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BIFURCATED BANKING: THE POLITICAL ECONOMY OF INCLUSIVE FINANCE IN PAKISTAN

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ABSTRACT

How inclusive is inclusive finance? In this thesis, I examine a phenomenon which I describe as 'bifurcated banking'. Exploring the case of Pakistan, I observe that policies of inclusive finance generate a heterogeneous financial space. The institutionalisation of inclusive finance leads to the emergence of a bifurcated banking system. Such a system is defined by mainstream commercial banks based on a traditional bank intermediation model on the one hand, and inclusive finance based on a disintermediated, or shadow banking model, on the other. My study of the Pakistani financial system shows that a bifurcated banking system is not transitory, but a structural feature of a developing capitalist country, where key relationships between inclusive finance and access to finance are best understood through what I call, shadow financial citizenship. My thesis is organised as two parts. In the first part, I develop a conceptual lens to analyse bifurcated banking. In the second part, I use Pakistan as a case study of inclusive finance to examine the core themes and concepts identified above.

0. BIFURCATED BANKING: THE POLITICAL ECONOMY OF INCLUSIVE FINANCE IN PAKISTAN

0.1 BACKGROUND AND OVERVIEW

My doctoral thesis is not about poverty, but like many other studies on the topic of financial access in poor countries, begins with Dr Muhammad Yunus' story of becoming a banker to the poor. Yunus' initial experience in the 1970s of using a small sum of his own money to alleviate the debts, improve the livelihoods, and spur the entrepreneurship of a small group of women in rural Bangladesh was the basis for creating the Grameen bank. As the founder of this institution, Yunus became the most prominent spokesperson for the transformational potential of microcredit and won a Nobel Peace Prize in 2005. For Yunus, the key problem which microcredit could overcome was the reluctance of mainstream banks to lend to the poor. This reluctance ostensibly came from a misperception about the capacity of the poor to repay their loans. To resolve this, the Grameen model used a joint liability system where villagers applied for loans as a group. Because they shared liabilities, they were expected to exert social pressure on each other to ensure that these loans were repaid. This strategy lost prominence as the microcredit movement underwent shifts and became commercialised and profit oriented. Microfinance replaced microcredit as the focal point of this movement and eventually microfinance was replaced by financial inclusion.

In his biographical account of this movement, Yunus reveals that he saw gaps in financial access as a structural problem (Yunus, 2009). Fixated with addressing this shortage, he developed a lending approach that made the risk of default much smaller than what a commercial banker might assume, showing that 'the poor always pay back' (Dowla and Barua, 2006). But in doing so, the Grameen model sought to address the symptoms of a structural problem; and not its causes. As such, inclusive finance is a part of a family of development interventions — along with 'base of pyramid' (Prahalad, 2005) and 'band-aid' (Birdsall and Szekely, 2003) strategies — that sidesteps engagement with the problem of what Else Øyen, the Norwegian scholar of social policy, calls 'poverty production'.

The concept of poverty production, in Øyen's (2004) commentary on social policy discourse, may be directly contrasted with that of poverty reduction. Strategies such as microcredit and its antecedents are described as poverty reducing; but they engage only superficially with the question of poverty production. So for instance, while poverty may come across as being 'produced' by a lack of access to finance which leads

to dependence on usurious money lenders, the discussion on why the lack of access to finance persists has been given limited attention in poverty reduction strategies. In the context of this study, perhaps the most relevant takeaway from Øyen's approach is the distinction she emphasises between frameworks of harmony and frameworks of conflict. Whereas the former exert disproportionate influence on social policy and generally lead to a consensus based on the lowest common denominator; the latter require that the opposing or contradictory agendas of different actors are confronted rather than drawn into a consensus. Given respective frameworks, consensus in development interventions may be regarded as reflective of either a lowest common denominator arrangement in which the most effective or well thought out policies are not the ones eventually agreed upon; or as contentious in which interventions reflect the preferences of the most powerful actor.

Inclusive finance is one such development intervention and reflects a 'lowest common denominator arrangement' as well as the preferences of a powerful actor. The problem of the lowest common denominator is not a novel one in this context: it is intrinsic to commentaries on how the transition from microfinance to financial inclusion was embraced by development as well as financial communities because its amorphous terminology allowed it to resist claims that it did nothing to combat poverty (Mader, 2015; Mader and Sabrow. 2015). Additionally, the consensus that motivates the ascendancy of inclusive finance in contemporary development practice reflects the preferences of the immensely powerful actor that is global finance capital.

To interrogate this consensus for inclusive finance then is to, like Yunus and the Grameen Bank, approach the need for inclusive finance as a structural problem, recognising that there is a reticence or inability on the part of the mainstream banking sector to serve certain segments of the public. This situation is reflected in what I describe as 'bifurcated banking': a phenomenon in which there is a separation in the banking sector between the areas of inclusive finance and mainstream finance. Bifurcated banking systems are a feature of poor countries in which financial access is used as a tool of development strategy. But what is often missing from the discussion is the presence of a large and robust commercial banking sector which offers the non-poor a level of service comparable to that in advanced capitalist countries.

Even in advanced capitalist countries, particularly those operating with an Anglo-American economic model, divisive practices in the financial sector gained the attention of geographers who noted how shifts in banking models disadvantaged large segments of the public (Dymski, 2005; Dymski and Veitch, 1996; Pollard, 1996; Leyshon and Thrift, 1995).[1] A key objective of this study is to highlight the relevance of this latter set of scholarship for poor countries: to draw attention to how the processes and practices that create bifurcated banking structures in the Global South are the very same that underlie financial exclusion in the Global North.

---

1 The Anglo-American economic model emphasises low government involvement and a flexible labour force: it may be contrasted with the European social model based on relatively more government regulation and protections for workers.

To do this, I begin with a straightforward question: why are poor people offered financial inclusion products? Within existing scholarship, one answer to this question is that the poor have unique financial needs and require financial institutions and instruments tailored for their particular conditions (Collins et al., 2009). This explanation sees poverty as the driver of demand for inclusive finance but engages only superficially with the question of why mainstream financial institutions are unable to accommodate the poor.

The alternative explanation, which is the focus of my research, is that the demand for inclusive finance is driven by practices which I liken — but do not equate — to 'financial infrastructure withdrawal': this is the very same process behind the rise of predatory lending in the Anglosphere (Leyshon and Thrift, 1995) and reveals that financial systems have inbuilt tendencies to be exclusionary (Dymski and Veitch, 1996). Given these tendencies, scholars of financial exclusion in advanced capitalist countries, have developed a concept of financial citizenship which notes that like nation states, financial systems have an inside and an outside (Leyshon and Thrift, 1995). Those who can access finance only in the form of, for instance, high-cost loans and not through mainstream banking institutions are relegated to the outside and are hence not financial citizens. The processes that underlie this relegation include the tendency of mainstream banks to cross-sell products within groups, privileging 'blue-chip' clients by offering them subsidies in exchange for brand loyalty. Less wealthy clients, as a result, inevitably pay more for the same products and services than their more affluent counterparts. For advanced capitalist economies, this separation in access to financial services is described as an issue of financial citizenship. The concept of financial citizenship captures the presence in the financial system of an 'outside' in relation to an 'inside'.

These practices may be attributed to shifting models of banking, as practices of disintermediation mean that lending and borrowing activities are no longer closely linked. Whereas in the past the dominant model was one in which banks relied on depositors to provide funds that could be loaned to borrowers, newer approaches to banking focus more on the 'slicing and dicing' of loans (Chick and Dow, 1988). These have pushed a departure from the branch-oriented approach to banking and allowed banks to overcome geographical constraints. In poor countries disintermediation has occurred in the inclusive finance segment for two reasons. One of these is because of the ready availability of finance from private sources, including through 'privatised Keynesianism' (Bonizzi, 2017) and from the 'philanthropy-finance-development complex' (Gabor and Brooks, 2017). This arrangement is not only a manifestation of shadow banking in the Global South but also an extension of shadow banking in the Global North. Shadow banking refers to credit intermediation activities carried out by entities outside of the regular banking system and is commonly associated with the global financial crises of the last decade. The institutions and practices of shadow banking wield immense influence over the shape of inclusive finance in the Global South: the two key mechanisms that drive shadow banking in rich countries are the same as those in poor countries and are respectively associated with (1) regulatory

avoidance and arbitrage, and (2) the demand for yield from institutional investors (Nesvetailova, 2017; Pozsar, 2013).

These mechanisms are studied in this thesis using case examples from the financial sector in Pakistan, with a focus on deposit taking microfinance banks. Inclusive finance is presented in this context as a form of regulatory avoidance as the microfinance banks studied here are equipped to circumvent rules related to financial stability and counter-terrorism: namely, the capital adequacy and leverage limitations imposed by institutions such as the Basel Committee on Banking Supervision, and the know-your-customer (KYC) requirements of the Financial Action Task Force (FATF) to counter money laundering and terrorist funding (de Koker, 2014). Additionally, the prominence of microfinance investment funds, and the involvement of global banks in impact investing and social ventures are also presented in the light of shadow banking. These investing practices are also described as 'market-based finance' and many scholars of international development have expressed deep concern over the increasingly commercial and privatised nature of developmental strategies (Gabor, 2018). As a result of this arrangement in which inclusive finance has been absorbed by shadow banking networks and practices, the poor always pay more, not only for their loans but also for other services such as remittances and payments: disparities underlie bifurcated banking systems in poor countries.

In this thesis I make the claim that bifurcated banking exists and persists. To understand why this is so I develop the concept of shadow financial citizenship: this builds on the work of Leyshon and Thrift (1995) to account for the grey area between financial exclusion and full financial citizenship, drawing attention to how financial inclusion differs from financial citizenship. When inclusive finance is presented as a remedy to financial exclusion or to the circumstance of being 'unbanked' or even 'underserved', bifurcated banking emerges because of exclusionary practices. This is so because these exclusionary practices that obstruct financial citizenship are embedded in the financial landscapes of poor countries. Shadow financial citizenship is the analytical lens that I use in this thesis to conceptualise how these practices arise from the shadow banking and inclusive finance nexus.

In the following section I show that the concept of bifurcated banking is an original contribution of my study. But in addition to that, it is also a starting point for the analysis of financial citizenship in a poor country. As such, the central claims of this dissertation are two pronged; (1) that a phenomenon of bifurcated banking exists, and (2) that this phenomenon has distinct drivers that can be conceptualised through a lens of financial citizenship.

0.2 RESEARCH QUESTIONS AND THEMES

The main purpose of this study is to probe the tendency of inclusive finance to bifurcate banking systems. I argue that bifurcated banking systems are caused by the absorption of inclusive finance into shadow banking. Such banking systems may be understood

better through a shadow financial citizenship lens which highlights how financial inclusion often precludes financial citizenship. My study is guided by the following research questions:

(1): How 'inclusive' is inclusive finance?

(2): What is the relationship between inclusive finance and bifurcated banking?

The process to answer these questions is centred on three core themes: (1) bifurcated banking, (2) inclusive finance, and (3) shadow banking. These are at the core of the concept of shadow financial citizenship, developed in this thesis. These themes are briefly summarised below, and then followed by a discussion on the relationships and causal mechanisms that link these concepts to each other:

Bifurcated banking

The concept of bifurcated banking is my original contribution to the literature on financial access. I identify and draw attention to this phenomenon as part of a systematic approach which critiques the capacity of inclusive finance to be 'inclusive' and enhance financial access.

Over the course of this study, to explain why bifurcated banking impedes financial access, I assemble the conceptual framework of shadow financial citizenship. I thus draw heavily on the financial geography literature from the 1990s — which described the nature of financial exclusion in the United Kingdom and the United States — to show how impediments in financial access in Pakistan are closely linked to those that emerged in the Global North because of shifts in banking models.

The idea that banking systems can be bifurcated in the context of poverty or exclusion has two possible contexts. One of these is that of informality, particularly in the Global South where the informal economy has historically been extremely large. The other context is that of credit rating and scoring processes, particularly in Anglo-American countries where segments of the population are deemed 'sub-prime' or not eligible for access to the mainstream financial system.

The former context may be studied in the light of early development economics literature, particularly the work of Sir Arthur Lewis on markets with unlimited supplies of labour (Lewis, 1954); also the field research of Keith Hart which introduces the concept of an informal economy (Hart, 1973); and the work of the Dutch colonial economist J.H. Boeke — who noted that there was a 'dual economy' in Indonesia which was separate from the capitalist model of the Netherlands (Boeke, 1942) — must also be mentioned here.

The dual economy conceptualisation is central to Lewis' (1954) study in which he describes developing countries as characterised by a market economy and a non-market economy; the latter lies outside the former. Lewis' seminal conceptualisation of a developing economy as comprised of two sectors — subsistence and capitalist — is relevant here for its assumption that the two would merge when the capitalist sector

became large enough to subsume the traditional sector. This eventual and hypothetical merger was premised on the notion that informality was a temporary phenomenon: this two sector model of a formal and an informal sector highlighted the wage gap between the two sectors (Lewis, 1954). The differential was attributed to the exclusivity of reproducible capital, which was available only to the capitalist sector. As a result, the capitalist sector would invariably outpace — and absorb — the subsistence sector as:

> 'Output per head is lower in this sector than in the capitalist sector, because it is not fructified by capital (this is why it was called "unproductive" ; the distinction between productive and unproductive had nothing to do with whether the work yielded utility, as some neo-classicists have scornfully but erroneously asserted)' (Lewis, 1954: 147).

But as Hart (1973) and subsequently the International Labour Organisation (ILO, 1972) contended, the informal economy is better seen as a passive adjunct of growth originating outside of the formal economy and thus carry the potential for economic transformation.[2] Both studies saw the phenomenon of urban unemployment as the underlying cause for informality. Further, they took a positive view on informality and concluded that the informal sector had considerable potential for income generation (Chen, 2012). Hart's (1973) study is notable for advancing a consensus on 'the informal sector' as a specific term: this facilitated the construction of operational definitions, leading to empirical studies based on quantitative approaches. Chen (2012: 8) notes that the 'informal sector as an economic reality received a mixed review in development circles' with no agreement on whether or not it would eventually disappear. Also, as the assumption that industrial development would not follow the pattern seen previously in developed countries gained traction, there was a reasonable basis to assume that the informal economy might continue to expand.[3]

Bifurcated banking in poor countries is closely related to the notion of a historical separation between the formal and informal economy. Colonial banking systems in the Indian subcontinent — which are discussed in Chapter 4 — did not actively service the informal economy which relied on individual moneylenders in addition to alternative sources such as familial and other networks for credit. The usury of moneylenders has been a core argument for microcredit (e.g. Yunus, 2009; Sengupta and Aubochon, 2007; Barr, 2004). And one of the most important successes claimed by inclusive finance practitioners has been the formation of an alternative to the extortionate rates charged by these same moneylenders.

---

2 Hart's 1973 paper was based on findings from an earlier study which the International Labour Organisation drew upon for their report.

3 Subsequent studies tweaked this dualist conceptualisation but retained the perception of a resilient, growing informal economy. For instance the structuralist view is captured in a set of studies compiled by Portes, Castells and Benton (1989): these present the informal economy as a permanent, albeit subordinate and dependent, feature of capitalist development given the reorganisation of production into small, decentralized and more flexible economic units. The work of Hernando de Soto (1986, 2000) emphasizes a legalist view which is based on the growth potential of an informal economy empowered with property rights: it is argued thus that the informal economy should be facilitated and not countered.

But despite these successes, inclusive finance continues to operate separately from, and does not merge with mainstream finance. What is more or less absent from discussions on the transformative potential of credit — realised through freedom from usurious lending, consumption smoothing, and enterprise growth — is the observation that mainstream commercial banks operate in parallel with deposit taking microfinance banks. While not all inclusive finance is offered through such institutions — other structures include institutions that only lend, many of which are non-profit organisations — the widespread presence of commercially oriented deposit taking microfinance banks that are separate from commercial mainstream banks reflects a persistent separation. The puzzle in this arrangement then is this: why are mainstream banks and microfinance banks doing the exact same thing? Or, why have mainstream banks not stepped in to offer the services that microfinance banks are offering? The existing scholarship on this is discussed in the upcoming Chapter 1 and is shown to have gaps arising from its orientation with poverty reduction. I suggest an alternative approach which resists the urge to analyse the causal chain that links inclusive finance with poverty reduction. Instead, I draw on the literature on financial infrastructure withdrawal in advanced capitalist economies to critique inclusive finance as a product of shifting models of banking, and for its links with shadow banking practices and networks.

Financial infrastructure withdrawal refers to strategies for cost cutting and risk management in banking and relates to the second context for bifurcated banking: this context highlights how shifting models of banking, in the United States and Britain, have resulted in uneven access to retail financial services.

> 'During the 1980s changes in regulation saw retail financial services markets expand as financial services firms competed for new customers. In the 1990s, faced with more difficult operating conditions, financial services firms have adopted more exclusionary strategies and have embarked upon a "flight to quality". Firms have begun to focus upon a more affluent, middle-class client base in line with a decline in the importance of debt-related financial products and a rise in the importance of investment-related products' (Leyshon and Thrift, 1994: 268).

This focus on a relatively affluent client base is analogous in the Global South to the emphasis by mainstream banks on what approximates a 'non-poor' client base. As a result, and as discussed in Chapter 1, clients who are poor — and as a result lack the eligibility to access mainstream banking and financial services — may access only inclusive finance, including through microfinance banks. And just as Anglo American communities became more reliant on pawnbrokers and licensed money lenders because formal financial services were less reachable, the poor of the Global South were pushed towards inclusive finance because mainstream banks were reluctant to serve them.

Bifurcated banking is analysed in this thesis as an outcome of (1) the failure of mainstream banking and finance to serve large segments of the population in poor countries, and (2) the push from a global shadow banking industry to generate new income streams through inclusive finance. This latter outcome is revealed in the spread

of shadow banking practices; particularly disintermediation as wholesale funding rather than deposits is used to fund loans. The role of the global shadow banking industry is also reflected in the presence of shadow banking networks which connect inclusive finance to international financial capital. These observations are and elaborated in the following sections about inclusive finance and shadow banking respectively.

Inclusive finance

Inclusive finance may be understood as the outcome of a set of conceptualisations and in the light of its antecedents: microcredit, microfinance, and financial inclusion are all similar but also different to inclusive finance. The three shifting conceptualisations mentioned here are based on the various shapes that banking and finance policies for the poor have assumed since the 1980s. The earliest conceptualisation is that of microcredit; as discussed earlier this was offered on the assumption that the poor require loans to grow their livelihoods. A reconceptualisation then produced the concept of microfinance; this was done on the assumption that the poor need not only loans but also insurance, payments services, and savings products. Another reconceptualisation then resulted in a movement for financial inclusion; unlike its antecedents, this was presented as an 'enabler' for reducing poverty and not a tool for poverty reduction. Mader and Sabrow (2015) discuss all of these shifting conceptualisations as 'strategic mission shift'. More recently, and primarily to capture a technological emphasis, the concept of inclusive finance has come to be used — perhaps most frequently in the grey literatures of the development and the finance communities — as a generic term for development interventions based on financial access. As such, inclusive finance may be used interchangeably with prior conceptualisations.

An enduring topic in the critical literature on all of the above conceptualisations is centred on the tension between profitability and socio-economic outcomes. Primarily for the first three conceptualisations described above, the focal point is the transformative meeting of microfinance and 'the Market' which commenced in the 1990s (Cull et al., 2009). This occurred when it had become clear that the deposited savings of the poor, even when combined with subsidised capital and charitable funds, would not be nearly enough to reach all those who were 'unbanked' and 'underserved': thus the shift from 'socially oriented nonprofit microfinance institutions to for-profit microfinance' (Cull et. al, 2009: 167). Debates on the trade-off between profitability and social goals question the choices and predilection of microfinance institutions to service those most in need, to offer these services at a reasonable cost, and in a responsible manner. Many studies note how this is rarely done in actuality (e.g. Mader 2015; Bateman and Chang, 2012; Dichter and Harper, 2007).

A key argument of this thesis is that the specific nature of inclusive finance calls for a renewed approach to critiquing financial access as a development intervention. This entails a departure from the discussion on whether or not commercially oriented

microfinance can achieve social goals. The emphasis of inclusive finance on technology makes it reliant on infrastructures that are markedly more complex than those associated with earlier approaches. While this reliance may be attributed largely to the role of digital and data oriented methodologies for business development, it relates also to more traditional products and services such as microcredit: this is discussed in Chapter 8 and reflected in the push for products such as loans that are offered as mobile money and approved through smartphones using geospatial metadata and other innovative credit scoring techniques. As such, inclusive finance raises questions about the strategies on which technology is centred; this is reflected in an emerging literature on how such strategies seek to turn the poor into 'generators of financial assets' (Gabor and Brooks, 2017: 423) and how this produces 'troubling new kinds of social sorting and segmentation' (Aitken, 2017: 274).

Because these strategies actively differentiate between the poor and the non poor, they espouse a financial system in which there is an inside, an outside, and a grey area. It is for this reason that the concept of bifurcated banking is useful for interrogating inclusive finance not only as a development intervention but also as an integral part of a wider financial system. A bifurcated system is hence not an unintended consequence but a deliberate tactic. Over the course of this dissertation I show that this tactic is exerted through a set of causal mechanisms which link inclusive finance to bifurcated banking. In this depiction, inclusive finance assumes the form of shadow banks; shadow banks thus play a crucial role in shaping bifurcated banking. For this reason, the phenomenon of shadow banking, particularly its function in contemporary development interventions in the Global South, is also a core theme of this thesis.

Shadow banking

Shadow banking is a core theme in this study because it offers an analytical basis to approach transformations in banking models. A detailed discussion on shadow banking is available in Chapter 3; this builds on the argument presented earlier, that transitions in banking models play a crucial role in shaping financial citizenship. These transitions — which are captured by the academic term 'financialisation' — are reflected in the emergence of shadow banking practices and also shadow banking networks.

For instance, for shadow banking practices, perhaps the most relevant transition is that from OTH 'originate to hold' to OTD 'originate to distribute'. The OTH model guided the operation of a 'typical bank' in the 1950s and 1960s. [4] Under this arrangement the bank accepted deposits and registered them as liabilities on the balance sheet, whereas loans were registered as assets; the business of the bank was thus 'maturity transformation', and its focus was on managing the constraints and risks associated with deposit taking and lending. The role of the bank is different in an OTD model: here, the

4 This notion is discussed in more depth through the example of the 'Jimmy Stewart' bank in Chapter 3.

bank is a financial intermediary that links the supply of capital with demand. This is done by originating loans with clients and then selling these loans to other participants in the financial system. These two models are also described as relationship/ conventional banking and shadow banking, respectively.

As observed by Nesvetailova (2017), new financial technologies and regulations were instrumental to the shift from OTH to OTD. Shadow banking is a form of financial innovation, the purpose of which is to create new techniques, products, and markets, and institutions, but also to subvert existing routines, rules, and boundaries (Nesvetailova, 2017; Polillo, 2011). The idea that inclusive finance is a form of shadow banking— and an example of financial innovation — is central to my study.

To elaborate further, in addition to shadow banking practices, I draw attention also to shadow banking networks. This are particularly relevant from the standpoint of the case study presented later in this dissertation. In addition, the notion of shadow banking networks complements the analysis on OTH vis-a-vis OTD as a transformation in practice, noting that the 'distribute' aspect of OTD is an extension of the yield seeking imperative of global financial capital.

This 'inclusive finance as shadow banking' contention is assembled in this thesis both conceptually and empirically. The conceptual argument understands that shadow banking as supply driven as well as demand driven: supply driven explanations depict financial innovation as a response to regulation and similar constraints, whereas demand driven explanations portray financial innovation as emanating from a search for yield. The empirical argument incorporates both explanations and draws upon a variety of case examples from Pakistan; these relate to macroeconomic structures including public finance constraints, the policies of international institutions, the role of private finance in development, and the growth strategies of inclusive finance providers.

Relationships and Causal Mechanisms

The concepts described above are the basis for the central claims of this study. My dissertation is thus centred on three observable implications of inclusive finance as a tool for enhancing financial access. These implications form the bases for three arguments, which I detail over the course of this study.

