooperative banks are often embedded in local communities and may have a specific focus on local community development. Members can exercise their democratic rights to elect board members and to decide the overall direction of the institution.

Alongside this focus on local community development, when credit unions are part of a wider network within a given region or country, they can bring enhanced stability to the sector and can mobilise greater credit from the greater

savings that they have attracted. Credit unions will have clear policies and procedures set out and will thus be more formally organised than many small or informal microfinance institutions.

As they are not driven to make the huge profits that mark-out private banks, credit unions can serve both low and middle income customers alike. According to the World Council on Credit Unions (WOCCU), savings accounts of up to US\$100 make up 75 per cent of credit union accounts while accounts of US\$1000 or more make up six per cent. Meanwhile, 26 per cent of total loans made are for less than US\$400, while 44 per cent are for over US\$1000.¹³⁷

The cooperative banking sector is already well-placed to extend its operations further; in 2006 a survey of 97 countries identified over 46,000 credit unions serving 172 million people, with global credit union assets surpassing the US\$1 trillion mark.¹³⁷ Other public-focused institutions (post-office banks and state banks) are also able to offer affordable financial services at non-exploitative rates and conditions and should be at the heart of financial inclusion strategies.

Cooperative lobbying

Considering the evidence about the negative impacts of financial services liberalisation on low-income communities, it is very surprising that the European Association of Cooperative Banks (EACB) is an active member of the European Services Forum, which has been lobbying Brussels decision-makers to liberalise financial services sectors via EU trade deals. In particular in 2007, the EACB chose to actively endorse an ESF position paper which welcomes the Global Europe strategy and outlines some steps to take it forward.¹³⁹

WDM has been in correspondence with the UK member of the EACB, the Cooperative Bank, about this matter. The EACB, via the Cooperative Bank, defends its position, arguing that it uses fora such as the ESF to help address *“the remaining obstacles for creating local cooperative banks in some countries”*.¹⁴⁰ Yet the evidence presented earlier shows that financial services liberalisation in India has led to the share of the market for cooperative banks falling by almost half from 62 per cent to 33 per cent.¹⁴¹ WDM considers the EACB's membership of the ESF and its support for financial services liberalisation through FTAs to be incompatible with the strong support for 'trade justice' shown by the UK's Cooperative Bank in recent years, and urges the EACB to urgently reconsider its position.

“The only good thing about this crisis is that it has made clear to any thinking, responsible person in this sector that international financial markets have developed into a monster that must be put back in its place ... we need more severe and efficient regulation...”

**Horst Köhler, German President
and former head of the IMF ¹⁴²**

6.2. Effective regulation in domestic banking

Regulation plays a vital role in maintaining effective pro-poor financial institutions and financial stability. Regulation which is clearly communicated, based on evidence, and which allows for innovation and diversity, could play a significant role in tackling financial exclusion. The experiences of India during its period of strong regulation of the banking sector from 1969 to 1991 indicates some of the positive gains of such an approach. National regulators can impose regulations which seek to rectify the imbalance between banked and non-banked areas, urban and rural areas, big business and small companies, rich and poor customers.

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Harsha Kumar

is 40 years old and works for a business in Bangalore. In February 2008 he needed a personal loan of 50,000 rupees. He applied to Barclays

with all the relevant documents but was told his salary was ineligible for a loan. A similar thing happened when he approached an Indian private bank called Indiabulls. A friend suggested that he visit the local cooperative society instead because he knew that many local people were already involved in the cooperative. At the end of April, he applied with the relevant documents as he had done with Barclays and Indiabulls. Within a day he had received the loan with an annual interest rate of 16 per cent.

Some countries such as France have adopted legislation which gives people the 'right' to own a bank account.¹⁴³ Meanwhile, some financial products are being developed specifically for low-income users who do not meet existing criteria. In South Africa, the Basic Bank Account or BBA has been designed for unbanked populations. It is essentially an account standard, rather than a product, and each participating institution can use an umbrella brand called 'mzansi' if it provides bank accounts which have certain core features such as no monthly fee, fixed fee ATM withdrawals, one free monthly deposit.¹⁴⁴ Within less than one year of its launch, 1.5 million mzansi accounts had been opened with the great majority of them opened by those who had never banked before.¹⁴⁵

All financial institutions, as well as policy-makers, must become much more sensitive to the needs of all unserved people; regulations must be toughened up as, if left alone, the evidence shows that the market fails to meet the needs of these communities.