First, I make the claim that inclusive finance is a form of shadow banking. This is revealed in the practices of the institutions that offer inclusive finance products and services using disintermediated models of banking, and in the networks that have emerged from an immense global shadow banking industry. The empirical basis for this claim is found in the official reports and audited financial statements of the institutions in this study. These documents are primarily used to analyse operating models and ownership structures.

Second, I argue that inclusive finance causes the banking system to be bifurcated. This bifurcated banking structure is characterised by a separation between mainstream commercial finance, which operates on a traditional banking model of

intermediation, and inclusive finance institutions which operate on a shadow banking model based on disintermediation, funded by global organisations which include private institutional asset managers, donor agencies, and philanthropic foundations. This is thus closely related to the above claim. Empirically, this claim is reflected in the reports and studies published by these global organisations, which is corroborated by the Pakistani financial institutions which receive this funding.

Third, I contend that bifurcated banking results in an inferior form of financial access. To analyse this, I generate a conceptual framework of shadow financial citizenship. This draws on the financial citizenship literature which describes impediments to financial access as a consequence of banking systems which have a distinct inside vis-a-vis a distinct outside. This separation is the outcome of shifting models of banking. I argue, using empirical evidence from Pakistani regulatory and policy institutions, as well as banks that the bifurcated nature of Pakistani banking should be attributed to the absorption of inclusive finance by shadow banking practices and networks. My analysis shows that shadow financial citizenship is expressed in a set of inequities; in rates and pricing, in eligibility and requirements, and in privacy and surveillance.

There is a core argument that joins these claims: a bifurcated banking system complicates financial access for the poor. More specifically, the financial landscape of Pakistan is shaped by shadow banking networks and practices; these have assumed the guise of inclusive finance, drive exclusionary practices, and result in a bifurcated banking system. Exclusionary practices make this bifurcated system problematic. I engage with these exclusionary practices by generating a conceptual framework of shadow financial citizenship. This conceptual framework examines the relationship between inclusive finance and bifurcated banking. To do this, I draw on previous explorations of how the strategies of financial institutions constrain financial access. The remainder of this introductory chapter outlines how these claims will be given theoretical and empirical support over the course of this thesis.

0.3 CONCEPTUAL FRAMEWORK

My thesis contains two sections. The key contribution of the first section is the conceptual framework of shadow financial citizenship. As mentioned above, the objective of this conceptual framework is to analyse the link between inclusive finance and bifurcated banking; to understand how and why a bifurcated banking system complicates financial access. In Chapter 3, I discuss in detail how the literatures on shadow banking and financial citizenship are the core of my conceptual framework; the remainder of this section offers a concise summary of this is done.

The shadow financial citizenship conceptual framework is prepared by first describing the exclusionary facets of financial systems in the Global South; this is done in Chapter 1 using the notion of 'bifurcated banking' and drawing upon the 'grey literature' — that is, reports and other publications from inclusive finance practitioners and other commentaries on policies and regulation — as well as academic scholarship

on inclusive finance. After this, in Chapter 2, inclusive finance is described as shadow banking in the context of the 'financialisation of development', which has occurred through shifts in development paradigms which have led to (1) the ascendancy of private finance, and (2) advances in financial innovation. Following this, in Chapter 3, there is a consideration of a 'social contract' in banking; this is joined with discussions on financial citizenship and shadow banking. These concepts are examined for their relation to bifurcated banking, and the analytical framework of shadow financial citizenship is used to conceptualise bifurcated banking

The second section contains analyses of inclusive finance in relation to the wider financial system in Pakistan; bifurcated banking is a product of this relation. Chapter 4 presents the institutional context of the financial system in Pakistan, drawing attention to the dominance of private capital. Chapter 5 highlights the structural features of banking and finance in Pakistan, particularly the penchant for banks to lend to large corporate institutions and the government; here inclusive finance is likened to shadow banking because it is a response to the reluctance of banks to service large segments of the public. Chapter 6 discusses how these trends and strategies have shaped the practices of two specific deposit taking microfinance banks — Telenor Microfinance Bank and the First MicroFinance Bank — and how this reflects the nature of shadow financial citizenship and the inequities that characterise it: (1) inequities in pricing, (2) inequities in eligibility, and (3) inequities in surveillance. Chapter 7 considers the demand side explanation for shadow banking in the light of practices such as blended finance and impact investing; these strategies are drawn to inclusive finance and reflect the responses of institutional investors to a 'global glut of savings'. Chapter 8 consolidates these findings and shows how they are the outcome of Pakistan's specific encounter with broader, structural patterns of financialisation.

0.4 DATA SOURCES

The data used for the second section includes primary sources, secondary sources, and grey literature. Additionally, during fieldwork, I conducted 19 semi-structured interviews with professionals working in inclusive finance and allied areas, including in the central bank, commercial banking, development agencies, fintech, and social enterprise.[5] All of them were based in either Pakistan or the United Kingdom: Islamabad, Karachi, Lahore, or London. These interviews expedited my access to primary sources and grey literature. Interviewees, during some meetings, shared official copies of reports and regulatory documents, and on occasion drew my attention to other published materials to support our conversations. Over the course of my fieldwork it became clear that the nature and quantity of the data available in the public domain is not only substantially rich, but also expansive enough to substitute for any analysis generated through interview content. The role of the interviewers in this study has thus been to facilitate the collection of data. The analysis in this dissertation is

5 A list of institutions is included in Appendix A.

principally based on published materials which constituted primary sources, secondary sources, and grey literature.

The primary sources used included policy and regulatory documents from government and multilateral institutions, and also the audited financial statements of financial institutions; through this, I obtained quantitative data for descriptive analysis. Secondary sources are comprised of the academic literature that relates to the political economy of finance and development in Pakistan. This was used mainly to draw linkages between country specific resources and materials, and broader regional and global trends.

Grey literature refers to research reports, white papers, and other commentaries published by government departments, policy institutions and think-tanks, non-profit organisations, financial institutions, businesses, and industry organisations, as well as other resources that are not produced by commercial publishers. Some of these materials overlap with what are considered primary sources; for example, World Bank studies that suggest how policy makers might use private finance for development.

0.5 CASE SELECTION AND METHODOLOGY

My principal unit of analysis is the inclusive finance industry in Pakistan: I review different aspects of inclusive finance — its evolution, institutions, regulation, and sponsors — to study the extent to which it exemplifies shadow banking. This single case study approach, like all research strategies, has its weaknesses as well as strengths. The weaknesses associated with this approach pertain to (1) its limitations in offering generalisable inferences and (2) issues of subjectivity and researcher bias (Flyvberg, 2006). These weaknesses have been debated in the literature about methodology in the social sciences (e.g. Yin, 2009) but look considerably less formidable in relation to the strengths of this approach: primarily that it is 'comparative', albeit to varying extents depending on much engagement there is with comparative themes (Halperin and Heath, 2012). The research strategy applied here is an exercise in theory building and generating hypotheses; the 'comparative' element emerges through arguments and theories that are relevant to other contexts and offer meaningful commentary not just about the case being studied, but also about general political phenomena.

As such, inclusive finance in Pakistan, is treated here as what some methodologists (e.g. Halperin and Heath, 2012; Yin, 2009) might describe as a 'revelatory' example: one used to study relationships that would not be clear otherwise. For this, I use a historical explanation approach (e.g. Mahoney et al, 2009) to examine and analyse published materials and fieldwork observations in the light of the research questions identified earlier, and thus to describe political and social phenomena and evaluate causal relations. The historical explanation approach is used in this thesis to explore the specific causal mechanisms that underlie the association between inclusive finance and bifurcated banking. My approach to this process is informed by the methodological literature on counterfactual analysis, in which outcomes are described

as the result of combinations — potentially four in total — of either necessary or sufficient causes (Mahoney and Barrenechea 2019; Mahoney et al, 2009; Goertz and Levy, 2007).

The causal mechanisms that link inclusive finance, as a component of the banking system — *as the cause* — to bifurcated banking — *as the effect* — involve the shifting strategies of institutions; domestic as well as international. The objective of identifying and describing these mechanisms is to arrive at conclusions that expand the academic literature on inclusive finance — and by extension financialisation — in Pakistan, and also offer tools to study similar phenomena elsewhere.

Thus, in my dissertation, and as shown through the central claims outlined above, the causal mechanism linking cause to effect involves the decisions of regulatory and policy institutions to formalise the provision of credit to the poor in the form of microfinance banks and institutions; this is revealed through the analysis of documents from the multilateral institutions which have endorsed and given financial support for formal microfinance in Pakistan, as well the regulatory framework launched by the central bank in Pakistan. An analysis of subsequent documents shows how these microfinance banks and institutions eventually come to rely on external sources of financial capital from private and public donors, as well as commercial organisations to fund banking services for the poor. Empirical support for these trends is drawn from documentation related to the United Nations led FfD or Finance for Development Agenda, which is closely linked to the targets set for the Millennium Development Goals, and Sustainable Development Goals.

The need for an alternative set of banking services is augmented by and expressed in the publications of international bodies such as FATF, in response to concerns about terror financing, and by the Basel Committee on Banking Supervision, to address apprehensions about financial stability. These trends catalyse innovation — through private investments — in banking products directed at mobile phone users and technologies which harvest mobile phone usage patterns and related behaviours to produce data for credit scoring. These strategies are revealed in the merger and acquisition patterns in the Pakistani banking and telecom industries. They serve to expand the suite of products and services which are created specifically for the poor. A bifurcated system of banking is thus the outcome of the institutionalisation of inclusive finance.

An alternative set of causal mechanisms may also be found in the literature. These form the view that is widely accepted among policymakers and donor institutions; that the poor have complex financial needs, which are not addressed through mainstream banking and finance, so the pressing need is for products and services designed specifically for poor people. In this perspective, the outcome of bifurcated banking is triggered by poverty. Here, the causal mechanism linking cause to effect involves altruistic donors and private investors providing poor people with alternatives not only to the traditional banking system but also to the informal money lender; this strategy is boosted by the involvement of the global development

community which sees lending to the directly poor as preferable to larger 'big ticket' projects; as awareness grows around the complexities of managing meagre incomes, financial institutions and technology companies create even more specific products to accommodate the circumstance of poverty. A bifurcated system of banking, in this narrative, is the outcome of persistent poverty.

Pakistan is selected as a case primarily because of the attention it has drawn within the 'grey literature' for enabling microfinance through its legal and regulatory frameworks (EIU, 2011). Along with the Philippines, Peru, and Bolivia, Pakistan is one of a few countries that has a separate legal framework in the form of prudential regulations for deposit taking microfinance banks (MFBs), and a separate regulatory framework for non-deposit taking microcredit institutions; additionally, the financial sector has been shaped by state led efforts to expand coverage through retailers and mobile network operators. This arrangement has its roots in the 2001 Microfinance Ordinance, which was passed by the Parliament to 'regulate the establishment, business and operations of microfinance institutions' (SBP, 2001). These rules articulate an explicit role for the private sector; this is unsurprising given that the Microfinance Ordinance — as discussed in Chapter 4 — is an extension of the 1990s Pakistani financial liberalisation policies moulded by the Washington Consensus. From the standpoint of the financialisation literature — particularly that focused on poor countries — what makes the Pakistan case especially appealing is how it reveals the contours of the transition from the Washington Consensus to what has very recently come to be described as the 'Wall Street Consensus' (Gabor, 2019).

0.6 CONTRIBUTION TO SCHOLARSHIP

The disciplinary contribution that I make through this thesis is to the international political economy scholarship on the Global South, and by extension, the field of development studies. In doing so, I augment the academic literature on financialisation; more specifically, the literature on financialisation in poor countries. I do this through a novel critical analysis of inclusive finance in Pakistan, for which I build the analytical tool of shadow financial citizenship. I use this as a conceptual framework to study bifurcated banking, a phenomenon that is defined, described, and explained here as occurring when inclusive finance becomes a form of shadow banking. A bifurcated banking system emerges from the practices, processes, and products of inclusive finance, when the latter is absorbed by shadow banking institutions, practices, and networks.

As such, the contribution made here augments scholarship on the 'activity centred' view on financialisation which emphasises — particularly where it draws on Post-Keynesian perspectives — the role of institutions in managing economic outcomes driven by investment (Nesvetailova, 2012). Financialisation is seen to affix the 'real' and the 'financial' realms together, by dispensing mounting quantities of assets into the financial system (Nesvetailova, 2012: 85). This activity centred view may be contrasted with an 'accumulation centred' or systemic view which emphasises the transformation

in capitalism that has occurred over recent decades (Lapavitsas, 2013; Krippner, 2005; Arrighi, 1994). There is no fundamental incongruity between these two views, but the study of inclusive finance carried out in this thesis is more given to expanding the scholarship on the former, rather than the latter. The former, 'activity centred' view is more appropriate for the analysis of financialisation outside of advanced capitalist economies because it resists the notion — central to the systemic view — that financialisation is a universal, homogenising process. The micro-level analyses carried out in this study show how inclusive finance — given empirical examples from Pakistan — is a form of shadow banking, and how this, in turn, bifurcates banking.

The linkages drawn in this thesis, between inclusive finance and shadow banking, place this study firmly within the set of literature that interrogates financialisation specifically in the context of poor countries, and generally in the context of countries that are not advanced capitalist economies. Inclusive finance is thus presented here predominantly as (1) an instance of the peculiarity of financialisation in Pakistan, but also as (2) an indirect instance of the generality or financialisation in developing and emerging countries; also known as 'subordinate financialisation' and characterised by burdensome foreign reserve accumulation patterns and currency hierarchies (Bortz and Kaltenbrunner, 2018; Lapavitsas, 2013).

0.7 OUTLINE

In addition to introductory and concluding chapters, this thesis contains eight chapters organised as two parts. Chapters 1, 2, and 3 form Part One which focuses on theoretical and conceptual issues. Chapters 4, 5, 6, 7, and 8 form Part Two, which uses case examples from Pakistan and also contains a discussion section to reflect upon the salient conceptual and empirical features of the overall study. A final chapter concludes by offering a summary, as well as limitations and avenues for further research.

Chapter 1 surveys the literature on inclusive finance and its predecessors, acknowledging the shifts that have occurred since the microcredit model of 1970s first gained credibility. The overview presented here also scrutinises how policies centred on financial access for the poor are 'inclusive' and thus a counter to financial exclusion. This is done primarily by invoking research, from various sources including grey literature, to compile a list of characteristics of financial access given the banking structures of poor countries. These underscore the bifurcated nature of banking in countries where financial access for the poor is a policy goal. In a bifurcated banking system there is a previously undefined grey area, or a space between financial exclusion and access to mainstream finance.

Chapter 2 draws attention to the linkages between inclusive finance and transformations in development thought and practice. This discussion considers the implications of a Post Washington Consensus in the framing of development and poverty reduction as issues of inclusion and inclusive growth. More recent approaches, endorsed by international institutions, have retained a focus on inclusion and

incorporated the role of private capital in strategies to attain it. These shifts underlie the incursion of shadow banking into development, which is the subject of an emergent Wall Street Consensus.

Chapter 3 presents a conceptual framework that applies a financial citizenship lens to bifurcated banking which is seen as emerging from a nexus between inclusive finance and shadow banking. The issue of bifurcated banking is problematised by drawing on the notion of a social contract in banking. This is linked this to the historical example of black banking in the United States and its connection with the American racial wealth gap. Through this analysis, two contentions are made: (1) that financial systems have an inside and an outside, and (2) that recent transformations in banking structures limit access to this 'inside'. These contentions demonstrate that shadow banking advances exclusionary practices that obstruct financial citizenship, noting that some of these exclusionary practices are already embedded in the financial landscapes of poor countries. The conceptual framework of shadow financial citizenship is developed thus. It is used to conceptualise the exclusionary practices which are demonstrated by the phenomenon of bifurcated banking. This phenomenon is expressed as a grey area that occupies a space between financial exclusion and access to mainstream finance.

Chapter 4 introduces the case study of inclusive finance in Pakistan. Processes of privatisation, liberalisation, and deregulation have shaped Pakistan's banking sector and created the setting in which the commercialised model of microfinance, offered primarily through specially licensed deposit taking institutions, came to be seen as globally successfully. This model, which exists parallel to a large and tightly regulated mainstream commercial banking sector has driven policy innovation in funding, and as argued here, functioned as a gateway to shadow banking through institutional investment. These trends arise from endogenous as well as exogenous factors. The endogenous factors pertain to the operating strategies of mainstream banks fixated with investments in government paper over lending; the exogenous factors include a search for yield from overseas investors which translates into debt and equity investments in the Pakistani inclusive finance industry.

Chapter 5 draws attention to the institutional and structural factors that underlie bifurcated banking in Pakistan. These include pressures from international institutions including multilateral donors and regulatory regimes such as the Basel Accord and FATF Guidelines, which limit banks in who they can service. Additionally, macroeconomic structures constrain mainstream banks from lending outside of large corporates and the government. These drive a form of shadow banking which is akin to that which emerges from regulatory avoidance and arbitrage, presents the building blocks for the inequities that characterise shadow financial citizenship: these three core inequities are (1) inequities in rates, (2) inequities in requirements, and (3) inequities in surveillance.

Chapter 6 discusses the nature and implications of bifurcated banking, which are examined here through two deposit taking microfinance institutions: TMB and

FMFB. Despite clearly different strategies and goals, both institutions came to adopt very similar approaches: this reveals the homogenising influence of global finance through the push to make institutions 'sustainable' through profit orientation. Bifurcated banking is seen to occupy a grey area between financial exclusion and financial citizenship and results in high service charges for loans, the compulsion to provide fungible collateral, and the insidious forfeiture of digital privacy. These outcomes are conceptualised through a shadow financial citizenship framework and reflected in the set of inequities highlighted earlier: (1) eligibility/ requirements, (2) rates/ pricing, and (3) privacy/ surveillance.

Chapter 7 revisits earlier discussions about financing development, particularly the specific, growing features of the global financial system that advance the nexus between shadow banking and inclusive finance. The Pakistan specific context for impact investing exemplifies contemporary development strategies in general and inclusive finance in particular. The role of patient capital in development offers a gateway for shadow banking practices, particularly given the shifts and transformations that have occurred over recent years in development initiatives by incorporating private and philanthropic capital. A focus on the specific practice or 'asset class' known as impact investing ties together some core themes centred on global finance and development practice. In particular, the proclivity for impact investors to seek out base-of-pyramid projects has been an important driver of shadow financial citizenship.

Chapter 8 brings together the observations made earlier to reiterate that inclusive finance is responsible for a bifurcated banking system. Built on this is the contention that inclusive finance, particularly as reflected through the case study of Pakistan, contains generalisable features which reveal its connections with broader, structural patterns of financialisation. More specifically: inclusive finance as a form of shadow banking exemplifies subordinate financialisation, and Pakistan's bifurcated banking system is related to its subordinate position in the global financial system. The notion of debtfare is applied to Pakistan to expand upon this connection. The macroeconomics of debt and austerity, and also the intrusions made by debt capital into an informal economy, make the Pakistani state prone to applying a mode of governance which facilitates a 'poverty industry'. Inclusive finance is a component of this poverty industry, which may be considered through a lens of subordinate financialisation. Such an approach acknowledges that financialisation is encountered differently by poor or emerging capitalist countries relative to their advanced capitalist counterparts. As such, suggestions to overcome shadow financial citizenship rely on strong participation from the state and also entail the need for an overhaul of the state's role in contemporary banking practice.

PART ONE

1. ACCESS, EXCLUSION AND THE SPACE IN BETWEEN: A GREY AREA

1.1 INTRODUCTION

The literature surveyed in this chapter problematises inclusive finance. This is done by querying the extent to which such policies are indeed inclusive, and thus a counter to financial exclusion. The key argument here is that inclusive finance does not resolve the problem of financial exclusion. More specifically, financial inclusion is not the notional opposite of financial exclusion. Rather than resolving financial exclusion, it creates a grey area. This grey area occupies a space between financial exclusion and financial citizenship.

This distinction presents a fresh critique of financial inclusion. Negative appraisals in the past have tended to focus on how microcredit does not work: it does not result in poverty reduction and does not empower women. Such claims carried especial relevance when microcredit was promoted as the poor country version, particularly because of large informal economies, of enterprise finance. But over the last decade or so, microcredit has come to be just one of a suite of products offered by firms known as microfinance institutions or banks. Microfinance products are thus likened more to retail finance, and less to enterprise finance. The aspirations of microfinance institutions have changed as a result: there is now less emphasis on growing small business and more emphasis on 'financially including' groups that are described as 'unbanked', 'underbanked', and 'underserved'. But access to the mainstream banking system is limited — and often non-exisent — for those who use inclusive finance. Despite a widening and deepening of initiatives to expand microcredit, microfinance, financial inclusion, and most recently, inclusive finance, there are substantial differences in the nature of financial access for the poor, relative to the non-poor.

The conceptual transitions associated with the shifting initiatives mentioned above are discussed in section 1.2 which is a concise history of financial inclusion critiques. Following that, some features of inclusive finance, presented as stylised facts, are listed in section 1.3 to bring to light the nature of financial inclusion, particularly in relation to mainstream banking. In section 1.4, the need for an appropriate analytical framework is underscored: one that moves beyond an inclusion and exclusion binary and to identify the systemic facets of uneven financial access. Concluding remarks are presented in 1.5.

1.2 INCLUSIVE FINANCE: A CONCISE HISTORY

The starting point for this study is, in many respects, the DFID funded document known as the Duvendack Report: this uses a systematic review methodology to analyse the impact of microcredit on poor people. [6] Well known for the verdict that there is 'no good evidence to support the claim that microfinance has a beneficial effect on the well-being of poor people', the authors of this report neither 'support nor deny the notion that microfinance is pro-poor' (Duvendack et. al, 2011: 75). In the words of Bateman and Chang (2012: 16), this was a 'quite devastating blow to the microfinance industry': it also closely followed two key occurrences that undermined the positive narrative of microfinance.

One of these was the proliferation of studies that questioned the positive effects of microfinance. Critical of the empirical link between microfinance and poverty alleviation (Roodman and Morduch, 2009; Banerjee et al., 2009; Karlan and Zinman 2009; Duvendack and Palmer-Jones 2011), these studies complemented earlier scholarship: indignation over the public listing of Mexican Banco Compartamos, in 2007, had amplified discontent about commercialised microfinance (Bateman, 2010; Lewis, 2008) and validated an economic development literature with an unsympathetic view of microfinance (Dichter and Harper, 2007).

The other occurrence was a global wave of 'hugely destructive sub-prime-style "microfinance meltdowns"' between 2008 and 2010 in Morocco, Nicaragua, Pakistan, and Bosnia as well as potential upheaval in the microfinance industries of Lebanon, Peru, Azerbaijan and Kyrgyzstan (Bateman and Chang, 2012: 16).

> 'One far-reaching result of all this bad news is that the microfinance industry has begun to drop the important claim to be facilitating poverty reduction, moving very quietly to redefine a new goal for itself in terms of facilitating the far more nebulous concept of 'financial inclusion' (Bateman and Chang, 2012: 17).

The transition to 'financial inclusion' from 'microfinance' is detailed in Mader and Sabrow (2015) as an occurrence that underlined the failings of microenterprise lending. More specifically, microenterprise lending was until a certain point, the core product of microfinance but became less prominent as microfinance was likened more to retail or household finance and less to enterprise finance (Cull and Morduch, 2017). These transitions are as described in Table 1.1. The shift in focus underlies the 'strategic mission shift' implemented by the microfinance industry in response to three trends: (1) growing criticism from new research, (2) an embrace of 'financialisation and its new rationalised myths', and (3) the immense influence of the Consultative Group for Action on Poverty or CGAP, a think-tank organisation housed within the World Bank (Mader and Sabrow, 2015: 19).

6 'Systematic reviews aim to find as much as possible of the research relevant to the particular research questions, and use explicit methods to identify what can reliably be said on the basis of these studies.' (EPPI Centre, 2018).