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Sumitra Devi is a 52 year old housewife living in Delhi. Until recently, she had no bank account. Instead she saved small amounts of money which over the years had accumulated into

a few thousand rupees. A friend suggested she open a bank account to save the money in a planned way to take care of the marriage expenses of her daughters. So, in November, she went to a nearby branch of Barclays. She went with her friend who was also illiterate. Sumitra says:

I could not understand the language spoken by the bank sahibs. All were wearing tie and coats and sitting in 'cabins' and everywhere there were mirrors [the glass walls of the cabins].

The bank staff asked about the availability of a particular form of ID, but she had never heard of it. Sumitra just said "bhai sahib, ghar ka kagaj aur ration card hai" (brother, I have papers pertaining to the house as well as my ration card). Sumitra says that the bank staff declined to open an account for her.

7. Epilogue: lessons from the financial crisis

“The money changers have fled for their high seat in the temple of our civilisation. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than mere monetary profit”.

**President F.D. Roosevelt,
inaugural speech, 1933**¹⁴⁶

The recent financial crisis has illustrated the endemic irresponsible speculation and risk-taking in our financial system, exacerbated by recent trends towards the deregulation of the financial sector. It remains the case that there is no mandatory international regulation and supervision of international financial operators.¹⁴⁷

A hands-off approach to regulation has allowed financial markets to take unacceptable risks with our mortgages, savings and pensions. Reckless financial trading in food commodity derivatives has seen volatile prices for consumers around the world, sparking riots and great hardship for many poor households. Meanwhile in today's globalised banking system, careless mortgage lending in the US has created huge instabilities around the world, ultimately threatening all of us with a bank account, a mortgage or a pension. It has also shown that making financial services and credit accessible to poorer people needs to be done in a responsible and non-exploitative way.

Developing countries are the “innocent bystanders” of this crisis but are likely to suffer greatly during the global downturn.¹⁴⁸ Particular threats include the draining away of liquidity in the form of credit and investment flows from developing countries. Meanwhile aid funding is set to be squeezed and a number of countries are likely to become more dependent upon IMF loans - with various strings attached.

While rich countries in the EU and the US are able to find hundreds of billions of pounds to bail out domestic banks, most developing countries cannot do likewise, leaving them in an ever-more precarious position. And large banks (and other corporations too) will be under increased pressure to repatriate profits made overseas back home.¹⁴⁹

Existing problems of access to credit across the global south are now being exacerbated by the financial crisis. Both CICC in Mexico and India

FDI Watch in India, together with the people they interviewed, could already see the impacts of the financial crisis on the availability of credit from the foreign banks visited. India FDI Watch reports that the European banks have stopped giving most types of loans to 'ordinary' people.

Trade liberalisation in the global south, and particularly further financial services liberalisation, will worsen all of these trends. According to UNCTAD, *"In many cases, particularly in developing countries, currency crises and banking failures are often preceded by financial liberalisation."*¹⁵⁰ Says UNCTAD, *"Accordingly, developing countries need to carefully weigh the costs and risks with the potential gains of financial services liberalisation."*¹⁵¹ Deregulated foreign banks no longer seem the solid, efficient, risk-free options that they once appeared, and their presence in developing country financial sectors could easily shift from being a distortion, to being destabilising the whole economy.

It is clear that there has never been a more urgent time to rethink both the global financial system and the Global Europe trade strategy with its associated free trade negotiations with India, ASEAN and other countries around the world.

In today's globalised money markets, a combination of national and international regulation will be required to at least start to tackle the crisis.

Positive proposals for reform include a substantial shake-up of the credit-rating agencies to ensure their independence, more transparent and effective accounting standards, clamping down on corporate tax havens and a so-called 'Tobin Tax' on global currency transactions.

Scrapping the IMF, which has failed to effectively handle this crisis, would be another key step, replacing it with something much more akin to John Maynard Keynes' original idea of an international clearing union which will focus on helping countries out of balance-of-payment deficits and surpluses.¹⁵²

WDM supports the proposals for a radical overhaul of the economy called for by the Green New Deal group initiative, which recommends *"an orderly downsizing of the financial sector"*.¹⁵³ This includes splitting the large financial services groups into much smaller entities, which would reduce both their influence and the global ramifications if they fail. The Green New Deal also recommends that retail banking should be separated from corporate or merchant banking, tighter controls on lending, and much more stringent oversight of risky derivatives trading.¹⁵⁴ With people around the world horrified at the way in which the large, globalised banks have been able to gamble so recklessly with our money, there is the need for an open debate about whether, how and for what purpose they exist, and if they should now be taken off the stock market and placed in public hands.

8. Conclusions and recommendations

The evidence presented in this report shows that the entry and ongoing presence of foreign banks within developing countries via financial services liberalisation, has a significant and negative impact on small and medium businesses and poorer households in countries such as India and Mexico in the global south.

The impacts include the active selection or 'cherry-picking' of high-value customers, and a decline in credit for low-income customers - trends that are particularly apparent in rural areas but which are also seen amongst poor urban communities too. For households and micro, small and medium businesses needing finance for productive purposes, financial services liberalisation leads to less credit being available; yet credit for high-end consumption and for large companies to access export markets rises.

Foreign banks themselves clearly prioritise the provision of services to these high-value and profitable sections of society, and by doing so push other providers to do likewise, leading to a distorted market which only exacerbates these trends. The resulting overall loss of access to financial services can only lead to a decline in welfare for these groups, and the frustration of hopes and aspirations of small businesses and households wishing to improve their livelihoods.

The Global Europe strategy and the proposed trade deals with India, countries in South-East Asia, Central America and elsewhere, together with the ongoing liberalisation agenda being negotiated at the WTO, threaten to lock countries into a liberalised financial services sector. This seems especially remarkable in the context of 2009, where the fragile nature of the liberalised bank sectors of the US and Europe has been exposed and almost universally criticised.

The debt bubble created by irresponsible banking practices was a financial catastrophe waiting to

happen, yet politicians and regulators largely ignored the warning signs and seemingly sleep-walked into the current economic nightmare. WDM believes that policymakers must now take affirmative action to stop the crisis from spreading and to fix a broken system. A genuine commitment to tackling financial exclusion and boosting livelihoods around the world would require the following policy actions:

Stop negotiations on Europe's proposed free trade agreements. As an immediate step, the European Commission should take financial services liberalisation demands out of the proposed bilateral and multilateral trade deals. There should also be mechanisms for countries wishing to 'roll-back' from existing financial trade liberalisation commitments. Such an approach would mean that countries were not 'locked in' for the long-term to a liberalised model, that they would retain full regulatory authority and that future governments could explore alternative financial and development models as they wished. Particularly important at times of crisis, governments would retain full policy flexibility to respond in appropriate ways to changing national or global circumstances.

Develop progressive trade policies not premised on liberalisation. It will not be enough to stop negotiations on the proposed unfair trade deals, as the existing trading system is not enabling developing countries to overcome poverty. Future European trade policies with countries in the global south should focus on principles of developing country autonomy, sustainable development, transparency, accountability, non-reciprocity and asymmetry. European trade policies should not directly or inadvertently jeopardise trade amongst and between countries in the south which could bring higher development gains than north-south trade.

Tackle financial exclusion in developing countries.

Donors, governments and development agencies must develop a clear agenda for getting financial services and productive credit to those that need it. Credit unions and cooperative banks, and other publicly-minded institutions, will play a central role in serving financially excluded firms and communities and good practice in the provision of microfinance must be promoted. Significantly better regulation and supervision of all financial providers will be critical.

Overhaul governance of the global financial system.

A sea-change is needed in the way the financial system works, so that it supports progressive social and environmental objectives. The architecture of the international financial system needs to be massively reformed, as the Green New Deal has set out.¹⁵⁵ In the banking sector, the size and power of the large international banks needs to be curtailed and retail banking should be split from corporate finance. The recent bailouts of US and European banks has shown the reality that these institutions have been allowed to become 'too big to fail'. They are akin to an essential public service and should be treated as such; where globalised banks have palpably failed, serious consideration should be given to placing them into public hands.

Ensure investments and lending of UK banks help to combat poverty.

No bank should operate in ways which undermine the development of local communities in the global south, including through the distortionary effect that their presence has on other financial services providers in domestic sectors. In particular the UK government must ensure that banks receiving public funds urgently rethink their overseas expansion strategies and investment criteria. Nationalised or part-nationalised banks should also be barred from lobbying public authorities and officials. All banks should review their membership of industry lobby groups which call for the removal of pro-poor financial regulations in developing countries.

Increase transparency and oversight of financial sector lobbying.