Table 1.1: Paradigm shifts around financial access

Paradigm	Microcredit	Microfinance	Financial inclusion	Inclusive finance
Strategy	Providing credit to microenterprises.	Providing all financial services to improve well-being of poor women and men	Providing and developing financial services that account for the diverse needs of poor women and men.	Use of digital technology for financial services (fintech) such as agent network managers, payment aggregators for digital finance ecosystem
Issues	Evidence that though some effect on business expansion and profitability, very little effect on women's empowerment, and virtually none on poverty alleviation.	Narrow supply-led view that does not account for broader financial ecosystem and thus tends to be reliant on donor funding and subsidised credit.	Effective use hampered by asymmetries of information as well as unsuitable product features or accessibility requirements.	High costs, weak infrastructure: closed systems make integration of broader range of solutions into existing payment platforms costly and cumbersome. Also many financial services require significant physical touch points.
Responses	Broadening of objectives beyond economic development and poverty alleviation to include ability of poor women and men to better manage risks, smooth income, productively, and build assets.	Espousal of holistic view of the sector and a more coordinated effort by government and industry to focus on increasing financial inclusion and, making markets work better for the poor.	Technology and innovation for new customers and for new service providers: such as agent network managers, payment aggregators etc.	Enhanced use and development of new technologies and strategies to induce investment in technology.

Source: Compiled by author based on Collins et al., (2010) and Ledgerwood et al. (2013)

In subsequently published research, Philip Mader (2018: 462) builds on this to depict financial inclusion as a 'contested and contestable enterprise' given the scant evidence for three core assertions made to promote financial inclusion: one is that it results in broader socio-economic development; another is that it has immediate benefits for the poor, and a third is that it has a compelling business rationale. Two of these assertions are recognizable from earlier critiques of microfinance, whereas the third offers an opening to query the meaning and nature — and not just the definition — of financial

inclusion. Such an approach, which acknowledges that financial inclusion and exclusion overlap, is an alternative to the characterisation of financial inclusion and exclusion as binaries and opposites. The 'overlap' may be conceptualised as a grey area: this is elaborated later in this chapter through a list of the exclusions the 'financially included' still encounter.

Philip Mader's work in this regard then may be seen as beginning where the Duvendack report ends, for whereas this particular systematic review offers a compelling set of findings that question the role of microfinance in poverty reduction, its focus is methodological and not economic. In singling out the dubious assertions that socio-economic development, and immediate benefits for the poor, are respective outcomes of financial inclusion, Mader (2018) enriches the arguments made earlier, for instance by practitioners, for instance Sinclair (2012), and scholars of international development (A. Roy, 2010; Dichter and Harper, 2007), of anthropology (Karim, 2011; Elyachar, 2005), and of international political economy (Weber, 2014; 2004; 2002; Soederberg, 2014; 2013).

Together, these studies form a core literature that has been consistent in querying the role of microfinance, and subsequently financial inclusion, in development.[7] Some themes stand out within these sources. For example, the rollback of the state is the subject of Julia Elyachar's (2005) study of market expansion in Egypt. The neoliberalism of NGOs is examined in Lamia Karim's (2011) research on indebted women in Bangladesh. Sinclair's (2012) insider account documents concerns about extractive practices. These themes have overlaps in Dichter and Harper's (2007) collection of studies of various organisations, practices, and geographic regions. Perhaps most relevant to Mader's (2018; 2015) research are perspectives that link financial inclusion to the widening and deepening of 'finance-led capitalism' (Soederberg, 2014: 92), and note the growing linkages between inclusive finance and global capital markets (Bonizzi, 2013; Aitken, 2010).

These growing linkages arise from a turn to commercial sources of funding for on-lending. Instead of subsidies, grants, or even client deposits, microfinance banks have, over the last decade or so, been accessing wholesale funding from large publicly and privately owned financial institutions (Cull et al., 2009). The commercial version of microfinance and subsequently financial inclusion has thus been the subject of various studies ever since the role of subsidies became questionable in the late 1990s, particularly because they came to be seen as limiting scale through donor dependence (Morduch, 2000; Ledgerwood, 1998).

The business case for microfinance was bolstered in subsequent years with the proliferation of microfinance banks that had previously been non-profit organisations, but transformed to become profitable enterprises (Drake and Rhyne, 2002). As the terminology of financial inclusion has gained ascendancy over microfinance in the last decade, inclusive finance tools based on information and communication technologies

7 A detailed list of sources is available in Mader (2015)

(ICT) are seen to promise a trend of cheaper financial services, implying more profitability for providers (WEF, 2011).

Such research endorses the view that commercial motives are not inconsistent with social motives; that it is possible for institutions selling inclusive finance to be doing well by doing good, or as the Economist (2008), commenting on the Compartamos controversy, puts it: 'Doing good by doing very nicely indeed'. Several scholars of the political economy of development find this ostensible harmony between commercial and social motives problematic. For instance A. Roy (2010) notes that the profit motive incentivises lenders to extend credit to those who do not need loans and/ or lack the means to repay; Taylor (2012) finds that the commercial model encourages coercive practices to push repayment; and Mader (2015) argues that commercial microfinance is a tool for capital accumulation — by financial institutions — as it extracts resources from the poor.

The commercialised nature of financial inclusion is thus contentious, but it also underlies both the success and failure of the agenda: whereas the success is the capacity to be profitable, its failure is in the continued presence of swathes of 'unbanked' and 'underserved' populations. This is Mader's third example of a core assertion of financial inclusion that prevails despite scant evidence.

> 'For financial inclusion to make good business sense, financial actors must succeed at profitably offering decent-quality services at affordable prices and at encouraging clients to use them' (Mader, 2018: 474).

Worded differently, this stance uses the persistence of financial exclusion to argue that financial inclusion as business does not work, because if it did it would have obliterated exclusion. This observation speaks to the problem at the core of this thesis: the need to interrogate the nature of financial inclusion and ask how 'inclusive' it actually is. This line of questioning is a departure from the business proposition argument which sees financial inclusion and financial exclusion as binary and separate. This binary view is troublesome because it implies that financial inclusion — applied through inclusive finance — extinguishes financial exclusion. The next section shows how this is not the case, and instead, the 'financially included' occupy a grey area and remain separated from the mainstream financial sector.

1.3 ATTRIBUTES OF INCLUSION: A GREY AREA BETWEEN FINANCIAL EXCLUSION AND MAINSTREAM FINANCE?

How and why do the 'financially included' remain separated from the mainstream financial sector? This question will be answered in two parts: the first part highlights the limited capacity of inclusive finance products to facilitate access to mainstream finance, the second part of the question requires an analysis of the structural aspects of banking and finance that impair its accessibility. This latter part will be addressed in Chapter 3 which conceptualises bifurcated banking using a lens of shadow financial citizenship.

The segmentation of markets for financial services has been problematised by scholars in the context of products such as payday loans and credit cards with exorbitant fees (Appleyard et al. 2016; Soederberg, 2014; Dymski, 2005). Outside of this research there has been only limited discussion about the stark differences between the financial products and services offered to customers of inclusive finance and mainstream finance respectively. This issue is partially addressed by Collins et al. (2009) in 'Portfolios of the Poor', a study of how those with low, erratic, and unpredictable incomes sustain themselves on a daily basis and in unforeseen situations. A key argument extended is thus: the poor have complex financial needs, which are not addressed through mainstream banking and finance, so the pressing need is for products and services designed specifically for poor people.

This view is influential and has obscured the potential of inclusive finance to serve as a stepping stone to mainstream finance.[8] The emphasis on 'the poor' thus motivates an agenda for inclusive finance that is centred on designing and selling financial services that are relevant only for the poor, or for those with no alternative. Under this arrangement a segment of the population is offered financial services of a nature that impede 'their ability to participate fully in the economy and to accumulate wealth' (Dymski, 2005: 440). This is detailed below by highlighting the circumstances of the poor who seek financial access, or worded differently, the attributes of inclusion.

The poor live and work in the informal economy

A sizeable overview of the relationship between informality and inclusive finance is in the seminal article by Milford Bateman and Ha Joon Chang (2012) 'Microfinance and the Illusion of Development'. A key argument of their work is that microfinance ignores the role of scale economies:

> 'By definition, microfinance produces microenterprises – that is, enterprises and agricultural units that are very small and almost always operate below minimum efficient scale. However, it is widely accepted that for all enterprise sectors there remains an identifiable minimum efficient scale of production, and operating below this level makes it virtually impossible for any enterprise to survive and prosper in a competitive business environment' (Bateman and Chang, 2012: 17).

As such, microfinance is prone to being a poverty trap: its focus on small, informal enterprises draws away finance from firms, particularly small and medium enterprises (SMEs). Because it limits finance for enterprises that have the capacity to generate

8 A point evidenced by CGAP's placement of 'Portfolios of the Poor' in its list of recommended readings. http://www.cgap.org/topics/financial-inclusion

employment, microfinance has unfavourable implications for the macroeconomy.[9] Bateman and Chang (2012) base this claim on examples from India, Bangladesh, and Mexico and also link it to the 'fallacy of composition'. The latter is apparent in the tendency for development policy to ignore the existence of local demand constrictions and assume that microeconomies have unlimited capacity to absorb the unemployed through an expansion of the informal — local enterprise — sector. Alice Amsden, the scholar of state-led economic development, notes that:

> 'To create employment requires action on the demand side, in the form of capital investments to expand entrepreneurial opportunities and increase productive jobs. Yet the anti-poverty programs that have swept through Africa take a "Capabilities Approach". They focus exclusively on the individual's supply side, as though a greater supply of better-qualified job-seekers (in terms of education, consumption, mobility housing and human rights) will automatically stimulate the demand to employ it, as in the Eighteenth-century "law" of the conservative French economist Jean Baptiste Say' (Amsden, 2012: 114).

Additional arguments that relate microfinance strategies to informality are based on: one, a hypothesis of deindustrialisation, and two, the issue of connectivity between enterprises of various sizes (Bateman and Chang, 2012). The deindustrialisation argument is extended to question the emphasis on trade and subsistence based enterprises which — given the example of informal economy growth in sub-Saharan Africa — constrains large scale industrialisation. Similarly, the ascendancy of survivalist enterprises limits prospects for horizontal and vertical relationships, based on cooperation, between enterprises; these inhibit large firms from expanding locally as they incentivise them to import instead. [10] Also, investment is obstructed when there is a lack of sub-contractors, particularly for greenfield projects; local enterprises tend not to be equipped to respond to the demands of technology and scale.

These concerns are reflected by Meagher (2015) who views the spread of informality in African countries as the outcome of adverse incorporation. The concept of 'adverse incorporation' sees poverty and inequality as a result, primarily, of unequal economic and power relations, thus requiring efforts to change the societal, political and economic dynamics that keep people disadvantaged (e.g. Hickey and Du Toit, 2013; Bird et al., 2002). Meagher (2015) thus draws attention to the relationship between inclusive finance and informality by noting how market led growth strategies — despite attempting to execute a kinder, gentler, approach to development by focusing on poverty reduction — result in selective inclusion.

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9 Such a claim assumes that banks are intermediaries of loanable funds: in this ILF model, banks accept deposits of pre-existing real resources from savers and then lend them to borrowers. The alternative view is the financing through money creation (FMC) model in which banks create their own funding, through deposits, in the act of lending, in transactions that involve no intermediation whatsoever. These differing views on the role of banks are discussed in the Post Keynesian literature such as Lavoie (2006) and Fontana (2003). Whereas many central banks appear to have endorsed the ILF model (Jakab and Kumhof, 2015), it can be argued, building on Chick and Dow (1988: p 2) that , for developing countries an ILF model is appropriate because the choice of model depends on 'whether or not the relevant stage of banking development has been reached'.

10 Bateman and Chang (2012) describe these as 'productivity-enhancing horizontal ('proto-industrial districts') and vertical (sub-contracting) connections'.

> 'The very design of this donor-led stable of inclusive market programmes views the informal economy as a boundless sponge, and takes no account of the power struggles taking place within it. Instead of addressing the stresses of market saturation, poverty and exclusion of the less advantaged, these policy packages channel graduates into the informal economy from above, and pump micro-credit borrowers into survival activities from below, intensifying the pressures already crowding out the poor, uneducated and desperate' (Meagher, 2015: 16).

The poor are disadvantaged by KYC requirements of mainstream finance

KYC or 'know your customer' requirements are a primary reason for financial exclusion. For businesses — financial institutions as well as others — KYC requirements necessitate the identification and verification of clients to deter money laundering and crime, particularly terror financing. The emphasis on KYC can be attributed to the USA Patriot Act of 2001, pursuant to which the United States Treasury issued regulations that made KYC mandatory for all banks. A related event is the October 2001 meeting of the G10 central banks and other supervisory authorities on terror financing where it was noted that — to prevent abuse of the financial system — it was necessary to develop and implement effect KYC and CDD (customer due diligence) procedures (Bantekas, 2003).

These events also underlie the transformation of the organisation known as FATF or the Financial Action Task Force on Money Laundering. Formed in 1989 by the G7 with the goal to combat money laundering from drugs crimes, until 2002 this was simply an intergovernmental body entrusted with the development and promotion of relevant domestic and international policies. However, at an extraordinary plenary held in late 2002, it broadened its mandate to encompass terrorist financing. More recently, FATF has formally acknowledged that financial exclusion is a money laundering and terrorist financing risk: this is detailed in its 2012– 2020 mandate (FATF, 2012).

FATF rules necessitate the use of careful documentation and procedures to verify the identity of clients; these are based on KYC and CDD, with the latter seen as a subset of the former.[11] Based on a survey conducted by the World Bank, Allen et al. (2012) note that tedious documentation requirements are the reason — reported by 17 per cent of adults— for not having a formal bank account. [12] One response to this, by some countries, has been to offer simplified accounts. These 'no-frills' accounts are suited to FATF guidelines because they limit transaction frequency and quantities; they thus allow the issuing bank to take a risk based or 'proportional' approach to KYC, which assumes that the risk from low value transactions is inconsistent with the need for onerous documentation (FATF, 2014). However, as de Koker (2011) explains, such

11 CDD or Customer Due Diligence is an information gathering exercise to assess the extent to which the customer exposes it to a range of risks: these include money laundering and terrorist financing.

12 Of over 65,000 adults who participated in the study (Allen et. al. 2012) . Other reported reasons: "[banks] are too far away" (20 percent); "[I] don't have the necessary documentation" (17 percent); and "[I] don't trust [banks]" (13 percent); "because of religious reasons" was cited by 5 percent of adults; and "someone else in the family already has an account," which identifies the group of indirect users (23 percent) (Allen et. al. 2012).

products almost invariably have rigid usage restrictions, such as caps on transaction amounts, injunctions on cross border transactions, and limits on frequency and maximum balances: while these accounts serve basic needs they are not flexible enough to meet the diverse needs of the underbanked, particular in the case of emergencies, illnesses, or other unforeseen circumstances.

> 'The CDD principles and the related "KYC" language reflect an era of banking where bankers and clients had personal relationships, where accounts were only opened after introductions and interviews and where transactions were primarily processed by persons who knew the client and could be struck by patterns of transactions that are at odds with their knowledge of the client' (de Koker, 2011: 368).

The poor face indignity and disrespect when accessing financial services

Mainstream commercial banks and microfinance banks often occupy neighbouring physical spaces. The issue of indignity and disrespect here speaks to a key puzzle; why are the financially excluded — particularly in urban centres where geographical proximity is not a constraint — unserved by mainstream commercial banks? One answer to this: rude staff. Client surveys— reported in the grey literature as well as academic research —indicate that this is a routine occurrence for clients and potential clients of mainstream institutions (Anjum et. al, 2017; Qureshi and Jalbani, 2012; de Montoya and Haq, 2008).

Anjum et al. (2017) demonstrate through an econometric study that staff behaviour is a key factor dampening consumer satisfaction. Qureshi and Jalbani's study on enterprise loans makes a related observation:

> 'There were political involvements in the process of loan sanctioning. Most of the participants stated that the loan processing time was a big problem. Regarding customer dealing, many participants expressed that the behavior of the concerned bank officers was bureaucratic and typically rude, while some had no issue with respect to customer service' (Qureshi and Jalbani, 2012: 87).

Haq and de Montoya (2008) report how survey participants 'often noted that they lacked the knowledge needed to understand bank services, were intimidated by them, and felt disrespected by bank staff'. Similar findings are made by Abbott and Rwakabamba (2010) for Rwandan banks, and by Honohan and King (2012) in a cross country analysis of Africa: these indicate that habitual encounters with rude staff are not unique to Pakistan.

Like mainstream institutions, microfinance institutions too may compromise the dignity and respect of clients, particularly when they are borrowers. This happen because of direct confrontations initiated by bank staff but also indirectly when co-borrowers as well as family members, neighbours, friends, and acquaintances are

involved. The use of such shaming techniques to reduce late payments and delinquencies has been criticised extensively (Mader 2015; 2017; Hina, 2014; A. Roy, 2010; Karim, 2008) not least so because antagonistic loan recovery techniques undermine the claim that microfinance can empower women. Ananya Roy illustrates this with a quote from Goetz and Sengupta's study on rural credit in Bangladesh, in which it is noted that lenders prefer women clients. This is because they are:

> '...are easy to locate, being much less able than men to leave a locality temporarily to evade field workers, and they are easier to intimidate into repayment than men, who can always threaten violence. In effect, the household is internalizing the high transaction costs of lending to men . . . These costs are primarily those of monitoring men's loan use and enforcing regular repayment. Women in effect offset these costs by using intrahousehold gender relations of obligation or persuasion to recover weekly loan repayments' (Goetz and Sengupta 1996: 55 cited in A. Roy, 2010).

A recent push for 'dignity and consumer protection' (CFI, 2017; CGAP, 2017) can be attributed to the negative attention drawn to microfinance because of coercive practices. Results from a cross country analysis done by the Smart Alliance — an initiative to promote respectable banking — show that clients in various countries are dissatisfied with how staff treat them.

> 'A basic demand from clients is for respectful and humane treatment. In Pakistan and Benin, clients complain that MFP staff lack human decency in dealing with clients who have problems paying their loans. Clients view the public shaming that is used in Benin and Pakistan extremely unfavorably. In Peru, 26 percent of clients report that MFPs do not treat clients equally, favoring those who are better dressed or who have personal connections to MFP staff. Poor service quality is not unique to financial services: respondents reported that nearly all formal institutions they interact with, such as schools, clinics, and police, treat them badly and like inferiors' (Meka and Sanford, 2016: 6).

The issue of problematic staff behaviour may be theorised as a class issue: it has a wider context in the literature on class structures. For instance, the anthropologist David Graeber, commenting on the rise of the professional managerial class, notes how mass indebtedness — an outcome of the financialisation of housing and higher education — had a severe impact on imagined class positions:

> 'An easy rule of thumb is: if you see a policeman on the street at night and feel more safe, rather than less safe, chances are you're middle class. This would anyway explain why most people in, say, Pakistan or Nigeria do not feel middle class, and most people in the United States, traditionally, have done. But one paradoxical result of financialization is that this is reversing. One recent survey revealed that for the first time, most Americans no longer consider themselves middle class. It's not hard to see why. If you find yourself facing eviction from your house, owing to an illegal robo-signing foreclosure that the government refuses to prosecute—even though armed government agents are, nonetheless, willing to arrive to actually expel you from your family home—then it doesn't really matter what your income level is. You will not feel particularly middle class. And millions

> of people are now finding themselves in this or in analogous situations' (Graeber, 2014: 76).

By attributing class experiences to 'vulgar Foucaldianism', where 'games of power create social reality itself', Graeber (2014) offers a lens to study poor countries as well: these did not — for various reasons, including colonialism — experience the social levelling and flattening of traditional hierarchies following the great depression and the crisis of two world wars (Halperin, 2013). For most clients and many providers of inclusive finance in Pakistan the understanding is, that equal terms of service for poor and non-poor clients, and respectful and courteous treatment at all times from staff is unlikely in the absence of considerable social change.[13]

The poor have limited options for recourse

The oppressive practices of lenders came to be seen as a dire problem, a decade or so ago, when repayment pressures following the global credit crunch, threatened an industry wide collapse. The prevalence of farmer suicides occurring across rural India and particularly in the state of Andhra Pradesh (Taylor, 2011), is associated with the debt traps that are described below:

> 'Beginning in the early 2000s, the industry began to display an "irrational exuberance" – a dramatic proliferation in MFIs, accompanied by an aggressive approach to extending the borrowing base – accompanied by increasing reports of the use of coercion. The pressure to repay, coupled with the increased availability of credit from a multiplicity of lenders, resulted in "overlapping" – or borrowers taking loans from one MFI to pay back another – and thereby getting caught in a debt-trap'(Haldar and Stiglitz, 2014: 5).

The response by the inclusive finance industry, to reports of mistreatment, has been to emphasise the importance of consumer protection, particularly of a nature that can be enforced outside of a formal judicial system. The costs of going to court tend to be high in relation to the relatively small sums of money in question making consumers prone to either not lodging, or abandoning complaints against lenders (Rutledge 2010). CGAP — the Consultative Group to Assist the Poor — suggests that this a predicament associated with base of pyramid (BoP) clients and markets and that it may be remedied through non-judicial means of recourse (CGAP, 2013).

This problem of the disengagement between the aggrieved poor and formal institutions has not been a salient feature of multilateral initiatives such as the G20 Principles of 2009 (GPFI, 2018) and the Maya Declaration of 2011 (AFI, 2017): both these agreements underscore that consumer protection is an essential feature of financial stability but do not attempt to remedy the matter of inadequate legal institutions in poor countries. Susanne Soederberg describes such initiatives, which are both

13 Private communications with microfinance practitioners in Karachi (August, 2017)

transnational and voluntary, as obfuscating the power relations that underlie inclusive finance: part of a global financial inclusion agenda, these are enshrined in a 'neoliberal-led global development project and finance-led capitalism' and also rely on an uneven balance of power between debtors and creditors (Soederberg, 2013: 599).

Recent data from the Smart Campaign (2017), which employs a cross country qualitative methodology to survey clients of microfinance, indicates that less than a quarter of aggrieved clients actually file a complaint and report the need for more channels, particularly beyond the loan officer (Meka and Sanford, 2016).[14] Specifically for Pakistan, the limits of recourse for customers of inclusive finance became acutely felt from fraudulent digital transactions and cyber-attacks on financial institutions: in cases where funds were transferred from commercial banks to microfinance banks and mobile money accounts, victims were limited in redress because the jurisdiction of the government ombudsman does not extend beyond commercial banks (Dawn, 2017).

The poor lack essential information about financial services

In responding to these negative consequences of financial inclusion, international organisations have emphasised the need for 'responsible finance', which CGAP (2011) describes as mutually beneficial for consumers and providers — as well as funders — of financial services. This draws on the mainstream corporate premise that 'the best way for corporations to do well is by creating shared value for customers and communities as well as shareholders'(Porter and Kramer, 2011 cited in CGAP, 2011).

Underscored in this concept, is the vital point that the poor have limited literacy, limited formal education, and limited financial knowledge (CGAP, 2011). Such a description is euphemistic because in many of the countries where microfinance usage is common, literacy rates are very low.[15] For example, in Pakistan only 57 per cent of adults over the age of 15 are considered literate, this is 73 per cent in Bangladesh, and 69 per cent in India[16].

Once widely acknowledged however, lack of information about financial services was confronted in the Global South with tools that were tried and tested in the Anglo-Saxon countries.[17] These had previously been applied in the late 1990s and early 2000s to offer financial literacy education as a remedy for high levels of consumer debt and complex financial products (Wolf, 2018) and appear to inform the OECD position as well:

14 With respondents from Pakistan, Peru, Benin, and Georgia

15 Adult literacy rate is the percentage of people ages 15 and above who can both read and write with understanding a short simple statement about their everyday life. For more details on measuring literacy please see https://data.worldbank.org

16 Based on UNESCO Institute for Statistics data which is available at https://data.worldbank.org

17 For instance in the United States the Jump$tart Coalition for Personal Financial Literacy: https://www.jumpstart.org/. And in the United Kingdom, Young Money (formerly pfeg) https://www.young-money.org.uk/

> 'For one thing, the growing sophistication of financial markets means consumers are not just choosing between interest rates on two different bank loans or savings plans, but are rather being offered a variety of complex financial instruments for borrowing and saving, with a large range of options. At the same time, the responsibility and risk for financial decisions that will have a major impact on an individual's future life, notably pensions, are being shifted increasingly to workers and away from government and employers' (OECD, 2006).

Later, in 2008, the OECD-backed Russia Trust Fund for Financial Literacy and Education was set up to support the advancement of financial literacy and capability programmes in low and middle-income countries: funding was provided by the Ministry of Finance of the Russian Federation, and the World Bank (OECD, 2018). This was followed by the OECD International Network on Financial Education project (OECD/INFE) which began in 2009. Recent survey results from an OECD led financial literacy survey indicate that weak financial literacy is not a phenomenon exclusive to the consumers of microfinance (OECD, 2016).[18]

> 'On average, just 56 % of adults across participating countries and economies achieved a score of at least five out of seven (considered to be the minimum target score), compared with an average of 63 % across OECD countries, indicating that many adults around the world are currently unable to reach the minimum target score on financial knowledge'(OECD, 2016: 9).

These gaps in financial knowledge — a component of financial literacy — create the justification for financial education: in the OECD context this tends to refer to 'the introduction of financial education into the school curriculum and the design and implementation of dedicated learning frameworks' (OECD, 2013: 3).

For instance, with the support and collaboration of various organisations including the Asian Development Bank, Pakistan Microfinance Network, and the Pakistan Poverty Alleviation Fund, Pakistan's central bank launched a Nationwide Financial Literacy Program (NFLP) in 2012 (SBP, 2012). Yaseen Anwar, who was at that time the governor of the State Bank of Pakistan, described the need for financial education as a 'demand side solution' to the bottlenecks that impeded financial inclusion, noting that 'the very low level of financial awareness and confidence of financially excluded groups remains a strong barrier to their access and use of financial services' (SBP, 2012: 2).

Such initiatives have been equated by Wolf (2018) to the mechanisms that enable a curated suite of ideas to influence policy design: this is a key theme in the work of Ban et al. (2016) on the role of international organisations in global financial governance. However there are key differences that become apparent in the execution

18 Countries and economies that participated in the survey are Albania, Austria, Belarus, Belgium, Brazil, British Virgin Islands, Canada, Croatia, Czech Republic, Estonia, Finland, France, Georgia, Hong Kong, China, Hungary, Jordan, Korea, Latvia, Lithuania, Malaysia, the Netherlands, New Zealand, Norway, Poland, Portugal, the Russian Federation, South Africa, Thailand, Turkey, United Kingdom.

of transmitted policies of this nature. For instance, unlike in the OECD countries, financial education in the official Pakistani context refers to central bank organised ‘financial workshops for low-income Pakistanis across the country’ (NLFP, 2012). Policy design here reflects the reality of a weak educational system that makes financial education at the school level unfeasible; a reminder of the gap that is difficult to address outside of a state directed effort.

The poor pay more for financial services, particularly loans and payments

Interest rates and their size are at the core of what makes microfinance controversial. As financial viability came to be a priority for microfinance providers, the line between microfinance and mainstream finance became blurred. Jonathan Morduch refers to this shift as ‘the microfinance schism’ where financial performance and social impact are incompatible: there is nevertheless backing for a supposed ‘win-win proposition’ where the principles of mainstream banking ensure wider client coverage despite high interest rates (Morduch, 2000). This ‘double bottom line’, though sought by many practitioners, has proven elusive (Tyson, 2012). Grameen Bank founder, Muhammad Yunus, interviewed shortly after the 2007 initial public offering of Mexican microfinance giant Banco Compartamos — an institution known to charge poor clients triple digit lending rates — expressed dismay at this situation:

> ‘”When you discuss microcredit, don't bring Compartamos into it”, he instructed. “Microcredit was created to fight the money lender, not to become the money lender”’ (Bloomberg, 2007).

High interest rates in the microfinance context refer to rates that are considerably more than those charged by mainstream banks for lending. This incongruity is defended by two arguments. The supply side justification attributes expensive loans to administration, particularly operating expenses, as small loans cost more per dollar lent, to administer than larger loans (Rosenberg et. al, 2013). The demand side argument is the same noted by Morduch (2000: 617): microfinance providers are drawn to outreach rather than impact because of the assumption that ‘poor households demand *access* to credit, not “cheap” credit’.

Interrogating the ethics of exorbitant interest rates on microloans, Sandberg (2015) takes a sympathetic view of this discrepancy, though stressing that it should not exist at all: he argues that the onus of lowering rates should fall not on microfinance providers but on other stakeholders such as governments and the international political community. This draws on Helms and Reille’s (2004) observation that investments in telecommunications, roads, and education are a more feasible approach — compared to subsidies and interest rate ceilings — for making lending fairer. A key reality touched upon earlier, in the context of education, is echoed here: many disparities originate when the state eschews a developmental role.

In addition to paying more for loans, the poor are also charged high amounts for payment services, such as for transferring money across different locations or paying bills. Such transactions have been made possible through financial inclusion initiatives based on digital technology or mobile money. But mobile money is expensive and this is noted even by CGAP (2017: 1): 'If a movie were made about financial inclusion, chances are mobile money fees would be cast as the villain'.

Costly transactions — often amounting to over 10 per cent of total value — may be attributed to pricing structures (Holloway et. al, 2017). Three types prevail: (1) slab based pricing, where transactions within a predefined range are charged a flat fee; (2) percentage based pricing, whereby the user pays a flat percentage of the amount sent, regardless of amount; and (3) free, with no transaction cost incurred by the user. The most widely used of these is slab based pricing; it facilitates transparency by evading the need to calculate fees based on variable amounts so is particularly useful for a clientele with limited literacy. But, slab based pricing also tends to be the most regressive structure as the smallest transactions become the most costly in percentage terms.

Mobile money providers justify high rates on the basis of heavy investment costs. Scale in this industry may only be attained through massive investments in agent networks (Aron, 2017): these include the training and monitoring of the personnel that facilitate over the counter transactions. Despite this arrangement, there is a strong push from governments and international organisations to promote financial inclusion through mobile money to overcome the constraints on access to mainstream banks: 'Prohibitive distances to the nearest financial services point, high costs of account maintenance, and fees for effecting transactions all exclude the poor from the formal banking system' (Logan, 2017).

The poor struggle to transition from inclusive finance to mainstream finance

Transitions from inclusive finance to mainstream finance have not been the subject of quantitative data; consequently it is difficult to comment on how frequently users of inclusive finance become users of mainstream finance. However, as documented in a cross country study by Shankar (2016), the presence of a 'missing middle' in Pakistan, India, and Bangladesh indicates that a lack of funding options might constrain borrowers seeking loans larger than those available from inclusive finance when 'needs fall in between the typical loan sizes offered by MFIs and commercial banks'. This use of missing middle terminology to describe the lack of financing options for firms is relatively recent: in the past it has been used to refer to the 'disproportionately small number of small and medium-sized enterprises as compared with the number of micro and large enterprises in many developing countries' (Tybout, 2014; Hsieh and Olken, 2014; Ayyagari et al. 2003).

As such, the missing middle appears to ensue from unavailability of an intermediate loan size; a problem that may be described as one of graduation or when microfinance clients 'outgrow' microfinance.

> 'With maturity of the microfinance sector, there are likely to be some "MFI graduates" who need to be serviced by another institution in the system. These borrowers are still too small to avail themselves of small and medium-sized enterprise (SME) credit from commercial banks, but their loan sizes are often far higher than the upper threshold of microcredit' (Shankar, 2016).

Loan sizes are a contentious issue because they are assumed to proxy household poverty: lenders that show a pattern of issuing larger loans are accused of 'mission drift' through a preference for less poor borrowers (Mader, 2015; Ashta and Hudon, 2012; Sinclair, 2012; Mersland and Strøm, 2010).[19] This assumption has been questioned by some microfinance practitioners who contend that a pattern of rising loan sizes is not to be construed negatively, and indicative of borrowers who gradually improve in terms of repayment, and lenders who manage risk by initially lending small amounts (CGAP, 2010). According to this argument, larger loans are reflective of mission success rather than mission drift.

Even if a progressive shift is used to make the — potentially tautological — claim that borrowers enhance their opportunities by borrowing more, there are two realities that suggest a less promising situation.[20] One of these is multiple borrowing — the tendency to borrow from multiple institutions — which is associated with over-indebtedness and also systemic risk from deteriorating portfolio quality (Tilakaratna and Hulme, 2015; Schicks, 2013). This phenomenon was the source of alarm when a number of farmer suicides were reported in India's Andhra Pradesh (Mia, 2017; Taylor, 2011). Over-indebtedness is, to a large extent, found to arise from the practice of borrowing from one institution to repay another (Mia, 2017; Mader, 2015; Schicks, 2013; Sinclair, 2012).

The other reality is loan limits; these tend to be imposed statutorily in a number of countries with tightly regulated microfinance sectors, including Pakistan (SBP, 2017c) and India (2015). Loan size limits have recently been increased in both countries and such measures are ostensibly a response to a consensus — evident in a burgeoning grey literature — from international organisations; particularly the World Bank and IFC. This sees small and medium size enterprises (SMEs) as the engine for GDP growth and employment and places a heavy emphasis on the role of finance in promoting these firms (Beck and Demirguc-Kunt, 2006; Nenova et al., 2009; IFC, 2017). This stance is also reflected in the efforts to introduce a separate category of 'micro and small enterprise lending' (MSEL) in Pakistan (Aslam, 2013); and also the Reserve Bank of

19 The concept of mission drift is commonly used in the charitable or non-profit sector to describe a situation in which funding strategies shape or alter organisational objectives. Bennett and Savani (2011) describe this in the context of reduced access to government support.

20 A potential tautology exists because larger loans cause more consumption which is associated with a higher living standard.

India's (RBI) introduction of a separate license for the category of 'Small Finance Bank' (RBI, 2014).

Such measures to address the restriction of limits on borrowing are taken under the assumption that larger loans are for enterprise growth and not consumption growth, including home purchases. It is also noteworthy that the response to constraints on transitions from inclusive to mainstream finance, has not been to seek reform of either inclusive finance or mainstream finance but to introduce a new and separate layer of regulation.

1.4 FINANCIAL CITIZENSHIP FROM INCLUSIVE FINANCE?

The issue of poverty is a central feature of financial inclusion as discussed above. The attribution of financial exclusion — and of the presence of unbanked communities — to poverty or the circumstance of 'being poor' is not an innovative practice. For instance in their study of the impact of microfinance in Asia and Latin America, Montgomery and Weiss (2005: 5) describe lack of access of credit as 'understandable in terms of the absence of collateral that the poor can offer' as well the ' high costs involved in dealing with large numbers of small, often illiterate, borrowers'. This same position is articulated in the financial diaries tracked by the authors of 'Portfolios of the Poor: How the World's Poor Live on $2 a Day' in which a quasi-ethnographic approach is applied to study the poor, in the light of how they manage their finances (Collins et al., 2009).[21]

This is an endogenous view of inclusive finance because the key assumption is that a demand for inclusive finance — and not mainstream finance — arises from the specific needs of the poor. The alternative to this is an exogenous view in which the demand for inclusive finance is an outcome of how the financial system is structured. This perspective is thus centred on the supply of mainstream financial services — or their absence — because it attributes financial exclusion to the structures and approaches of the mainstream banking industry.

These structures and approaches are associated by Gary Dymski with financial globalisation: particularly in the 1990s this had homogenising effects on consumers as global financial institutions widened their reach and began offering traditional banking services— namely those that had already been available in the US for over a decade — in new markets (Dymski, 2005). But homogenisation of this nature is shown have a distinct class element as Dymski (2005: 443) observes that there is a difference between 'homogenization within class' and 'homogenization across classes'. This analysis draws on Philip Cerny's suggestion that financial globalization may also be measured by organizational changes (Cerny, 1994) which is extended to note that the financial practices and products of globalised firms contribute to financial exclusion.

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21 Based on the analysis of personal diaries which track all the financial transactions of selected households in Bangladesh, India, and South Africa between 1999 and 2005; only 250 diaries are studied so the scope for quantitative analysis is limited.

For instance, the risk-management and information technology tools that were once used by banks for corporate clients were adapted for new models of consumer banking: as a result, relatively affluent customers are targeted by banks to 'cross sell services and aim at nurturing brand loyalty and 'one size fits all' services for the customers of their 'upscale retail banking' activities' (Dymski, 2005: 449). Additionally, cross subsidies have been impeded by the explosion of choice available to blue-chip clients, who can as a result no longer be made to implicitly support loans for smaller clients (Dymski, 2005). Cross subsidies continue to be offered across markets but within customer class for those whose business is sought for multiple products: those clients who have only the potential to consume a limited number of financial products are retained as customers but pay full price for a restricted set of services (Dymski, 2005).

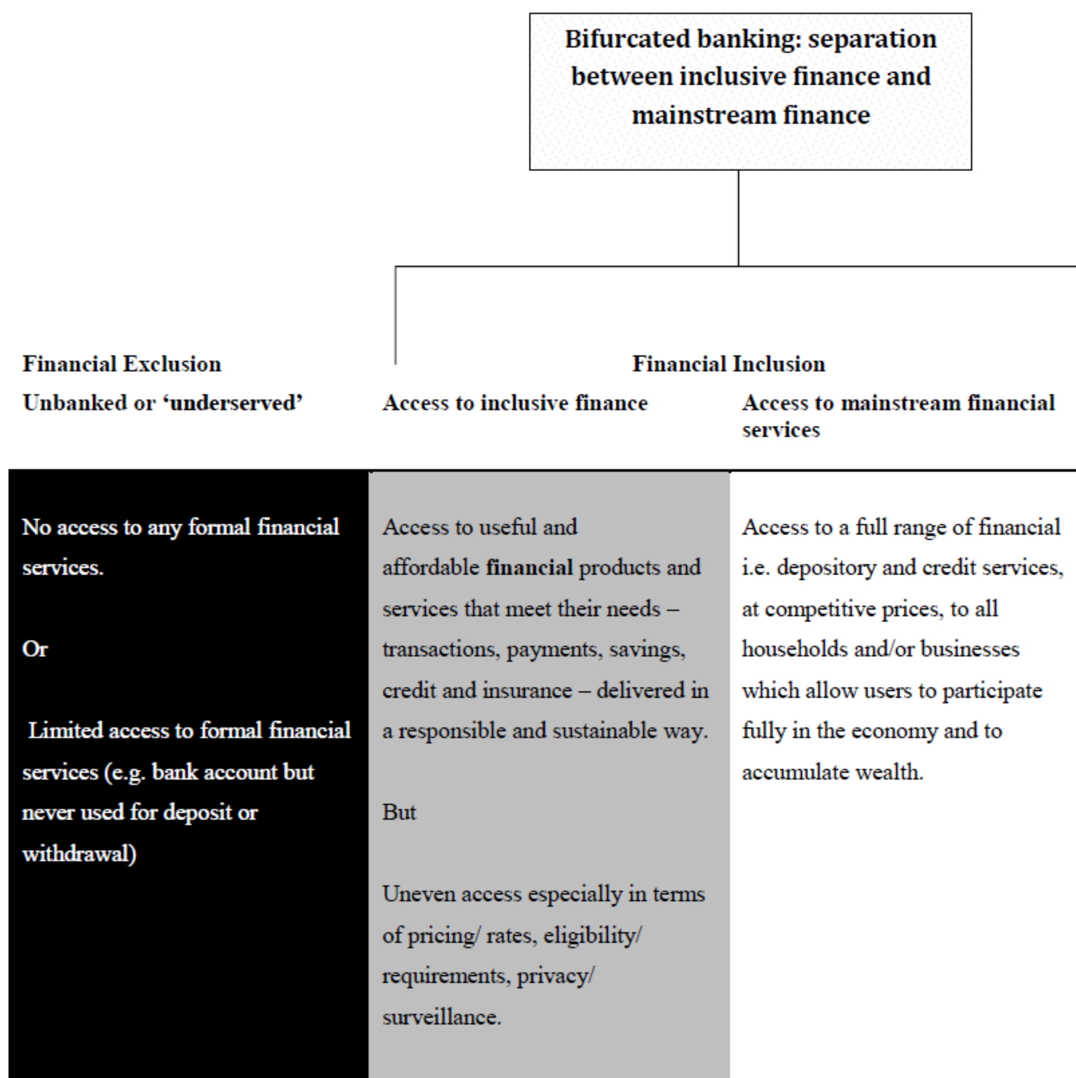
These observations draw on the literature associated with the British geographers, Andrew Leyshon and Nigel Thrift who attributed — in their seminal article on 'Financial Abandonment in Britain and the United States' — exclusionary banking practices to the response of financial institutions to a crisis of indebtedness and competition (Leyshon and Thrift, 1995). As a mode of resistance, they propose a notion of 'financial citizenship':

> '...as a means of putting pressure on states to reform their financial systems so that they include rather than exclude and of putting pressure on financial systems to realize that they have some state-like responsibilities which reach beyond consumer sovereignty into basic human right' (Leyshon and Thrift, 1995: 336).

Thus, the onus of countering financial exclusion is placed on the state and on financial systems. This emphasis is distinct from the contemporary agenda of financial inclusion, particularly in the sense of what Anke Schwittay describes as 'a global assemblage of subjects, technics, and rationalities that aim to develop poor-appropriate financial products and services' (Schwittay, 2011: 381). A financial citizenship approach is thus an alternative to the narrative of inclusive finance in which the consumers of such products are impeded by poverty in accessing the mainstream financial system. In such a context it is a departure from the perspective that financial access is impeded by poverty. The same financial exclusion that has been characterised as a problem of more advanced capitalist economies exists in poor countries as well.

The main premise of this research therefore, is that the concept of financial citizenship offers an apt tool to understand the grey area between access to mainstream financial services and financial exclusion: this indefinite space has tended to be overlooked in the existing literature on financial inclusion in poor countries. Financial citizenship is of course not a novel concept and many scholars, some mentioned above, and also others, have applied it to link uneven development and marginality (Kear, 2013) as well as subjectivity (Lai and Tan, 2015), with the politics of accessing and distributing finance. In the context of the Global South, except for recent work by Abdul Rahman et al. (2019), there has been limited engagement between the concepts of financial citizenship and uneven access to finance.

Figure 1: Bifurcated banking and the grey area between financial exclusion and access to mainstream finance[22, 23]



Compiled by author

1.5 SUMMARY

This chapter presents a concise history of what emerged in the late 1970s and early 1980s as the microcredit model and underwent various transformations. Contemporary inclusive finance is the outcome of these transformations. Much has changed in policies which seek to enhance financial access to the poor, but the problem of financial exclusion is nevertheless consistently seen as emerging from poverty and the circumstances associated with it.

22 See Klapper (2019)
23 See https://www.worldbank.org/en/topic/financialinclusion/overview

To probe the nature of financial inclusion, this chapter draws on existing studies, including the grey literature on financial access for the poor. A comparison of inclusive finance in relation to mainstream banking highlights the uneven nature of financial access. The salient features of this unevenness include the: (1) informal economy orientation of inclusive finance, (2) inconsistent disadvantages of 'know your customer' requirements, (3) patterns of indignity and disrespect which shape financial access, (4) limited options for recourse, (5) lack of essential information about financial services, (6) relatively higher rates and fees, (6) constraints to transitioning from inclusive to mainstream finance and banking.

Uneven financial access is expressed in the phenomenon of bifurcated banking. To query this further, there is a need for an appropriate conceptual framework that moves beyond an inclusion and exclusion binary and (1) seeks to identify the systemic facets of uneven financial access, and (2) to outline how the concept of financial citizenship is relevant for a poor country. An analysis of the exclusionary nature of the financial system is conducted over subsequent chapters to show how shadow banking — through inclusive finance — limits full financial citizenship. This impaired version of financial citizenship may be described as 'shadow financial citizenship' and is introduced in Chapter 3 as an analytical framework to discuss bifurcated banking. Before that, Chapter 2 describes the broader context of inclusive finance and its relation to the global financial system.

2. Development as Inclusion and Development as Finance

2.1 INTRODUCTION

The previous chapter notes how patterns of uneven access to formal financial services persist despite the traction gained by a market based model of inclusive finance. Such commercially oriented models are funded primarily by private capital. The implications of the role of private capital in inclusive finance are examined in this chapter.

The growing role of private finance in development combined with a strategic emphasis by development policymakers on poverty, and consequently 'inclusion' has come to underlie how inclusive finance is distinct from mainstream finance. Inclusive finance is the outcome of shifting development paradigms, particularly the Post Washington Consensus, and the approaches that followed it. These paradigmatic shifts underlie transformative processes. Through these, micro-credit, and then microfinance, subsequently financial inclusion, and eventually inclusive finance came to play a prominent role in contemporary development practice.

Inclusive finance, as a development intervention, is a product of the changing relationship between development and poverty reduction in which the latter has gained prominence over the latter. This re-conceptualisation has entailed a shorter term view of targets and outcomes and is captured neatly in Alice Sindzingre's remark that 'to speak of poverty is to postpone speaking of development' (Sindzingre, 2004: 176). This emphasis on poverty is troubled by the complexity of a concept which is at once economic, political, and sociological: it eventually resulted in a focus on inclusion. Initiatives that emphasise inclusive growth, inclusive development, and of course, financial inclusion reflect this focus.

This fixation with inclusion is discussed here as a component of the Post Washington Consensus; this has been followed by strategies extricated from the NSE or New Structural Economics framework (Lin, 2012), which have come to overlap with what has recently been labelled a 'Wall Street Consensus' (Gabor, 2019). These three approaches are brought together through an emphasis on institutions, but the type of institution each approach emphasises is different: the Post Washington Consensus highlights the need for safety nets, the NSE framework is — at least superficially — centred on a rejuvenation of industrial policy, and the Wall Street Consensus seeks to enable development interventions funded by private capital.

Private capital is probed in this chapter through a comparative discussion — on finance in general, and inclusive finance in particular — of heterodox and orthodox or

mainstream perspectives on the function of private capital in development. The idea that there is a sharp divide between orthodox and heterodox thought on inclusive finance is emphasised here to critique the role of inclusive finance in development. Inclusive finance as a form of financial deepening is a developmental tool because it is associated with higher GDP growth; but the use of a financialisation lens — in which inclusive finance is depicted as a financial innovation — uncovers what drives inclusive finance beyond the imperatives of economic growth and development. A core argument thus made here is that inclusive finance may be understood better as a financial innovation rather than a development intervention.

The remainder of this chapter proceeds as follows: Section 2.2 discusses responses to the Washington Consensus which motivate the fixation of development interventions with 'inclusion', Section 2.3 examines the significance of inclusive finance in the 'development discourse', Section 2.4 is about the 'financialisation of development', particularly the idea that private capital is instrumental to contemporary development strategies, Section 2.4 draws attention to the how financialisation — expressed through financial innovation and subordinated financialisation — is a key issue for development, and Section 2.5 offers concluding remarks.

2.2 DEVELOPMENT AS INCLUSION

Preoccupied with income poverty, the Washington Consensus approach has been to resolve both poverty and inequality through economic growth (Saad-Filho, 2010; Mehrotra and Jolly, 2000). Washington Consensus policies reflect principles of monetarism and new classical economics and between the mid-1970s and the late 1980s shifted development theory towards a 'trickle down' approach.[24]

> 'By the start of the 1990s, the apparent failure of this strategy, the rise of new institutional economics and growing pressure on the World Bank and the International Monetary Fund (IMF) by several country Governments, international organizations (including some United Nations agencies), non-governmental organizations (NGOs), universities and social movements compelled the mainstream and the international financial institutions (IFIs) to address the problems of inequality and poverty reduction explicitly once again' (Saad-Filho, 2010: 1).