A common refrain throughout this report has been the strength of the financial services lobby and the degree of access to decision-makers in both London and Brussels that it enjoys. The European Commission must carry out an immediate assessment of interest groups' influence on the development and implementation of European trade strategy. Both officials and politicians need to be transparent and accountable about correspondence and meetings with lobbyists, via a mandatory lobby register, and measures must be taken to ensure far less corporate influence on this policy agenda. Instead, European trade policy processes must be opened up to far greater democratic accountability and scrutiny by parliamentarians and civil society in Europe and the global south.

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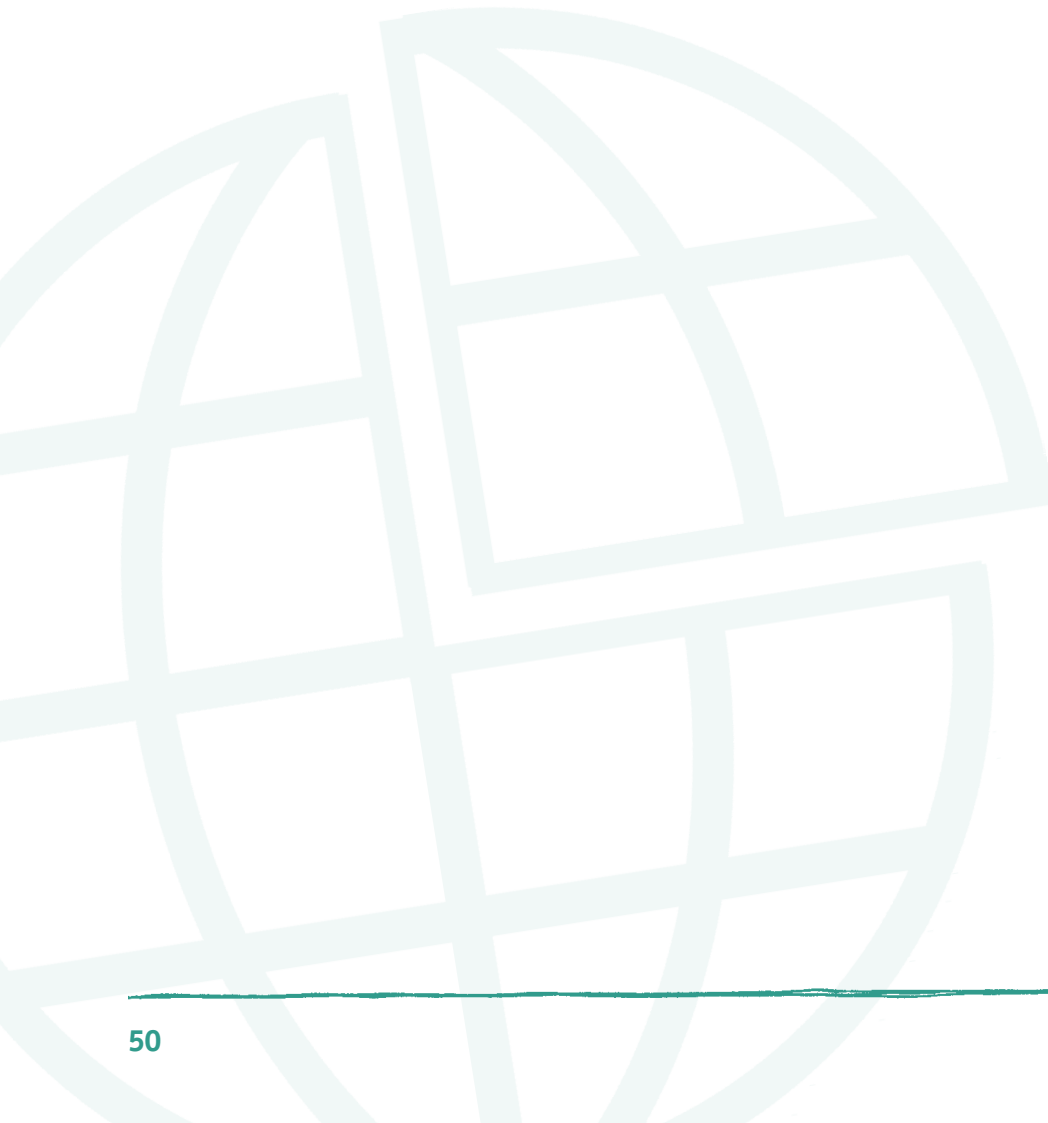
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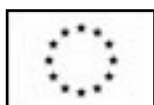
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