The Post Washington Consensus (Birdsall and Fukuyama, 2011; Stigltiz, 2008) — which is reflected in the incorporation of Joseph Stiglitz's writings into the research publications of the World Bank — stresses on the need for institutions to address social

24 Saad-Filho (2010) compares the Washington Consensus to a Cold War pre-Washington Consensus that guided development policy under the World Bank presidency of Robert McNamara and sought to promote the economic infrastructure required for private sector-led industrialization. Dependency theorists contested such approaches, and argued for socialism because development and underdevelopment constitute 'two sides of the same coin'.

inequalities: however, market forces and economic growth are still considered the best strategy for poverty reduction (World Bank, 2000).[25]

> 'Development should no longer be a monopoly of economists. But the proposed post-Washington Consensus consensus can also be interpreted as simply a change to preserve the old order by making it more effective as well as more humane' (Gore, 2000: 800).

Despite an unwavering commitment by international organisations to market mechanisms, and growth, a consensus emerged among donors in the 1990s that poverty reduction was the overarching aim of development (Sindzingre, 2004). This was heavily inspired by the work of Amartya Sen, particularly his collaboration with Mahbub-ul-Haque, which resulted in the Human Development Index or HDI. This summary composite index captures education, health, and wealth income, which are assumed to be elementary aspects of the ability to live a full and meaningful life (Haq, 1995). Sen's work on 'capabilities' allows for poverty to be framed in a social justice context that augments Rawlsian concepts (Dean, 2009) and leads to the contention that poverty is not simply a problem of well-being but of an inability to pursue well-being because of deprivations. The capabilities approach is thus a powerful basis to argue that economic growth alone is insufficient for countries to attain a desirable position on the HDI. Access to finance may thus be seen as a tool to enhance capabilities to pursue well-being (Michel and Holimalala, 2018; Tseng, 2011): this is an extension of strategies that see poverty reduction as a goal, rather than as a by-product of growth.

The terminology of 'inclusive growth' and 'inclusive development' has roots in the idea of 'pro-poor growth': this latter term reveals the claim that not all growth is pro-poor (Rauniyar and Kanbur, 2010). The concept of pro-poor growth is somewhat complex and there are competing definitions of what it constitutes. Martin Ravallion (2004) identifies two definitions: pro-poor growth as growth in which poverty is reduced, and pro-poor growth as growth in which poverty is reduced more than it would have if all incomes had grown at the same rate. For Rauniyar and Kanbur (2010) the latter definition comes closer to a criterion of inclusive growth as measurable through the growth elasticity of poverty: this is done by converting poverty changes per unit of increase in per capita income into elasticity. The conflation of pro-poor growth with inclusive growth, and inclusive development — particularly in the form of donor funded interventions — is articulated in the literatures of the World Bank (Commission on Growth and Development, 2008) and the Asian Development Bank (Ali and Yao, 2004).

What poverty is, and how it may be measured, are questions that underlie a disconnect between macroeconomic theory and development practice. This is evident, particularly since the late 1980s, from the repeated attacks on the discipline of development economics not just for lack of mathematical rigour, but also for misgivings

25 Stiglitz was Senior Vice President and Chief Economist of the World Bank between 1997 and 2000.

regarding the Washington Consensus (Reinert, 2011). Development economics struggled with the mathematics of modelling imperfect competition and by the 1960s had clearly begun to disengage with what was gradually becoming a mainstream (Krugman, 2012). Additionally as Pierre-Richard Agenor observes, mainstream macroeconomics too could not prioritise poverty; with the disintegration of the Neoclassical-Keynesian synthesis the question of distribution came to be a secondary issue (Agenor, 2005).[26]

How does this 'inclusive' turn in development relate to inclusive finance? For Mader and Sabrow (2015) the rise of financial inclusion is a response — from stakeholders in the microfinance industry — to the failure of microenterprise lending and the related need to change the depiction of the microfinance industry as exploitative and ineffective.[27] Microenterprise lending was until a certain point, the core product of microfinance, as described in Chapter 1, but became less prominent as microfinance was likened more to retail or household finance and less to enterprise finance (Cull and Morduch, 2017). This shift reveals the growing distance between inclusive finance and the finance-led growth model associated with McKinnon (1973): that gained prominence in the 1980s with the endorsement of the World Bank (World Bank, 1989).[28]

This shift in focus underlies the 'strategic mission shift' implemented by the microfinance industry in response to three trends: growing criticism from new research, an embrace of 'financialisation and its new rationalised myths', and also the immense influence of the Consultative Group to Assist the Poor or CGAP, a think-tank organisation housed within the World Bank (Mader and Sabrow, 2015). A key action from the CGAP has been to align itself closely with the stance taken by Collins et al. (2009). This is discussed in Chapter 1 and contends that the poor need assistance not only in growing meagre incomes, as is already widely known, but also in managing irregular incomes: the gap between income received and income spent is the cause of consternation as well as impoverishment

> 'But over the past few decades we have also learned that poor households need access to the full range of financial services to generate income, build assets, smooth consumption, and manage risks—financial services that a more limited microcredit model cannot provide' (CGAP, 2018a).

The prominence of financial inclusion in the development discourse may also be attributed to two wider tendencies. One of these is the growing influence, which coincides with the launch of the Millennium Development Goals in 2000, on the notion of 'inclusion'. Interventions such as financial inclusion are endorsed by private, public,

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26 Generally, other than approaches that emphasise causality from GDP growth to poverty reduction, there are four approaches to studying poverty as an economic phenomenon. These are; unemployment, which is viewed as causally linked to poverty; consumption, prices, and inflation, which are related to the living standards of the poor; fiscal policy, which discusses the issue of redistribution; and marginal productivity theory which seeks to explain income differentials (Schaller, 2014).

27 Primarily the CGAP, Accion, and the ASA (Mader and Sabrow, 2015).

28 The World Bank view is orthodox and holds that financial development promoted economic growth: the heterodox view is summarised in Joan Robinson's claim that 'where enterprise leads finance follows' (Robinson, 1952: 86).

and nongovernmental organisations to facilitate the attainment of MDGs. The World Bank (World Bank, 2018) describes financial inclusion as an 'enabler' for seven of seventeen SDGs and also to 'reduce extreme poverty and boost shared prosperity'.[29]

The other is the process which Peck and Theodore (2015) describe as 'fast policy' to accomplish transformations of states and societies by mobilising policies across differing contexts, particularly from one economy to another. The concept of fast policy shines a light on how inclusive finance came to be embraced by development practitioners. But before the MDGs and fast policy can be discussed effectively, it is necessary to query the notion of development and of a development discourse.

2.3 FROM MODERNISATION TO MDGS

Financial inclusion as a development strategy is an example of 'the making of development' (A. Roy 2010). The concept of development is in itself contested and the most serious challenge to it is perhaps offered by the PD or Post-Development school. The PD school is sceptical of development because it is a concept weighed down by Eurocentric, depoliticising and authoritarian overtones (Escobar, 1995; Sachs, 1992; cited in Ziai 2013). Additionally, given how diverse the research on the topic is it might be considered unreasonable to refer to it as a unified whole, given the vast and diverse scholarship it encompasses. This includes literature by modernisation theorists and also dependency writers, as well as debates on balanced or unbalanced growth, export orientation or import substitution, and also capitalist or socialist development (Ziai, 2013).

The making of development

The concept of a development discourse emerges from a set of core and secondary assumptions — involving normative, practical, and methodological aspects of development — which underlie 'nearly everything that is written and spoken on the topic' (Ziai, 2013: 57). Some assumptions in this list include: goal specification because the Global South needs development, process specification because the Global South needs economic growth, industrialisation, and modernisation in order to become developed, and also process legitimation because development interventions have the legitimate backing of expert knowledge to attain a good society to improve the lives of the people (Ziai, 2013).

Ananya Roy notes that in recent times there is an ascendancy of a new global order of 'millennial development' which is distinct from the previously dominant approach of modernisation which assumed that all countries were at various stages of development with many in the process of 'catching up'.

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29 Another intervention used as a policy tool for MDGs is conditional cash transfers or CCTs: this has been the subject of critiques similar to those directed at financial inclusion for a tacit acceptance of 'the sexist, racist and capitalist structures and systems underlying poverty and exclusion' (Cookson, 2016: 1201).

> 'What is unusual about the present historical moment is that poverty has become visible as a global issue. The focus has shifted from the modernization of national economies to the alleviation of the poverty of the "bottom billion," the 1.4 billion people such as Felicita living under the threshold of the international poverty line. There is also a rapid globalization of the responses to poverty—from the global campaigns that are being waged to "make poverty history," to the global dissemination of poverty-alleviation "best practices," to the radical critiques that link poverty to the global economy and thus insist that "another world is possible" and necessary' (A. Roy, 2010: 6).

This globalisation of responses described above is contained within what Phillip McMichael describes as a switch from 'the development project' to the 'globalization project' (McMichael, 2011: 149). The development project was informed heavily by the experience of Europe following the Marshall Plan in the aftermath of World War II, which is the basis for a modernisation theory which is both teleological and Western-centric: the development project also relied on, and thus collapsed with, strategies reliant on the international economic arrangements of the Cold War (McMichael, 2011).[30] The globalisation project is portrayed as the successor to the development project and has replaced a focus on national economic growth with a focus on participation — or inclusion — in a global economy (McMichael, 2011). This is reflected in the manner in which development has become associated with the MDGs and SDGs and is evident in David Hulme's commentary on these strategies which are led by the United Nations.

> 'The shift that had been occurring in development over the 1990s, and confirmed at Copenhagen, was now being institutionalised. Development was no longer about national development (nation building, economic growth and general improvements in welfare). Rather, it was synonymous with poverty eradication (or reduction)' (Hulme, 2007: 8).

The Millennium Development Goals and subsequent Sustainable Development Goals — known as MDGs and SDGs respectively — are approaches to development that operate by setting specific targets in what are considered focal points in global poverty and inequality (UNDP, 2005). The MDG/ SDG focus thus showcases the concept of inclusive development and marks a departure from previous approaches to development and poverty reduction that were questioned for their income or GDP centricism. This movement for a more socially conscious form of development is examined by Porter and Craig (2004: 387) as a 'Polanyian turn within a wider liberal project, which seeks to re-embed and legitimate a liberal social and economic order': this is a response to policy neoliberalism in the 1980s and 1990s where discontent was fomented by the 'lost decade of development', debt and currency crises, recurring state failures, disintegrating social

30 Sandra Halperin observes that the 'notion of a division between a developed and a developing world emerged after 1945 precisely because it was only then that this developmental divergence occurred' (Halperin, 2013: 10)

services, persistent poverty in the Global South, violent anti-globalisation riots, as well as other occurrences. [31]

The MDGs were established in 2000 following the UN Millennium Summit held in New York: these committed nations to a series of time-bound targets including poverty reduction, with a deadline of 2015. In 2012 the UN Secretary General appointed a High-level Panel to advise on the global development agenda beyond 2015: this eventually resulted in the launch of the SDGs which called on countries to attain a series of seventeen targets by 2030. This emphasis on targets, set in quantitative terms, has been the subject of scepticism. Sindzingre (2004) sees MDGs as exemplifying the troublesome aspects of quantitative objectives, particularly the preclusion of scrutiny within the development discourse of poverty and inequality. For instance, a focus on halving global poverty within a time frame tends to avoid the discussion on underlying causalities — such as the impact of falling international prices on commodity exports — and where observations regarding causality are made, they tend to focus on association and thus circumvent analysis of systemic and structural mechanisms (Sindzingre, 2004).

Within the development discourse, inclusive finance has a direct link to the SDGs. This framing may be attributed to the World Bank, given that this organisation describes financial inclusion as an 'enabler' for seven of seventeen SDGs and also to 'reduce extreme poverty and boost shared prosperity' (World Bank, 2018: 1). Similarly, for the CGAP (2016) inclusive finance has a role as 'a means to an end' but also in facilitating the delivery of 'other social benefits and innovative private-sector solutions'. The role of international organisations holds special relevance in a study of inclusive finance because it offers an avenue to consider isomorphic practices in policy formulation as well as implementation. Isomorphism refers to a similarity of the processes or structure of one organization to those of another (DiMaggio and Powell, 1983).[32] Of particular relevance is the isomorphism between the policies around financial exclusion, as expressed in OECD countries, and financial inclusion, as a problem of poor countries. An analysis of how these concepts differ across geographies is a deficiency of the literature, on financial exclusion as well as on financial inclusion. This gap may be addressed by applying the literature on policy transfer, particularly relating to international organisations, to the notional relationship between financial exclusion and financial inclusion.

31 This period refers to the 1980s, particularly in the context of Latin America, the Caribbean, and Africa where debt crises had led to policies of fiscal austerity that were seen to have exorbitant social and economic costs: Hans Singer describes this event as 'Development in Reverse' (Singer, 1989).

32 DiMaggio and Powell (1983) discuss isomorphic practices in their study of organisational change in which they observe that various processes, other than competition and efficiency, causes structural change that makes organisations more similar to each other but less efficient.

Inclusive finance as 'fast policy'

The literature on policy transfer through international organisations views them as 'centres of policy diffusion that drive normative change' (Broome and Seabrooke, 2015). For instance, Bazbauers (2018) draws inspiration from Gramsci for a framework to study the tension between coercion and consent in international development assistance: particularly for the World Bank, the concept of technical assistance has evolved and engaged new labels such as technical cooperation and capacity building.[33] Broome and Seabrooke (2015: 956) examine how international organisations integrate training with technical assistance to ensure that policy implementation is carried out by 'sympathetic interlocuters'.

The involvement of international organisations in strategies of poverty reduction and development interventions draws attention to the phenomena of 'fast policy' (Peck and Theodore, 2015; Peck, 2011 Peck; 2011a). Fast policy describes the processes and practices through which policies from one setting are applied to another, given 'that the marketplace for social-policy ideas and models is deeply structured by powerful institutional actors and enduring asymmetries' (Peck, 2011a: 172). These dynamics are relevant here because they describe the political — rather than technocratic — nature of policy making. The presumption that policy making is overwhelmingly technocratic is expressed in what Jamie Peck and Nik Theodore describe as the orthodox view of policy transfer studies. This relies on a rational actor framework in which 'decision-makers more or less freely choose between policy models-cum-options, albeit with varying degrees of knowledge and uncertainty' (Peck and Theodore, 2015: 7).

Among the limitations of such an approach is that it overlooks how 'the definitions of problems or solutions are socially constructed' (Dolowitz and Marsh, 1996: 357). In the literature on policy transfer there is a distinction between pluralist and structural perspectives. Pluralist perspectives, which reflect the dominant approach and rely on a rational actor framework, tend to focus on the decisions taken by individual actors: structural perspectives focus on the constraints from institutional and structural inequalities (Dolowitiz and Marsh, 1996). There is thus a need for an approach which resists the tendency to overemphasise the role of intentions and of politicians and bureaucrats: an alternative approach would account for structural and economic factors and view policy making as a messy and complex process (Peck and Theodore, 2015; Benson and Jordan, 2011; Dolowitz and Marsh, 1996).

Peck and Theodore (2015) use such an approach to study two policy interventions which they describe as transnationally connected: conditional cash transfers and participatory budgeting. Both these policies have Global South roots but eventually came to be 'hybridized or customized in locally specific ways' (Peck and Theodore, 2015: 225) with conditional cash transfers becoming the policy choice of New

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33 Described so because of Antonio Gramsci's contribution to political theory which expands on the view of the state through an analysis of politics as coercion and consent.

York City's Mayor Michael Bloomberg, and participatory budgeting coming to be seen by the World Bank as a 'corruption-resistant guarantor of transparency' for auditors and accountants and also 'as a model of good governance' immune to macroeconomic turbulence (Peck and Theodore, 2015: 167).

These examples demonstrate the aptitude of the policy transfer literature to see policy development and political decision-making as shaped by globalised markets and transnational interdependence. Of particular interest is the resistance such approaches present to the role of coercion. For Garrett et al. (2008), coercion — along with emulation, learning, and competition — is one of four causal mechanisms of international policy diffusion. Each of these mechanisms explains, to varying extents, how policy formations are not endogenous to nation states (Peck and Theodore, 2015).

In this approach, emulation and competition are identified as two causal mechanisms with the strongest explanatory capacity. Emulation is revealed in 'follow the leader' models where policymakers imitate the strategies of successful and powerful actors and/ or institutions, or in the form of 'expert theorization' when epistemic communities express their support for policies and the transactions through which they are disseminated: competition in diffusion occurs because of pressures, in a market setting, to attract investment given limited and mobile resources, and is often manifest in 'race to the bottom' regulation pertaining to the environment or welfare (Peck and Theodore, 2015: 21-23).

The other two mechanisms are learning and coercion. Learning is described as a situated social construct because learning models assume that successful policies will be replicated and failed policies deliberately avoided: but the identification of successes and failures is not objective and thus contingent upon specific paradigms and belief systems (Peck and Theodore, 2015: 22). Coercion models account for power asymmetries and explain the diffusion of policy formed under pressure from powerful nation states or institutions, for instance the IMF or the EU (Maggetti and Gilardi, 2016): but because of the complexity of distinguishing cause from effect, it has been difficult not only to identify where coercion has occurred, but also to determine whether it has been effective (Peck and Theodore, 2015: 24).

A key argument made by Peck and Theodore (2015) relates to the need for approaches to study policy diffusion in a geographical context. Because a study of fast policy is an endeavour to 'follow the policy', it responds to the need for a geographical lens, which Peck and Theodore (2015) utilise for two specific case studies: conditional cash transfers and participatory budgeting.

Given development interventions, 'spatial interconnectedness' is central to Gillian Hart's opposition to the view that policies — those described as neoliberal capitalist — were transmitted from 'the 'core' and spread from there to the 'periphery' (Hart, 2010: 117). Ananya Roy draws upon these observations to interrogate the notion of an 'Asian Century' which entails the participation of global consulting forms and

conceptualisations of inclusive growth (A. Roy, 2016).[34] In earlier work, 'Poverty Capital' A. Roy (2010) takes a 'follow the policy' approach to reveal how global financial markets are constructed. Particularly relevant is A. Roy's coverage of knowledge production — which is portrayed as a public good — and its control by the World Bank and its subsidiary, the CGAP. The CGAP, it is noted, is engaged through its knowledge products in transforming the microfinance model associated with Bangladesh and the Grameen Bank, to one that is a component of a global financial industry:

> 'What is at stake here is a crucial shift from the idea of development as social services and the improvement of human capital to development as integration into global financial markets' (A. Roy, 2010: 47).

There are, as yet, no studies that examine the geographical mobility of policies related to financial exclusion and inclusion. While it is outside the scope of this dissertation to address this gap, the transnational connectivity between these policies highlights the contested nature of inclusive finance as a development intervention. Policies designed around financial exclusion and financial inclusion seek to address similar problems but a key distinction between the two terms is this: financial exclusion is used mostly for advanced capitalist countries and financial inclusion is used mostly for poor countries.

The earliest description of financial exclusion is attributed to Andrew Leyshon and Nigel Thrift, who in their seminal article use the term to refer to those 'processes that prevent poor and disadvantaged social groups from gaining access to the financial system' (Leyshon and Thrift, 1995: 312). Devlin (2005: 75) uses a description in which financial exclusion is 'a situation where a proportion of the population have limited access to mainstream financial services'. The contrast between these two descriptions of financial exclusion is noteworthy because in one it is attributed to processes and in another it is a situation. These approaches often overlap. Thus, a consistent theme in the academic research — based on Britain as well as the United States — is the relationship between the situation of financial exclusion and processes such as financial infrastructure withdrawal (Dymski and Veitch, 1992; Leyshon and Thrift, 1994), 'the mismatch between domestic financial regulation and the requirements of competition in retail markets' (Pollard, 1995: 1209) and 'the global homogenization and stratification of financial practices' (Dymski, 2005: 439). The debate on financial exclusion in the early 1990s was mostly about physical access to banks — or the geography of financial services provision — but eventually it became broader, drawing attention to the dimensions of financial exclusion, the people who experience it, and the ways in which it occurs (Lowe et al, 2016; Kempson et al., 2000).

In Europe and particularly in Britain, the concept of financial exclusion is closely linked to that of social exclusion: what Naila Kabeer describes as 'northern social policy discourses' (Kabeer, 2000). Social exclusion, given its multi-dimensionality, is

34 The Asian Century refers to projected ascendancy of some Asian countries in the 21st century because of economic prowess and an influential middle class. See ADB (2011)

offered as an alternative to the of concept poverty. This substitution is problematised by the Norwegian scholar of poverty, Else Øyen:

> 'Let me start by saying that neither social exclusion, nor social inclusion, are analytical concepts. They are political concepts, and they have been introduced for political reasons. The original concept launched by the European Union's Targeted Socio-Economic Research (TSER) programme was poverty. Apparently the politicians found this concept too loaded, so they asked for another concept and were satisfied with social exclusion/inclusion' (Øyen, 1997: 63).

In the policy discourse then, financial exclusion is presented as one of the dimensions of social exclusion. This is so even though the concept of financial exclusion pre-dates the concept of social exclusion (Kempson et al., 2000). When the Labour Party came to power in the United Kingdom in 1997, the eradication of various exclusions — derived from ethnicity, gender, sexuality, disability etc. — was central to their vision of social justice and government prerogative (Finlayson, 2009). The eradication of financial exclusion had a special role to play in the provision of an 'asset based welfare model' associated with the retrenchment of welfare (Finlayson, 2009; Berry, 2015).[35]

> 'From the early twentieth century onwards, the welfare state offered novel protections to individuals against socioeconomic risks, propelled by the notion of social citizenship. But in recent decades, citizenship has become 'responsibilised' as the state inculcates into everyday life the need for greater self-reliance' (Berry, 2015: 522).

This 'responsibilisation' imperative is replicated in the inclusive finance strategies of the Global South, where loans for poor individuals and households are framed as social policy: instances of this are noted by Mader (2015) for India, and by Lavinas (2018) for Brazil, and are a recurring theme in CGAP publications, particularly those preceding the various microfinance repayment crises that occurred between 2009 and 2011:

> 'Microfinance—or formal financial services for the poor—helps people fight poverty on their own terms, in a sustainable way. Poor people use loans, deposits, and other financial services to reduce their vulnerability, seize opportunities, and increase their earnings. Indirectly, microfinance improves schooling, health, and women's empowerment' (CGAP, 2006: 1).

Another instance of where policies related to financial exclusion and inclusive finance overlap is in the growing influence of the financial sector on poverty reduction strategies. Various scholars observe that in the United Kingdom, steps taken to counter financial exclusion by the government under Tony Blair, are directly linked to the 'wider financialisation process—the inclusion of ever more people in the financial markets from sub-prime lending to the creation of savings accounts for those otherwise

35 As such, Tony Blair's fixation with 'human potential' is a reflection of what Alan Finlayson calls 'a utilitarian justification for the pursuit of social justice', in which individuals are enabled to contribute more in terms of productivity and thus use up less of the common resource and welfare (Finalyson, 2009: 405).

detached from the industry' (Finlayson, 2009: 414): this is characterised by the increased financial participation of individuals, and also by a state which abdicates its role in shaping macroeconomic structures through welfare (Berry, 2015). The influence of the financial sector in poverty reduction efforts in the Global South is captured in Heloise Weber's argument that microcredit facilitates financial sector liberalisation and the expansion of global finance (Weber, 2002: 537), and also in Ananya Roy's exposition of the construction of global finance markets (A. Roy, 2010). This finance and development nexus came to be institutionalised in the FfD or Finance for Development agenda, largely due to the backing of the United Nations in the early 2000s.

2.4 FINANCE FOR DEVELOPMENT AND THE FFD AGENDA

The Finance for Development or 'FfD' agenda is closely tied to the Millennium Development Goals or MDGs and the notion that development goals can be attained by providing poor countries with monetary assistance to enable private investment to thrive. The American economist Jeffrey Sachs — the architect of deregulation policies for Latin America and transition policies for Eastern Europe in the 1980s — is among the best known proponents of this approach, which is detailed in his 2005 book 'The End of Poverty'.

> 'Extreme poverty is a trap that can be released through targeted investments if the needed investments are tested and proved and the investment program can be implemented as part of a global compact between rich and poor countries, centered on a Millennium Development Goals based poverty reduction strategy' (Sachs, 2005: 286).

This stance is a partial reflection of the United Nations International Conference on Financing for Development held in Monterrey, Mexico in 2002. The ensuing Monterrey Consensus was a response to the concern that the MDGs required immense financial resources: several studies attempted to place a cost on the MDGs, with USD 50 billion per annum offered as a commonly cited figure (Clemens et al., 2007). The Monterrey Consensus made FDI one of the six pillars of development finance, underscoring the role of private finance in an FfD or Financing for Development agenda. In the 16 years since its inception, FfD has been subject to shifts: initially designed for MDGs with a target date of 2015, a revised plan was presented in the July of that year at the Third International Conference on Financing for Development in Addis Ababa, to accommodate the SDGs of the 2030 Agenda for Sustainable Development (UN, 2015).

FfD, NSE, and the Wall Street Consensus

In the period between the Monterrey Consensus and the Addis Ababa Conference, Justin Lin of the World Bank inaugurated what became the NSE paradigm: this is

detailed in the 2012 publication 'New Structural Economics: A Framework for Rethinking Development and Policy'.[36] As Fine and Van Waeyenberge (2013) note, NSE is offered by Lin as a 'third wave' of development thinking, preceded by the Post Washington Consensus, which is in turn preceded by 'old structural economics' (e.g. Chang 1949; Lewis 1954; Myrdal 1957; Hirschman 1958, cited in Lin, 2012). NSE is centred on a state led industrial policy executed through efficient markets, and guided by the reality of a nation's comparative advantage in the global economy: Lin (2012) thus argues for a structural transformation strategy that acknowledges the position — in terms of factor endowments — of developing countries with scarce capital and plentiful labour and/or resources.

The critique of Lin's NSE framework is that it relies overwhelmingly on the idea of comparative advantage; in doing so — and despite pronouncing a role for industrial policy — NSE is committed to the neoclassical economic compulsion for state minimalism (Fine and Van Waeyenberge, 2012). As such the NSE, and also the literature around it, reflects the deep seated antagonism — a recurrent theme in World Bank scholarship — to the developmental state paradigm:

> 'And, over a wider range of literature, there would appear to be the equivalent of a conspiracy to forge analytical principles, postures and their application allowing for the possibility of interventionism in principle but containing it in practice' (Fine and Van Waeyenberge, 2013: 368).

This potential for posturing and containment, as described above, is revealed in the observations of Kate Bayliss and Elisa Van Waeyenberge on the resurgence of the PPP or public-private-partnership approach to provide infrastructure in developing countries; led by the World Bank, the renewed exuberance for such policies has also been expressed by other multilateral development institutions, bilateral donors, national governments and various other organisations (Bayliss and Van Waeyenberge, 2017). Under these initiatives donor and government funds are used to leverage private finance — in the form of debt as well as equity — for infrastructure: such financing arrangements are often described as 'blended finance'.[37]

> 'While earlier drives for privatisation in donor advocacy formally highlighted the potential efficiency gains deriving from increased private sector involvement in public service provision, the more recent wave of PPP advocacy is anchored almost entirely in arguments seeking to match a glut in global savings with the need to upscale public service provision in developing countries. This has created an increasingly financialised approach to infrastructure, as policy is framed in terms of investment opportunities for financial investors and institutional arrangements bearing on infrastructure provision are reconfigured to facilitate their entry into the sector' (Bayliss and Van Waeyenberge, 2017: 578).

36 Justin Yifu Lin is a University of Chicago trained Chinese academic who served as chief economist to the World Bank in 2008-2012.
37 This is discussed in more detail in Chapter 6 of this thesis.

Further advances in this 'financialised' approach are expressed in the Wall Street Consensus described by Daniela Gabor: the salient features of this include a shift from growing foreign financial inflows to the development of domestic bond markets, primarily to address environmental and social challenges:

> 'The ambition, clearly spelled out, is that institutional investors and their asset managers could redirect their investment efforts towards assets with potentially positive social or environmental aspects, such as: green bonds, development impact bonds, and infrastructure bonds' (Gabor, 2018: 4).

Gabor's appraisal draws on policy reports such as the European Commission's *Sustainable Finance* initiative and the *Maximising Finance for Development* agenda of the World Bank.[38] These bolster the principles of the FfD agenda by calling for them to be funded through innovative financial instruments for social as well as environmental aims. For such financial instruments to be transacted proficiently there is a need for efficient local bond markets: Gabor (2019) observes how in this context, the ideal type of market is articulated as the American or Wall Street template.

The newer version of the consensus thus places a heavy emphasis on the corporate sector through blended finance and public-private partnerships (PPPs). Additionally a direct relationship with inclusive finance is emphasised by the United Nations Capital Development Fund which seeks to mobilise private and public funds for targets oriented around the SDGs:

> 'UNCDF's financing models work through two channels: financial inclusion that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and localized investments that show how fiscal decentralization, innovative municipal finance, and structured project finance can drive public and private funding that underpins local economic expansion and sustainable development' (UNCDF, 2019).

Moreover, there is the incorporation of a philanthropic component to FfD. This is the outcome of the rise of blended finance strategies and may be attributed to initiatives led by the OECD. For instance, the joint *ReDesigning Development Finance Initiative*, from the World Economic Forum and OECD, describes blended finance as the 'strategic use of development finance and philanthropic funds to mobilize private capital for development' (World Economic Forum, 2015: 3):

> 'There is a huge, and largely untapped, potential for public, philanthropic and private actors to work together towards win-win-win solutions: wins for private investors, as they make an attractive return on their capital; wins for public and philanthropic providers, as they make their limited dollars go further; and most importantly, wins for people in developing countries as more funds are channelled

38 These reports are accessible from the respective websites of the European Investment Bank, https://www.eib.org/en/efsi/ and the World Bank http://www.worldbank.org/en/about/partners/maximizing-finance-for-development

> to emerging and frontier markets, in the right way, to help transform economies, societies, and lives' (World Economic Forum, 2015: 3).

The role of finance in a global economy?

The FfD view sees financial resources as 'a necessary catalyst to kick-start the process of development' (Hudson, 2014: 1). This is the ascendant view of global finance and development in which the relationship between rich and poor countries is one in which the former provide capital which the latter may utilise to overcome poverty traps characterised by low savings rates, weak infrastructure, and high population growth (Sachs, 2005).

> 'Success is measured in dollars and failure to meet pledges and perceived backsliding are the focus for criticism. Hence the subsequent debates are about the provision of these resources, the lack of these resources, the reasons for shortfalls, and to whom and how money should be given to maximise their effectiveness' (Hudson, 2014: 11).

This reflects the dominant view on the role envisioned for finance in development strategies.[40] This view has been met with opposition by critical political economists who find the FfD approach simplistic at best and destructive at worst.[41] The simplicity of FfD is critiqued on the grounds that it places undue emphasis on what development countries are lacking, instead of questioning the political and social nature of financial and economic systems (Hudson, 2014). More specifically, the critical political economy approach seeks to highlight the asymmetries, between rich and poor countries, that are a feature of capitalist financial systems. This view emerges from the work of Susan Strange in which finance is one of the four principal structural spheres of global capitalism[42]:

> 'The power to create credit implies the power to allow or deny other people the possibility of spending today and paying back tomorrow, the power to let them exercise purchasing power and thus influence markets for production, and also the power to manage or mismanage the currency in which credit is denominated, thus affecting rates of exchange with credit denominated in other currencies' (Strange, 1994: 90).

The destructive capacity of asymmetrical relations lies in the coercive power of finance. This is exemplified in the capacity of international organisations such as the IMF to

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40 Aside from being endorsed by the United Nations, the FfD view is also central to the interventions of other international organisations including the World Bank, the IMF, and the International Finance Corporation or IFC: this is reflected in the Addis Ababa Action Agenda (United Nations, 2015). The Consultative Group to Assist the Poor or CGAP, a specialist think tank for financial inclusion, also takes an FfD approach which is reflected in their extensive list of publications of donors and private funding, for instance in Tomilova and Dashi (2017).
41 Scepticism about the FfD agenda has also been expressed by UNCTAD (Ghosh, 2012 cited in Fine and Van Waeyenberge, 2013)
42 An in depth discussion of Susan Strange's concept of structural power, as applied to financial innovation, is available in Nesvetailova (2014).

impose Washington Consensus policies (Soederberg, 2004) and structural adjustment programmes which compromise national sovereignty (Killick, 1998). Less obvious examples lie in the hierarchy of currencies through which poorer countries find themselves consistently subordinated (Bortz and Kaltenbrunner, 2018). The clearest example of this perhaps lies in the dominance of the US dollar as an international currency. This underlies the position of the issuing country, the United States, as a global superpower and its capacity to fund both domestic and foreign policies (Hudson, 2014).

The respective positions of FfD and the critical political economy of finance and development thus echo the broad debates on the role of finance in a global economy characterised by asymmetries or uneven development.[43] Hudson (2014) expands on this separation by noting how there are distinct positions within these debates, which are essentially clashes between orthodox and heterodox perspectives. The orthodoxy of the FfD is captured in two assumptions of this approach: one is that markets are self-regulating and the other is that the state should have a minimal, or at least limited, degree of involvement in the economy. The alternative view builds on the heterodox economic response to such assumptions: that the market does not regulate itself or tend towards equilibrium, and that the state should replace the market, or more radically, commit itself to the project of 'delinking from global circuits of capital' (Hudson, 2014: 49).

These positions may be placed on a left to right spectrum: the respective positions on the extremes are radicalism and neoliberalism and the corresponding positions in the centre are described as critical reformism and liberal institutionalism (Hudson, 2014). Critical reformism and liberal institutionalism share concerns about the shortcomings of market based approaches to development but also agree that development can occur in a system with markets: there is thus a consensus on the need to 'civilise capitalism' (Hudson, 2014: 50). This consensus and the differing stances — regarding the role of the state — on which it is based, is according to Hudson (2014), demonstrated quite neatly in the DPR Debate between World Bank Chief Economist Justin Lin and heterodox economist Ha Joon Chang. Both economists agree that 'climbing up the ladder' is arduous and complex work that involves more than 'getting the prices right' (Lin and Chang, 2009: 501), but they disagree about the suitability of neoclassical economic models for making decisions about government intervention.

Heterodoxy and inclusive finance

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43 The concept of uneven development is commonly used in the economic geography literature to describe the '... unequal distribution of people, resources, and wealth that is a fundamental characteristic of human geography. Uneven development is evident at the global, regional, national, and urban scales. Concern with uneven development stems from the fact that vast differences in human well-being exist at each of these scales.' (Crump, 2006: p 508). The phenomenon is closely linked to the simultaneous existence of the equalising and differentiating tendencies of capital; whereas capital can equalise production levels and conditions across geographies but also retreat to seek higher profits (e.g French et al, 2011; Harvey, 1982).

How do these positions relate to inclusive finance, and how mainstream/ orthodox and heterodox positions in inclusive finance vary? A heterodox lens for inclusive finance may be demonstrated through a consideration of different stances — neoliberal, liberal institutionalist, critical reformist, and radical — on a vital and enduring issue of financial inclusion: high lending rates.[44]

> 'MFIs that claim to be helping poor people nevertheless charge them interest rates that are substantially higher than the rates richer borrowers pay at banks' (CGAP, 2009).

A neoliberal stance would be that the setting of lending rates should be market based because to do so otherwise would limit the supply of credit: this is based on the financial repression argument of the McKinnon-Shaw hypothesis where interest rate ceilings impede efficient credit allocation (McKinnon, 1973; Shaw, 1973; Montiel, 1995). Additionally, the contention that diminishing marginal returns cause smaller entrepreneurs to see higher growth rates relative to larger entrepreneurs with more capitalised firms has also been used to justify higher rates (Hudon, 2007).

A liberal institutionalist stance would not see high interest rates as a problem to be addressed directly but would acknowledge how it undermines goals of poverty reduction and the wellbeing of poor people. The specific response to expensive lending — for instance, of the Consultative Group for Action on Poverty (CGAP), and thus the World Bank — has been to recommend consumer protection laws and loan cost disclosure requirements (Duval, 2004). The World Bank's 'institutional' drift is notable: this organisation has an enormous role in the production of knowledge on development (Mehta, 2001), and thus has in the past, been described as an 'active component in the construction of a neo-liberal global architecture' (Harrison, 2005: 242). Cameron (2004) notes that the body of work known as new institutional economics became central to the World Bank's policy prescriptions in the 1990s: these incorporated an activist and efficient government in sharp contrast to earlier policies which fixated on a minimal state.[45] Hence the understanding that interest rates should be decided by market forces and not regulated, but their undesirable effects are to be addressed through institutions.

A critical reformist stance would see high interest rates as a problem of excessively liberalised and insufficiently regulated financial markets where pressures to attract global capital drive up rates. Aitken (2010: 234) comments how such a system positions 'microfinance as a financial object itself, an object capable of generating and sustaining forms of financial profit and accumulation'. This is a crucial view of critical reformists on finance: that it needs to 'be seriously reined and returned to the role of servant of the economic system, not the master' (Hudson, 2014: 87). This stance is

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44 This exercise is inspired by David Hudson (2014) who uses a historical example of global financial crises in the 1980s and 1990s, and the responses it elicited, to exemplify various perspectives on the political economy of finance and development.

45 New institutional economics, or NIE, as applied to the context of development is largely based on the work of Ronald Coase, Douglass North, and Oliver Williamson: the embrace of their approaches by the World Bank is examined in Hammer (2013).

heavily informed by the work of heterodox economists who take, as their starting point, 'The general theory of employment, interest, and money' by John Maynard Keynes (1936), and are thus described as 'Post-Keynesian'.[46] Finance is at the core of Post-Keynesian responses to supply side economic thinking, which is rooted in Keynes' challenge to the orthodox view that markets fail to clear because of supply side issues, for instance, regulation. In the heterodox position, this view is flawed because it does not account for the money that does not flow freely across the market and the economy because it is held as a store of value or a form of wealth (Keynes, 1936). This is expressed in saving and hoarding tendencies which have negative effects on aggregate demand and consumer confidence: they thus increase uncertainty and advance the need for liquidity. Because the failure of effective demand is a problem of uncertainty, money, and liquidity preference, there is a need for regulatory interventions to support investment: there also a need to curb what Keynes (1936) calls 'animal spirits' or the confidence of individuals and firms in the market (Dow and Dow, 2011). Because animal spirits have the potential to overheat the economy and impel speculative finance, the role of the regulator is to control liquidity, innovation, and speculation (Nesvetailova, 2007).

In a radical stance, high interest rates would be perceived as a tool of extraction that reproduces inequalities. Radical perspectives encompass a number of approaches and include Marxist, world systems, dependency theories, and theories of imperialism, as well as theories of underdevelopment, and also post-development approaches (Hudson, 2014): the latter are discussed in this chapter. At the core of the radical stance is the view that development interventions, as externally executed strategies, reinforce hierarchies: as such, radical theorists agree that the relationship between development and finance is imperialistic and negative (Harvey, 1982; Prebisch, 1981; Amin, 1974; Dos Santos, 1970; Frank, 1969). Of particular interest, given the context of inclusive finance, is the Marxian contention about the limits of capital: these are reached when capitalists impoverish the consumers who are also the labourers from who surplus value is extracted (Harvey, 1982). The capitalist response to this is what David Harvey describes as spatial and temporal fixes: the spatial fix is what pushes capital into new markets to extract more value and the temporal fix entails creating 'fictitious capital' in the form of debt (Harvey, 1982).

While the discussion above is an instance of how orthodox and heterodox approaches to inclusive finance differ, it is simplistic given that (1) there is more to inclusive finance than credit, and (2) it evades the topic of what determines interest rates. These are drawbacks which may be overcome by recognising that inclusive finance is a financial innovation. As a financial innovation, inclusive finance is associated with the phenomena of financialisation: as a development intervention it is a tool of financial deepening.

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46 Sheila Dow (2002) mentions that Joan Robinson, who collaborated with John Maynard Keynes at Cambridge, probably coined this term.

Given such a framing, the discussion about financialisation in relation to financial deepening might come across as one about regulation, in which financialisation perspectives emphasise the need to curb 'animal spirits' and control speculative finance, whereas financial deepening perspectives emphasise deregulation and liberalisation so that market forces determine the supply of and demand for finance. The following section shows how the objectives of financial deepening and financialisation are incompatible, not only because financialisation causes instability, but also because poor countries, owing to their 'subordinate position', are at a relative disadvantage when they encounter financialisation

2.5 INCLUSIVE FINANCE EITHER AS FINANCIAL DEEPENING OR FINANCIALISATION?

Inclusive finance is presented as a development intervention because it assists financial deepening: this stance reflects the assumptions of orthodox or mainstream economics that financial markets are efficient and individual agents rational. The argument that financial deepening results in higher growth builds on the Efficient Markets Theory or EMT which exerted enormous influence on policymakers in the 1970s: the EMT is the lifeblood of contemporary financial theory (Nesvetailova, 2013) and rests on two core assumptions. One of these assumptions is that the role of financial markets is to mobilise and allocate capital — a scarce resource — to meet the needs of the economy; the other assumption is that decisions in financial markets are made by rational agents.

Inclusive finance and efficient markets

Drawing upon the recent history of financial liberalisation, deregulation, and deepening — outside of advanced capitalist countries — Karwowski and Stockhammer (2017) identify two streams of research on financial development. The earlier stream is based on the financial repression hypothesis of McKinnon (1973) and Shaw (1973). This attacked the choice of many governments, in the aftermath of World War II, to use controls to suppress interest rates. Applied to financial markets to promote credit-financed investment and trade for capital accumulation, interest rate controls were described as financial repression: because interest rates in liberalised and deregulated financial markets are higher they promote saving among the domestic population and subsequently lead to investment. So for developing countries the mainstream economic prescription — particularly of the 1980s — was financial sector reform primarily to get 'interest rates right' (Karwowski and Stockhammer, 2017). The shortcomings of this approach include the weak sensitivity of saving to interest rates in poor countries which is so because 'consumption choices are heavily influenced by subsistence considerations' (Ostry and Reinhart, 1995: 16); also, recent quantitative analyses from Africa indicate that financial liberalisation and financial development have a possible negative correlation (Rashid, 2013).

A second stream of research thus emerged in the 1990s in which liberalisation was a means — and not in end in itself — for attaining financial development or financial deepening which was positively associated with economic growth. For instance, Robert King and Ross Levine build on the Schumpeterian view that the search for monopoly profits spurs innovation in contending that:

> 'Better financial systems improve the probability of successful innovation and thereby accelerate economic growth. Similarly, financial sector distortions reduce the rate of economic growth by reducing the rate of innovation' (King and Levine, 1993: 513).

Based on this, it was inferred that the expansion of the financial sector and private credit offtake would result in higher growth rates. But this view was the subject of scepticism following global financial crises in 2008. For instance Cecchetti and Kharroubi (2012) find that growth from financial development faces a U-shaped curve because after a certain stage financial sector growth is a drag on productivity growth. Additionally, Sahay et. al (2015) observe that while emerging market economies face twin challenges related to growth and stability as their financial systems expand, these are still well below the size of financial systems in advanced economies.

Insofar that inclusive finance is presented as a development intervention its role in a financial deepening agenda is straightforward. In several studies (Christen et al., 2004; Richter, 2004 cited in Vanroose and D'Espallier, 2013), and also Barr (2004), microfinance institutions are described as a form of financial development, and as a part of the financial system. More recently, as highlighted by Mader (2017) there is increased emphasis on the 'micro' rather than the 'macro' dimension of financial inclusion; given that financial inclusion is an extension of microfinance. Whereas the 'macro' dimension relied on a financial development perspective of entrepreneurship and firm growth, the 'micro' dimension focuses on how financial inclusion can enhance investment and consumption choices for the poor.

> 'Financial inclusion proponents generally argue that it brings poor people significant, tangible, direct benefits, and their argument rests on the intertemporal intermediation theory of change: that financial services are crucial because they allow poor people to move money over time and mitigate shocks, in order to enhance their economic opportunities, gain access to goods and services, and manage and allocate their resources better' (Mader, 2017: 469).

In such a context, where the impetus behind inclusive finance is no longer based on mainstream economic theory and econometric models, the relevance of financial innovation —which is mentioned in both mainstream and heterodox literatures — becomes explicit. As observed by Nesvetailova (2013: 69), for mainstream economists financial innovation is a 'functional reality' whereas for heterodox economists financial innovation underlies the advance of financialisation. To understand inclusive finance then, outside of a mainstream economic perspective, it is necessary to consider the

heterodox perspectives which are contained in the two major approaches to financialisation.

The most cited definition of financialisation is attributed to Gerald Epstein (Sawyer, 2014; Bonizzi, 2013):

> '…the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international levels' (Epstein, 2005: 1).

Taken on its own, this definition lacks an analytical framework and also a specific temporal or geographical context: the key questions that ensue from this gap are about where and when financialisation initially emerged (Sawyer, 2014). These may be addressed by emphasising — as scholars such as Malcolm Sawyer (2014) and Anastasia Nesvetailova (2013) have done — that there are two major approaches or analytical frameworks for understanding financialisation. One of these may be described as either a historical or a structural approach, informed by Marxist political economy, in which the present era is a new epoch or stage of capitalism characterised by the dominance of finance. The other may be described as either a contemporary or an evolutionary approach which reflects post-Keynesian thought on the relation between non-financial business and financial markets. Despite a consensus between these two approaches on the growing influence of finance, there is disagreement on whether this ascendancy indicates a disjuncture between finance and the real economy or alternatively a 'growing embeddedness of daily life in the global financial system' (Nesvetailova, 2013: 68).[47]

A comprehensive synopsis of the heterogeneous perspectives and approaches to financialisation is offered by Shaun French, Andrew Leyshon, and Thomas Wainwright, who present a case for more thorough analyses of the spatial element of financialisation:

> 'We contend that this literature has, for the most part, focused on processes and effects at three particular spatial scales: the nation state; the firm or corporation; and the household and individual. As a consequence, the financialization literature has been insufficiently attentive of other spaces, such as the region and the international financial system, and of geographical registers other than scale' (French et al., 2011: 814).

Later sections of this thesis, which draw linkages between inclusive finance in Pakistan and the international financial system, speak to the gap highlighted above. In the existing scholarship, time and space in the context of financialisation are consistent with the contemporary approach which offers micro-level analyses and consequently focuses on various settings in which financialisation manifests itself: qualitative and quantitative techniques may thus be applied to test hypothesis on when and where this occurs. In the structural approach, the focus has tended to be on the latter part of the

47 This is also framed in the literature as a split between the sphere of production and sphere of circulation (Nesvetailova, 2013).

twentieth century as well as the present one in which macro-level analyses problematise capitalist structures in advanced economies.[48] This is so particularly in the light of distributive justice in varying contexts or 'accumulation regimes' including those highlighted by Boyer (2000) as 'finance-led' in the UK and US since the 1990s, 'competition-led' in most of the OECD, and 'export-led' in East Asia until the crisis of the late 1990s (Hein et al., 2014). [49]

Financial innovation

The role of financial innovation in driving financialisation is acknowledged in both approaches: structural and contemporary. This is discussed in a broad range of contexts, including those on expanding capital markets, and the liberalisation and deregulation of banking; particularly as these relate to information technology and the politics of Anglo-American governments (Nesvetailova, 2013). In macro-level analytical frameworks there is an emphasis on how products of human activity, as well as risk and the probability of change, can be priced and traded (Nesvetailova, 2013). For micro-level analyses the focus is on the mechanics of this process, especially the practices of 'identifying, parcelling, marketing and relocating risks' (Nesvetailova, 2013: 70) and also on linkages with the rise of financial profits and financial incomes (Bonizzi, 2013).

The processes that underlie financial change may be described as either exogenous or endogenous (e.g. Polillo, 2011). This distinction allows for financial innovation to be presented as the outcome of forces endogenous to financial markets, rather than as the result of exogenous pressures such as diminishing profitability elsewhere in the economy, or from political influence. The exogenous view is associated with the Marxist tools used, for instance, by Arrighi (1994) and Krippner (2005) to attribute rising financial wealth to declining industrial investment and production.[50] An exogenous view is also adopted by Joseph Schumpeter who acknowledges that the process of creative destruction — central to innovation and entrepreneurship — could be compromised when bankers are not sufficiently detached from the projects that they fund and also from politics (Schumpeter, 1962). In this light, financial innovation is associated with — drawing on Schumpterian terminology — with 'wildcat' or deviant bankers (Polillo, 2011).

The motivations of such wildcat bankers are heterogeneous, particularly when viewed through a sociological lens. While some of them seek to expand the freedom of the market, others seek to challenge the authority of entrenched financial elites (Polillo, 2011). The endogenous view of financial change is based on the challenge presented by

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48 According to Sawyer (2014) this period coincides with the neoliberalism of the Thatcher and Reagan regimes in the UK and USA respectively: 'the dominant capitalist economies'.
49 Such perspectives are also associated with theories of regulation, which Bonizzi (2013) identifies as a third theoretical framework additional to Marxist IPE, and post-Keynesian economics. Regulation approaches will be considered here in Chapter 3 in the discussion on shadow banking in the Global South.
50 For Marx the credit system is used to overcome the limits to production that are reached when capitalists rely only the capital that they own: credit allows those who do not own capital to access it nevertheless (Polillo, 2011).

the latter group to the former group: this is expressed through financial innovation (Polillo, 2011). There is an overlap between such a perspective and the Minsky (1986) hypothesis on financial instability. As noted by Nesvetailova (2013), Hyman Minsky's observations on American capitalism described financial fragility not as the outcome of macroeconomic shocks or political events, but of financial innovation in economic cycles: because of which 'no equilibrium or equilibrium path is likely to exist' (Minsky, 1986: 34).

These perspectives build on the post-Keynesian stream of heterodox thought on financialisation. This analysis of contemporary capitalism is through the lens of financial relationships: particularly the role of money and finance in macroeconomic stability. For Minsky, the primary conflict between the financial system and the real economy is 'centred on the process of financial innovation and the ability of private financial firms to raise and emit debt as their major form of financing' (Nesvetailova, 2013: 64). [51] Debt or credit thus plays a pivotal role in how financial markets function: this has become more widely understood since the last global financial crises and has thus presented a challenge to the contentions of the EMT (Nesvetailova, 2013). In undermining the contentions of the EMT then this heterodox view also calls into question the expediency of financial deepening.

External vulnerability and subordinate financialisation

The argument made above may be summarised as follows: because financial deepening is prone to advancing itself through financial innovation, it leaves the economies in which it occurs more vulnerable to crises. The imposition of this external vulnerability is a key concern around financialisation in the Global South and is articulated academically through the prism of 'subordinate financialisation' which notes how, for emerging and developing economies 'the encounter with financialization is from a subordinate position' (Bonizzi et al., 2019). This literature highlights how financialisation in poor countries is a problem not only because it drives economic instability and vulnerability to financial crises, but also because it induces disadvantageous shifts in global patterns of capital accumulation. As such, there is a nascent literature on how the subordinate positions of emerging and developing countries shape domestic financialisation processes.

The roots of this subordination are in the dramatic growth of the external assets and liabilities held by emerging and developing countries; this has transpired as the 'traditional' institutional investors in these economies — mainly banks and specialised funds — have been joined by others such as pension funds, mutual funds, insurance funds etc. (Bonizzi et al., 2019). As a result, emerging and developing country governments are increasingly exposed to volatility from exogenous factors:

51 Associated with economic stability and full employment (Nesvetailova, 2013).

> 'First, in line with the expansion of global finance, ECEs' external assets and liabilities rose from under 33 per cent to more than 130 per cent of their GDP between 1970 and 2013. Capital inflows and outflows rose from 3.52 per cent and 2.22 per cent of GDP in 1976–85 to more than 6 per cent and nearly 8 per cent respectively in 2006–15' (Bortz and Kaltenbrunner, 2017, cited in Bonizzi et al., 2019: 8).

For example, to manage their vulnerability, governments in poor countries are compelled to accumulate foreign exchange reserves by constraining billions of US dollars from making their way into the economy: this is done as a safeguard against sudden and large foreign capital outflows, and also to manage currency volatility against outflows as well as inflows (Bonizzi et al., 2019). Additionally, and as summed up in Kaltenbrunner and Painceira (2018), such economies are also beset by monetary subordination, the salient features of which are: (1) heightened external vulnerability, (2) the inability to borrow in domestic currency, (3) a dominance of short term portfolio flows, and (4) structural balance of payments crisis.

The consequences of the above for inclusive finance, and for the Pakistani financial system are highlighted in Chapter 8. This is an important discussion because it highlights the relevance of inclusive finance not only to the broader financial system but also the macro economy; it thus connects two literatures by asking, how does inclusive finance relate to subordinated financialisation? This is done by drawing on the work of Susanne Soederberg on the debtfare state, particularly her analyses on Mexico (Soederberg, 2012). These examples draw attention to the similarities of the Pakistan case, particularly as they relate to fragile export and capital markets, troublesome current account and public budget deficits, and high socio-economic inequality arising from a policy fixation on economic growth through expanding the private sector. Such an environment is one in which the need for inclusive finance is fed through policies that enhance vulnerabilities in the poorest members of society, but also one in which there is limited policy space to do otherwise.

2.6 SUMMARY

This chapter examines the role of private capital in inclusive finance through two streams of scholarship on finance and development. One of these streams is comprised of the research on development strategies and examines how paradigms have shifted since the Post Washington Consensus of the 1990s. It is as a result of these shifts that 'inclusion' and eventually by extension 'inclusive finance' gained immense traction with the development community that had repeatedly sought 'development with a human face'. Subsequent approaches centred on the principles of New Structural Economics emphasised structural weaknesses in the economies of poor countries as issues of factor endowments lacking capital: this opened up space in the policies of international institutions and multilateral organisations for an endorsement of private and external capital. Consequently, there is an emergent Wall Street Consensus that seeks to attract

private capital through innovative financial instruments and the establishment of American style bond markets.

The second stream of scholarship examined in this chapter is that on financialisation. The financialisation literature counters arguments made in favour of financial deepening. Financial deepening strategies advance financialisation and this undermines growth and development when financial innovation causes economies to become crisis prone. Additionally, because of their subordinate position in the global financial structure, poor countries are likely to face additional disadvantages from financialisation. Inclusive finance is presented in this thesis as an example of how financialisation carries disadvantages for such countries.

Financial innovation is also articulated in the form of shadow banking. The connection between shadow banking and inclusive finance is discussed further in Chapter 3. The next chapter restores the focus on bifurcated banking by expanding on the shadow banking – inclusive finance nexus identified here. This allows for the assembly of a new conceptual framework: shadow financial citizenship.

3. Shadow Financial Citizenship: A Conceptual Framework to study Bifurcated Banking

3.1 INTRODUCTION

A framework of shadow financial citizenship is assembled in this chapter to analyse the relationship between inclusive finance and bifurcated banking. Previous chapters show that inclusive finance, notwithstanding critiques from scholars of financialisation, continues to be used as a key development policy tool in various countries of the Global South. The advance of inclusive finance has imposed formal financial mechanisms, including pricing, banking, risk management, and credit onto new previously, unbanked or excluded layers of the population. This process has created a bifurcated financial system in which inclusive finance is offered separately from mainstream or commercial finance. Under this arrangement, inclusive finance is offered to counter exclusion but does not provide access to mainstream finance. As a result there is a grey area between being financially excluded and being included in the mainstream financial system.

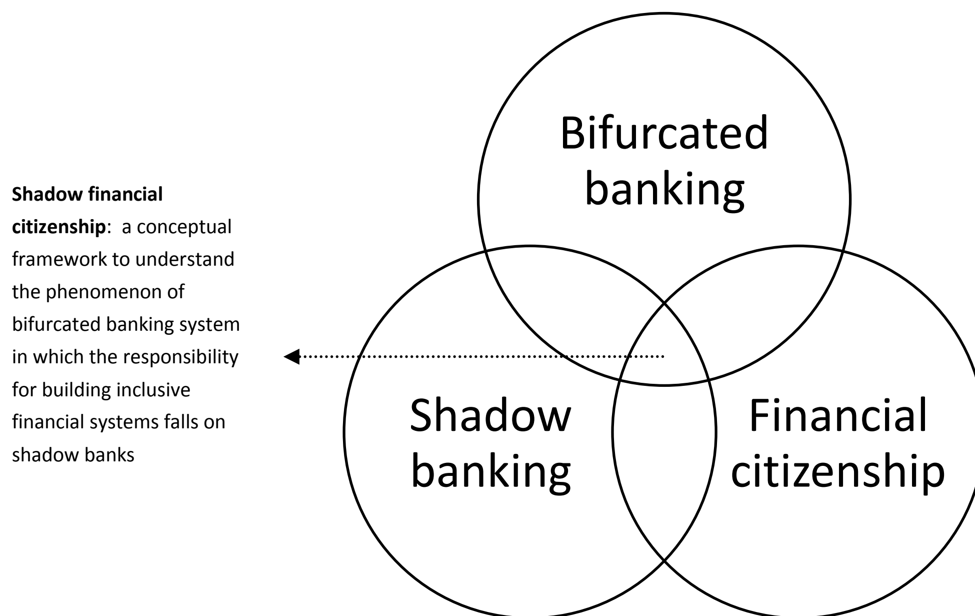
How might this grey area be conceptualised? Chapters 1 and 2 show, that this grey area is an outcome of respectively (1) a bifurcated system of banking and financial services, and (2) the financialisation of development strategy expressed as shadow banking. Shadow financial citizenship is used here as the analytical tool to understand the grey area which lies between financial exclusion and full financial citizenship.

As mentioned earlier, the phenomenon of bifurcated banking is one that emerges because of exclusionary practices when inclusive finance is presented as a remedy to financial exclusion, or to the circumstance of being 'unbanked' or even 'underserved'. The exclusionary practices that obstruct financial citizenship are embedded in the financial landscapes of poor countries. These practices arise from the shadow banking and inclusive finance nexus that is a core theme of this dissertation. Given this nexus, inclusive finance, as a form of shadow banking, is used here as an independent variable to 'explain' bifurcated banking. This is done through an analysis of the literatures on these themes. Two observations are thus highlighted: (1) that financial systems have an inside and an outside, and (2) that recent transformations in banking structures limit access to this 'inside'. The concept of financial citizenship is used for (1). The concept of shadow banking is used for (2).

The remainder of this chapter is organised as follows. Section 3.2 describes bifurcated banking through a lens of financial citizenship, drawing attention to the inequities that emerge from inclusive finance and limit financial citizenship. Section 3.3 examines shadow banking in terms of its evolution, geographical variation, and politics.

Section 3.4 discusses the case for shadow financial citizenship, showing how shadow banking and financial inclusion creates bifurcated financial systems that contain grey areas, or spaces in between formal and informal finance. Section 3.5 queries why and how notions of citizenship are relevant to financial access; this exercise draws on the work of geographers who affix spatial patterns of financial exclusion in advanced capitalist economies, to shifting models of banking and finance. Section 3.6 problematises bifurcated banking by drawing attention to earlier, advanced capitalist contexts, in which it is exemplified. Section 3.7 concludes and offers a road map for answering some of the questions raised within this chapter.

Figure 2: Shadow financial citizenship: a conceptual framework based on three literatures



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3.2 BIFURCATED BANKING AS AN ISSUE OF FINANCIAL CITIZENSHIP

Bifurcated financial systems have uneven extractive capacities. Whereas all financial systems, which advance monetary forms of capitalist accumulation, may be described as extractive, contemporary financial institutions, in particular, are known for positioning themselves as essential for households and individuals to meet their housing, education, health and transport requirements (Roberts, 2016; Lapavitsas, 2013; Aalbers, 2008). Consequently, households and individuals that are poor are more prone to dependence on financial institutions: this is a symptom as well as a cause of inequality.

The literature on financial citizenship is central to this analysis because of its capacity to acknowledge that the problem of financial abandonment or financial exclusion — studied with geographical tools — in Britain and the United States in the 1990s, is similar to the one that development practitioners and policymakers in poor countries target through inclusive finance. The concept of financial citizenship then is

no less relevant for poor countries than for advanced capitalist countries. But this concept must be altered to fully capture the specifics of financial landscapes in the Global South. These are bifurcated because of shadow banking institutions, activities, and practices, that operate in the form of inclusive finance. The augmented notion of shadow financial citizenship emerges from these modifications

The principal objective of the shadow financial citizenship framework for describing bifurcated banking is that it provides a systematic means of engaging with uneven financial access. It thus provides a way to conceptualize the variation and complexity of this phenomenon. In this analytical approach, shadow financial citizenship is constituted by a set of inequities, which are shown to be intrinsic to contemporary financial systems.

Sections that appear later in this chapter discuss how this framework captures earlier problematisations of financial access that are found in the respective literatures of shadow banking, and financial citizenship. The shadow banking literature shows how inequities emerge from regulatory constraints imposed by national and international institutions on domestic financial institutions. Additionally, they are anchored in the dependence of inclusive finance on disintermediated models of funding, which seek to create new asset streams and extract value by expanding the frontiers of the global financial system. The financial citizenship literature is an avenue to engage with the normative component of bifurcated banking; this research offers tools to reject the idea that uneven financial access is (1) the depoliticised condition of poverty and life in the informal economy, and (2) the outcome of a risk-return calculus that is an essential feature of capital markets. The next section offers a brief summary of the constitutive qualities of shadow financial citizenship

Inequities in rates

The observation that inclusive finance is more expensive relative to mainstream finance is not a novel one and is centred overwhelmingly on how microcredit is expensive in relation to loans made by mainstream commercial banks. Such comparisons are premised upon inclusive finance as a lending product, and there is now growing attention directed at the high amounts users of mobile money and digital payments services pay relative to their more affluent counterparts who use their accounts at mainstream banks for similar transactions. From a shadow banking perspective, these practices emanate from a search for yield, either from existing financial instruments which are repackaged to incorporate poor borrowers as a source of return of financial return.

Inequities in requirements

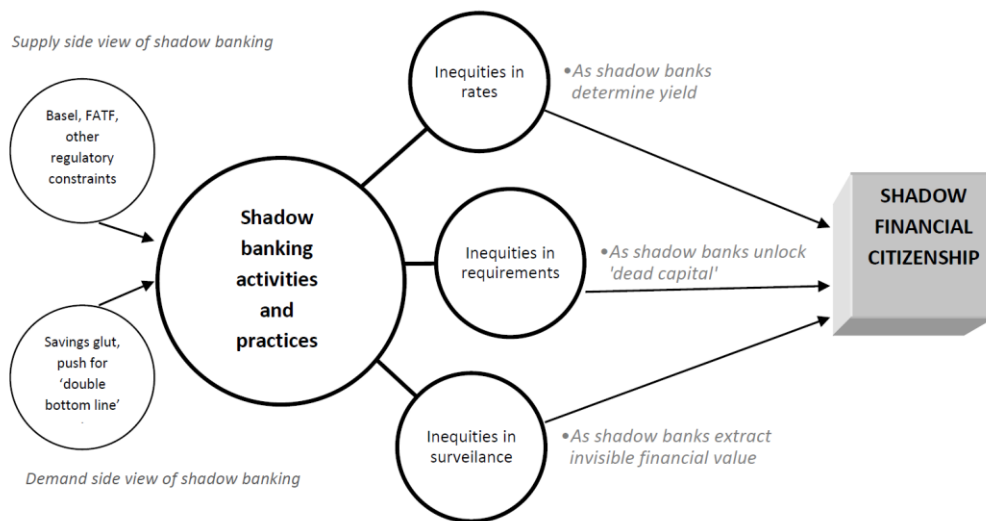
As mentioned earlier, KYC and other documentary requirements complicate financial access, particularly because the poor have a close relationship with the informal

economy. Steps to overcome this have entailed the collateralisation of everyday life such as through the use of gold jewellery and livestock to procure credit. These inequities in requirements arise because shadow banks seek to unlock what Hernando de Soto describes as 'dead capital' (de Soto, 2000). But the burden of 'unlocking' such capital is borne exclusively by the inclusive finance industry, with those using mainstream banks able to access finance through credit cards, and personal loans, without the need for any collateral. Through such approaches, shadow banks are able to expand the boundaries of the financial system.

Inequities in surveillance

Another set of inequities arises from recent advances in technology, particularly fintech. These are particularly exemplified by alternative credit scoring techniques which rely on personal data. Because there is often limited data to ascertain the creditworthiness of the poor, technological innovation is now increasingly used to analyse the social and behavioural patterns of the poor to determine whether or not they might be worth lending to. Shadow banking networks endorses such techniques because they identify and subsequently extract invisible financial value, under the assumption that 'all data is credit data' (see Aitken, 2017).

Figure 3: Shadow financial citizenship: drivers and features



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3.3 SHADOW BANKING

Shadow banking refers to practices of maturity, credit and liquidity transformation that occur outside the traditional banking system (Adrian et. al, 2016). The term 'shadow banking' is typically associated with the 2007-9 financial crisis and attributed to Paul

McCulley of PIMCO in 2007 (McCulley, 2009 cited in Nesvetailova, 2017a).[52] The conceptual chronology of shadow banking is disputed, based on whether or not it is a recent phenomenon.[53] The literature on shadow banking first appeared just one decade ago with articles by Poszar (2008) and Adrian and Shin (2009) using the concept to accentuate the need for reforming how financial systems are regulated.

Shadow banking is, however, more than just a phenomenon associated with recent financial crises and instability: it manifests numerous shifts that have occurred in banking and finance over several decades, including that from originate-to-hold to originate-to-distribute (Guttman, 2017; Toporowski, 2017). These shifts continue to shape banking and finance in advanced capitalist economies as well as in the Global South.

Shadow banking as an evolving concept

The ramifications of originate-to-distribute (OTD) as an alternative to originate-to-hold (OTH) models is the central theme for the first of the three waves of scholarship identified by Nesvetailova (2017) on financial innovation: subsequent waves respectively seek to account for this OTD rise and question the limits of global finance. The figure above illustrates the differences between traditional and modern models of banking.

Each set of literature on shadow banking has contentions as well as critiques of the scholarship on shadow banking, as shown in the table above. This 'third wave' is particularly noteworthy because it has bolstered perspectives which acknowledge that 'the global financial system, while elastic, is now defined by fragmentation, over-specialisation and hierarchies, rather than shaped by single cohesive force' (Nesvetailova, 2017a: 12). Such observations speak directly to questions about financial citizenship because they reflect concerns that have been raised about segmentation, for instance, in lending:

> 'In some nations, financial exclusion is a transhistorical component of social life, which persists even as market relations are transformed in real time: only elites operate in formal financial markets, now and in the past. In other nations, financial exclusion for some households results from the process of financial stratification and homogenization: the division of customers into ever-more-precisely defined segments, which are internally homogeneous but subject to vastly different terms and conditions in the loan market' (Dymski, 2005: 454).

Although the emphasis on fragmentation is a key contribution of the most recent wave of studies on shadow banking, earlier work on regulatory arbitrage is of importance as well. These differing perspectives on the drivers of shadow banking are described as supply side and demand side respectively (Nesvetailova, 2017; Lysandrou and Nesvetailova, 2015). The former perspective relies on the opportunities presented by

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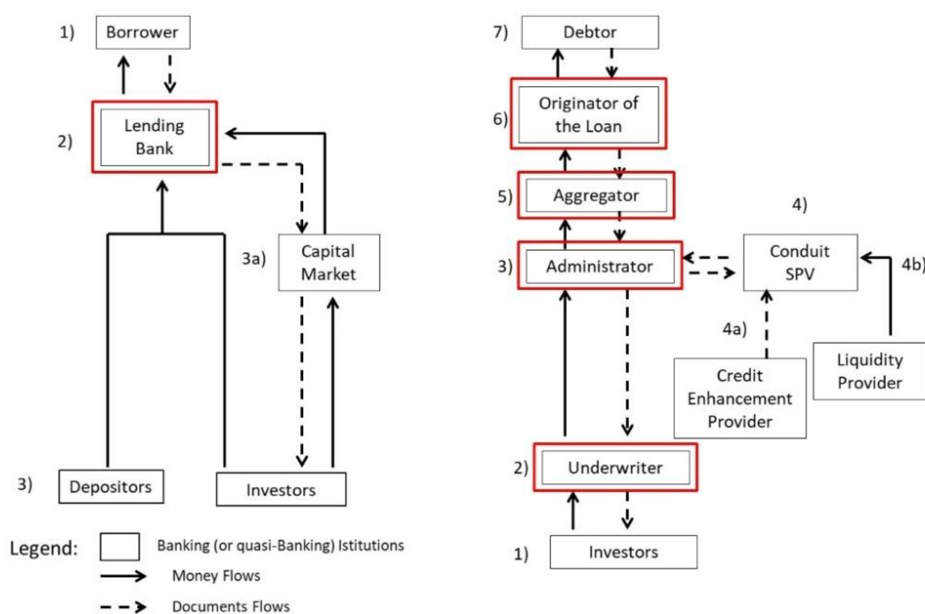
52 PIMCO is the Pacific Investment Management Company, LLC, an American investment management firm.
53 See Battisti (2014) for sources on shadow banking in the 17th century.

regulatory arbitrage and avoidance to explain the creation of new financial markets, products, techniques, and institutions: the latter perspective contends that because demand for investables outstrips supply, new financial markets, products, techniques, and institutions are created as a response.

Figure 4: Models of banking (OTH vs. OTD)



Source: Battisti (2014)

Table 3.1: Shadow banking perspectives

Waves	Inferences	Debates
First: Financial innovation as shadow banking	Shadow banking is a recent phenomenon. And Shadow banking may be addressed by reforming the financial system through international and national regulation.	The response to the unstable tendencies of shadow banking should be better regulation (Adrian and Shin, 2009; Poszar, 2008). vs. The unstable tendencies of shadow banking are inherent to global financial capital and cannot be addressed simply through regulation (Guttman, 2017; Toporowski, 2017).
Second : The origins and operation of financial innovation	Shadow banking has a 'supply side' explanation as it is caused by market players seeking regulatory arbitrage and regulatory avoidance.	Shadow banks emerge because regulation is stifling (Tett, 2009; Chick, 2008). vs. Shadow banks emerge because of the political influence of 'greedy' financiers (Pagliari, 2013; Erturk and Solari, 2007). Shadow banking creates new money (Moe, 2017). vs. Shadow banking simply redistributes wealth among existing parties (Guttman, 2017; Kaurova, 2017).
Third : The structural problems of finance	Shadow banking as a 'demand side' explanation because the global financial system has reached the limits of natural growth so financial innovation is	Shadow banks are the outcome of financialisation: a single cohesive force with homogenising tendencies (Cerny, 1991). vs. Shadow banks are the outcome of hierarchical and fragmented systems (Palan and Wigan, 2017).

	employed to allow continued expansion.	

Based on Nesvetailova (2017)

Shadow banking in the Global South

These themes are related to the exclusionary practices of financial institutions and the overall financial system as well. But in the context of inclusive finance in the Global South — which is a form of financial innovation — the missing discussion is about how mainstream finance in relation to inclusive finance. Is inclusive finance a stepping stone for access to mainstream finance? Or do mainstream and inclusive finance serve clienteles that are so different from each other that they obviate any need for convergence?

The idea that financial systems in poor countries are bifurcated — and hence a context for discussing shadow banking or financial citizenship — comes across as unexceptional given the historical prevalence of informal finance and its linkages with colonial formal finance in the global South (e.g., Bouman and Hospes, 1994). Informal finance is an essential feature of dual economies (Lewis, 1954) where there is a separation between economic sectors: depending on the specific regional context, this may be a rural-urban separation or even a subsistence-capitalist separation. Such views apply a dualist lens, attributed to the seminal work of Sir Arthur Lewis 'Economic development with unlimited supplies of labour' in which the formal sector eventually grows large enough to subsume the informal sector (Lewis, 1954): here, the corollary assumption is that eventually informal finance is absorbed into formal finance.

Informal finance is defined as contracts or agreements conducted without reference or recourse to the legal system to exchange cash in the present for promises of cash in the future (Schreiner, 2000). In many studies on poor countries, this is percevied as a temporary phenomenon, eventually to be replaced by formal finance. In an analysis of informal finance in the Global South, Fischer (1996) expresses scepticism over the use of this dualist lens — which he finds, underestimates the substance of contemporary informality — as empirical evidence shows informality to be persistent and resilient. The transient nature of informal finance has been the subject of studies by numerous economic anthropologists including Geertz (1962) and Drake (1980), Kurtz (1973), and Chandavarkar (1985). The logic of such scholarship is that informal finance is a residual category, created from the marginalisation that occurs because of formal finance's penchant for mainstream economic activity. As Andrew Fischer notes:

> 'In the 1950s, when theories of growth were popular and colonialism was still kicking, informal finance was considered by most academics and policy makers to be a manifestation of traditional (indigenous) economic attitudes. The attention towards basic needs in the 1970s led many to interpret informal finance as an adaptation by the third world poor to their marginalisation from formal economic activities. And of course, the drift towards neoclassicism in the late 1970s and 1980s

generated a focus on informal finance as a mutant yet liberal response to overly interventionist governments' (Fischer, 1996: 6).

Similar opinions are expressed in Thomas (1992) who noted that while rural credit has tended to receive considerable policy attention; the same could not be said about informal finance: he attributed this to the struggle many policymakers faced to overcome seeing a well-established rural-urban dichotomy as analogous to the informal and formal financial sectors. Because of the reluctance of formal financial institutions to lend to rural clients, informal finance, and to a smaller extent government and cooperative credit, came to function as a parallel system: this expanded in the 1980s and 1990s, when NGOs shifted their policies to prioritize income generation over welfare and relief (Bouman and Hospes, 1994).

The formal-informal divide in finance may also be seen as an artefact of colonialism. This perspective is based on the position that T. Roy (2016) describes as 'new institutional economic history' approach: it is the same lens used by Acemoglu and Robinson (2012) in their 'Why Nations Fail' hypothesis. A key feature of colonial financial development was a duplicitous stance, by imperial governments, on monopolies. While these were restricted at home, in the colonies they were propped up for extractive reasons and thus benefited from local production and trade (Fischer, 1996). The outcomes of this were; first, a heavy concentration in colonial finance that was anomalous relative to the banking system at home; and second, an overt preference for the formal which allowed informal financial institutions and practices to thrive as colonial finance was absent in the local economy (Fischer, 1996). Some examples of these institutions and practices are in the table below.

Table 3.2: Fischer's typology of informal financial firms

Motive	**Individual focus**	**Group focus**
Collective	Personal loans	RoSCA, ReSCA
Associative		Village association, insurance association
Commercial	Moneylenders pawn brokers, interlinked credit	Finance Corporations, Pawnbrokers, Chit Fund Companies, Interlinked Credit Indigenous Bankers and Brokers, Mobile Bankers

Source: Fischer (1996)

For instance, in British India, credit rationing practices led to a trade-off between financing agriculture and financing industry: informal financiers were ill-equipped to fund industrialisation because they did not know how to manage 'slack season surplus' (T. Roy, 2016). These constraints are discussed in Chapter 4 and pertain to a lack of investment options, partially due to the state not offering an instrument that 'would be liquid enough to meet seasonal fluctuations'; and also to the politics of formal institutional development against the backdrop of a pro-peasant but anti money-lender ideology (T. Roy, 2016).

Because the recent popularity of a financial inclusion agenda has coincided with two key shifts in the global financial landscape, inclusive finance has come to be not only very much like shadow banking, but also an extension of the same shadow banking industry associated with the volatility and fragility of the global financial crises of 2007-9. One of these shifts is the commercialisation of inclusive finance, which has resulted in the dependence of the microfinance industry on wholesale sources of funds. These are often provided by international institutions attracted by high rates of returns and the profitability of microfinance banks and also relate to earlier concerns expressed by scholars about the financialisation of development (Mawdsley, 2018; A. Roy, 2010). More recent concerns about the role of global finance in development relate to initiatives such as *From Billions to Trillions* and *Maximizing Finance for Development* (Financial Times, 2018a). Initiatives such as these have amplified concerns that shadow banking is not only occurring, but is also poised to expand in the Global South.[54] This is a departure from earlier thought about shadow banking which was engrossed in the context of the 2007-9 financial crises. For instance, Gabor (2018) comments that in the past, the closest the Financial Stability Board came to considering countries that were not advanced capitalist economies was when it included South Korea in its first monitoring exercise. Even then, unease about shadow banking in emerging economies only became prominent when FSB head, Mark Carney issued warnings about systemic risk and financial instability.

At present, there is a small but growing literature on shadow banking outside of advanced capitalist economies. There are two prominent features of this literature. One of these features is that the research is oriented to the supply side view. A recurring contention is thus that non-bank financial intermediaries expand because mainstream banks are constrained by regulation. Another feature is that the focus of the research is on emerging rather than developing economies. The perception that there is a meaningful difference between emerging and developing economies is one heavily endorsed by the financial community — for instance Goldman Sachs invention of the BRICs label — but also questioned by scholars of development (Desai, 2007).[55] Nevertheless, the narrative of investment appeal is central to the demand side view of shadow banking: it may be argued then that it is not just regulatory constraints but also a search for yield from global investors that has resulted in the rapid growth of alternatives to mainstream banking.

For instance, Acharya et. al (2013) claim that the activities of non-bank financial corporations, or NBFCs, in India — which tend to be well capitalised — is a form of shadow banking, despite eliciting very different macro and micro prudential considerations. Mainstream banks lend to NBFCs in India because they see such practices as a substitute for direct lending in non-urban areas: this is corroborated by

54 These concerns are articulated in an open letter circulated through the Critical Finance blog. See: https://criticalfinance.org/2018/10/10/the-world-banks-new-maximizing-finance-for-development-agenda-brings-shadow-banking-into-international-development-open-letter/

55 BRICs is the acronym for Brazil, Russia, India, China, which Jim O'Neill of the investment bank, Goldman Sachs coined in 2001 to highlight the economic potential of these nations as 'emerging markets' (O'Neill, 2001).

the finding that banks without rural branch networks are more likely to lend to NBFCs (Acharya et. al, 2013). Interestingly, the potential for such an arrangement to provide a complete spectrum of credit in non-urban areas of the economy appears to be constrained by asymmetries in government support for different banks and also by restrictions on the number of branches a bank may have (Acharya et. al, 2013). These gaps in the credit spectrum appear to create a need for inclusive finance. Given that it is government policy that underlies this gap, this Indian example extends the view that inclusive finance is driven by suppliers of credit seeking to circumvent regulatory constraints.

Other examples of shadow banking outside advanced capitalist economies include a study of Russia (Kaurova, 2017) which offers a survey of the various linkages and innovations between financial institutions. These linkages connect what is described as 'the de facto two shadow banking systems in Russia' (Kaurova, 2017: 87): these transpired from the economic transitions in the 1990s and refer to a one, a grey credit and payment network associated with an underground economy, and two, another system with origins in financial liberalisation policies and the eventual expansion of bank and non-bank financial intermediation. Here too, the deepening and widening of shadow banking practices comes across as a response to regulatory constraints which have created a chasm between the financial economy and the 'real' economy: in particular domestic capital markets offer only weak access to corporations which have to seek alternative funding and risk insurance mechanisms (Kaurova, 2017).

Recent shadow banking examples in China further enhance the scholarship on regulatory arbitrage and avoidance by drawing upon the political economy of global financial regulatory governance (Knaack and Gruin, 2017). The prerogative taken by regulators from advanced economies to define shadow banking overwhelmingly in terms of systemic risk potential has created a fixation with tight monitoring and control: the outcome of this is a setting in which the Financial Stability Board (FSB) — 'the G20's handmaiden in global financial regulatory reform' (Knaack and Gruin, 2017: 2) — allegedly curbs the financial development capacity of nonbank financial institutions (NBFIs). The response of Chinese authorities to such constraints has been to frame shadow banking as financial inclusion, particularly internet finance: this strategy has allowed for 'greater policy space and legitimacy to promote non-traditional financial services' (Knaack and Gruin, 2017: 15). Daniela Gabor's study of China is a departure from a regulatory arbitrage focus and thus the supply side approach, which she labels the 'viable credit alternative' view given the argument that nonbank finance is a substitute for mainstream finance (Gabor, 2018: 395). She draws attention to the shortcomings of existing literature which overlooks not only the influence of the global financial market in domestic shadow banking, but also overlooks the trend of market based finance which reflects a 'renewed global push, led by Germany in the G20, to extend the reach of financialized globalization' (Gabor, 2018: 398).

Shadow banking and its politics

Such insights augment the shadow banking literature as well as that on financial development: financialised globalisation may thus be cast as the shadow banking-financial development nexus. This is an opportunity to question the extent to which the goals of financial development and the imperatives of shadow banking are concurrent and also contradictory. Gabor's (2018) commentary on the role of the German state and G20, and Knaack and Gruin's (2017) on the FSB are of particular value because they highlight how activities that resist or embrace financialised globalisation acquire diplomatic overtones: this echoes Nesvetailova's (2017: 11) contention that 'non-pecuniary motivations and objectives' may drive shadow banking. There is thus more to shadow banking than the economics of financial mobility and regulation. Helgadóttir elaborates on this assertion through the use of political science frameworks to 'suggest a distinctly political reading of the trajectory of shadow banking' (Helgadóttir, 2016: 918). Three frameworks are thus employed: rent-seeking, institutional adaptation, and inequality.

To expand on the notion that inclusive finance is shadow banking, Helgadottir's (2016) concept of 'banking upside down' is useful: in demonstrating how 'economic' features of shadow banking may be viewed through a political lens, it draws attention to how traditional banking and shadow banking differ.

> 'Rather than using short term liabilities (deposits) to fund long-term assets (loans) like traditional banks do, shadow banking uses securitization and financial engineering to turn individuals' and corporations' long-term liabilities (mortgages and other kinds of debt) into short-term instruments (securities and derivatives based in such debt)' (Helgadottir, 2016: 921).

The distinction between an economics approach vis-a-vis a politics approach is apparent through the economics literature that describes shadow banks as 'bank-like' because they carry out maturity transformation (Adrian and Ashcraft, 2012; Pozsar et al., 2010, cited in Helgadottir, 2016). This description underpins the claim that troubled shadow banks are an economic reality and thus entitled to public support: 'if shadow banking is understood as an intrinsic part of the current financial landscape, government institutions, too, must adapt to this new reality.' (Helgadottir, 2016: 918).

But such an understanding obviates the political nature of shadow banking because it does not explicitly mention (1) the rent-seeking tendency of shadow banks, (2) the logic to the institutional adaptation underlying bailouts and safety nets for shadow banks, and (3) the role of wealth inequality in the growth of shadow banking (Helgadottir, 2016). So, while the discussion in the previous chapter, on the respective supply and demand views of shadow banking, pertains to the drivers of shadow banking, the discussion here highlights the context in which these drivers operate.

For instance, the rent-seeking tendency of shadow banks, as well as institutional adaptation practices are described by Helgadottir (2016) in two contexts: the use of

public backstops and the 'symbiotic' relationship between shadow banks and traditional banks through which traditional banks can avail of the regulatory privileges of shadow banks such as through securitised assets. While Helgadottir's (2016) examples pertain to Anglo-American financial institutions beset by the 2007-9 global financial crisis (GFC), they can be tweaked to apply to shadow banking in poor — or emerging market — countries as well. Rent-seeking is an example of a term imported by political scientists from economics: its usage has been extended through the use of concepts such as 'moral hazard', 'too-big-to-fail' and 'regulatory arbitrage' (Helgadóttir, 2016: 923). Such concepts illustrate the clear link between rent-seeking and financial innovation, as exemplified by banks relying on public bailouts, and corporations using tax havens. Helgadóttir (2016) also draws attention to a less obvious aspect of rent-seeking, which is the symbiotic relationship between traditional banks and shadow banks. Securitisation is one feature of this two-way relationship: its disadvantages, in the light of the 2007-9 financial crisis, are well-documented (Mian and Sufi, 2015; Nesvetailova and Palan, 2008). The other feature of this symbiotic relationship is that traditional banks have gained many advantages through the regulatory dexterity of shadow banks: it is thus unsurprising that shadow banking entities — such as special purpose vehicles that engage in securitisation — are often subsidiaries of mainstream banks (IMF, 2014).

Institutional adaptation is a feature of the extensive institutionalist political science literature (Acemoglu and Robinson, 2012; Hacker and Pierson, 2010; Hall and Taylor, 1996).[56] Economists have used this to justify safety nets for shadow banks (Helgadóttir, 2016). So, just as the Federal Reserve was a response to the collapse of the call loan market in 1913, and the Federal Deposit Insurance Corporation was a response to the volatility associated with Great Crash of 1929, safety nets for shadow banks are a response to the most recent financial crisis (Helgadóttir, 2016). This parallel offers precedents to understand the use of public backstops; it also underscores the perceived importance, to the state, of the shadow banking system. Gabor and Ban's (2015: 632) study of repo markets in the European Union is relevant here; they find that the 'standing of a sovereign in financial markets now hinges on the collateral quality of its debt, which in turn depends on (shadow) banks' expansion strategies'. Shadow banks thus have not only economic but also, political importance. The contemporary setting of 'giant pools of money seeking returns and a growing number of borrowers' (Helgadóttir, 2016: 915) is itself a site for institutional adaptation, and thus brings to light the connection between inequality and shadow banking. In particular, the use of public backstops during the GFC demonstrates how shadow banks can take advantage of government policy.

The symbiotic relationship between shadow banks and traditional banks also facilitates both rent-seeking and institutional adaptation. Helgadottir (2016) finds this to be the case when traditional banks use securitisation and thus opt for a strategy

56 Interestingly, the concept of institutional adaptation has been embraced by the World Bank, particularly in the context of how institutional change can be externally directed and offer lessons for aid donors (Islam, 2018).

based on 'slicing and dicing' to lower credit risk rather than the traditional strategy of originating loans to hold and fund them up until maturity. This arrangement is mutually beneficial because traditional banks circumvent regulation and make loans with less capital, and because shadow banks gain the protection of government backed safety nets: this relationship is explicated in Pozsar et al's (2010) 'shadow banking maps'.[57] And more simply, in Mehrling et. al's (2013) description of shadow banks as parasites.

Inequality, as it relates to economic growth, the concentration of wealth, and the accumulation of capital, has been a preoccupation of political economists including Adam Smith (Rasmussen, 2016) for, at least, centuries: it has been placed in the context of advanced capitalism in recent work by Piketty (2014). The shadow banking literature builds on this by highlighting how skewed patterns of capital accumulation and wealth concentration drive a growing reliance on debt. In doing so, this literature speaks to both the demand and the supply side perspectives of shadow banking: concentrated wealth creates a demand for debt and securitisation responds to this by creating a supply of debt (Helgadóttir, 2016). Inequality is central to this relationship because the demand for debt exceeds supply: this is evidenced by the predatory lending practices that characterised sub-prime mortgages in the United States (Adrian and Ashcraft, 2012; Gorton, 2008).

These observations highlight how shadow banking is part of a larger political transformation of central banks and bond markets', the vulnerabilities of which became exposed during the GFC (Helgadottir, 2016: 929). A specific problematisation of shadow banking is revealed here: why are governments loath to regulate shadow banking activity and to refuse shadow banks safety nets? Or: 'does shadow banking play a societal and economic role that justifies such extensive public support?' (Helgadottir, 2016: 929). But as mentioned above, this problematisation is shaky for cases when shadow banking is regulated tightly enough so that institutions are not systematically important or when no institution may be deemed 'too big to fail': this is discussed above for Indian NBFCs and also applies to Pakistani microfinance.

For such cases an alternative problematisation may be as follows: are shadow banks needed to fulfil the credit needs of an economy? Or worded differently: is the economic and societal role of shadow banking important enough to justify regulatory facilitation? Helgadottir discusses this in the context of wealth inequality by noting how the relation between inequality and shadow banking is captured by the respective concepts of debt and wealth. Debt is at the core of shadow banking, particularly given how it is generated through securitisation. Wealth, particularly in a concentrated form, underlies the impetus to invest, and thus the need for investments. These concepts represent the 'supply side' and 'demand side' views of shadow banking respectively: these underpinned, in the GFC, the unstable relationship between immense cash holdings and demand for credit, including from those tagged as 'subprime'.

57 These maps are presented in (Pozsar et al.,2010) to schematically represent the funding flows of the shadow banking system

Given a general context of inclusive finance, the connection between inequality and shadow banking is important enough to be reiterated: large pools of cash and the opportunity to create asset streams through the consumption needs of the poor have driven what Mader (2015) describes as the financialisation of poverty. Here, a distinction may be made between the patterns of commercialisation and financialisation as they apply inclusive finance. Commercialisation reflects a shift from a model funded by charity and altruism to one that is funded by financial capital whereas financialisation reflects a shift from a model in which the poor are viable clients for financial institutions, to one in which activities of the poor are 'converted into financial asset streams' (Aitken, 2013: 474).

3.4 THE CASE FOR SHADOW FINANCIAL CITIZENSHIP

This rendering of shadow banks as prone to rent-seeking, institutional adaptation and a reliance on inequality, demonstrates the overlap between financial exclusion and financial innovation. For poor countries, the provision of financial services under the guise of inclusive finance is a specific feature of the shadow banking system. The argument that inclusive finance is a form of shadow banking has so far received very limited coverage in the existing literature: this chapter demonstrates how such a portrayal can enhance an understanding of financial access.

Shadow banking, particularly in poor countries, has causes as well as symptoms. The causes, as discussed earlier are reflected in the two respective views of shadow banking: the supply side view captures the regulatory and macroeconomic constraints, and the demand side view captures the search for yield from global institutional investors. These views represent the drivers or causes of shadow banking: the outcomes or symptoms may be seen as a response to (1) the need to identify and determine sources of yield in the form of interest, (2) the imperative to unlock what is sometimes described as 'dead capital' (Zulfiqar, 2018; World Bank, 2010; de Soto, 2000), and (3) the imperative to 'constitute and extract financial value from the places where it is invisible' (Aitken, 2017: 275). It is from these practices and activities that shadow financial citizenship emerges as an arrangement that is disadvantageous for the poor as it entails: inequality in rates, inequality in requirements for eligibility, and inequality in surveillance. These are illustrated in figure 4, above.

Shadow financial citizenship is distinct from similar, overlapping concepts which have drawn attention to how changing approaches to banking drive uneven financial access. This is so because (1) shadow financial citizenship attributes gaps in financial citizenship, explicitly, to shadow banking practices and networks, and (2) in doing so, it operates as an analytical toolkit equipped to draw causal linkages between private capital and exclusionary trends in finance. Related concepts have sought to make similar claims in the past — and these related concepts are outlined in Table 3.2, later in this chapter — but the focus has tended to be on Anglo-American geographies and on specific trend of financial infrastructure withdrawal. In contrast, the conceptual

framework of shadow financial citizenship captures how unevenness takes the form of inequities which emerge because of shadow banking practices.

Shadow financial citizenship, and the exclusion which it seeks to describe and account for, emerges from two sets of scholarship: the geographies of money and finance and also financial innovation. The geographical literature stresses the need for a concept of financial citizenship given that policies on inclusion overlook the reality that financial exclusion and financial citizenship lie on a continuum: the space between financial exclusion and citizenship is not only a grey area, but also an impediment to financial citizenship. The literature on financial innovation differentiates financial deepening — and financial development — from financial innovation, and thus offers a basis to question the role and nature of finance in poor countries.

As a conceptual framework, shadow financial citizenship can enhance two sets of scholarship on the political economy of finance. One of these is the scholarship on banking and finance in poor countries as shadow financial citizenship draws attention to the manner in which shadow banking exists and operates in the Global South: it can thus enhance scholarship on the role of finance in development. Additionally, and perhaps most importantly in the context of this dissertation, shadow financial citizenship may be employed as a tool to study the phenomenon of bifurcated banking in financial markets in poor countries: this is done by highlighting the gap between financial inclusion and financial citizenship. The next section considers the value that a financial citizenship lens brings to an analysis of bifurcated banking.

3.5 FINANCIAL CITIZENSHIP

Scholarship on the concept of citizenship may be described as either a normative type or an empirical type: respectively, these are 'normative theories that try to set out the rights and duties citizens ought to have, and empirical theories that aim to describe and explain how citizens came to possesses those rights and duties' (Bellamy, 2008). The financial citizenship literature, particularly the context in which it is employed and invoked in this dissertation, falls firmly in the empirical category. Here, the primary purpose of applying a financial citizenship lens is not to evaluate what form of financial access should people have. Rather the purpose is to describe and explain the nature and origins of uneven financial access; specifically, how rights and responsibilities around finance came to be possessed and also dispossessed. A normative argument may of course be extracted even from this empirical approach, — that access to finance should be even across the banking system — and this is considered through the discussion in this chapter on credit as a right, and the role of the state in facilitating financial access.

As an emerging concept, financial citizenship entered the vocabulary of political economists through the work of economic geographers interrogating spatial patterns of

financial exclusion.[58] Sarah Hall finds that 'a distinctly economic-geographical imagination in relation to money and finance' developed, mostly, in the 1990s: this was spurred by research on regulatory and informal norms of international and offshore finance, post Bretton Woods, amidst floating exchange rates (Hall, 2012: 93). The decade described by Mervyn King as 'nice' for non-inflationary consistently expansionary (King, 2010), and the ensuing expansion of the financial services sector offered rich materials for economic geographers and numerous opportunities to engage with the phenomenon of financialisation, and also to expand upon institutional approaches to finance (Hall, 2012)[59] Financialisation as an analytical concept was thus embraced by geographers, as it was by scholars in other disciplines.[60]

> ‘One the great strengths of the concept of financialization is that it has proved a rallying point for researchers interested in money and finance across a number of cognate social science disciplines’ (French et al. 2011: 814).

This exuberance is questioned by Brett Christophers who finds that the usage of the term financialisation is excessive and careless, lacking novelty in an historical as well as theoretical sense: for Christophers (2015), these reflect inherent analytical limitations of this term, severe enough to justify abandonment, at least by geographers. Manuel Aalbers argues that much of this critique is unwarranted and comments on the 'potential for financialization to conjoin real-world processes and practices that are conceptually treated as discrete entities', underscoring that financialisation is an' inherently spatial phenomenon that should be much more central to economic-geographic analysis' (Aalbers, 2015: 5). This perspective echoes French et al.’s (2011) call for more awareness of the geographic unevenness of financialisation processes. The issue of unevenness is a core theme in the literature on financial infrastructure withdrawal and expressed through the concept of financial citizenship. Berry and Serra’s (2012: 4) remark that 'if we are not financial citizens, then arguably we are not citizens at all' is an extension of Leyshon and Thrift’s (1995) commentary on ‘insiders’ and ‘outsiders’. These exist in relation to the financial system, just as they do in relation to the state: hence the need for a lens of citizenship to examine exclusion, or in other words, an ‘outside’ vis-a-vis an ‘inside’ (Leyshon and Thrift, 1995).

Why citizenship?

58The transfer of ideas from economic geography to political economy has been a two-way process of importation and economic geographers have in recent decades drawn heavily on concepts from political economy literatures: several examples are available in Hall (2012).

59 The literature with a focus on institutions differs from that on financialisation in seeking to answer questions about the ascendancy and the reproduction of financial economics and financial theory which is studied as a ' negotiated process, involving institutions such as regulators, policymakers, and academics' (Hall, 2012; p 95). In contrast, the literature on financialisation emphasises its tendency to be 'an uneven process' (Froud and Johal, 2008) and thus seeks to answer questions about structural change in geographies and in economies.

60 For more detailed discussion of this term see Chapter 2 .

There are disadvantages and advantages to using a citizenship lens to study exclusion. The concept of citizenship carries limitations because it is largely — unlike for instance 'democratic theory' or 'state theory' — without a great body of systematic theory: numerous typologies and classifications nevertheless do exist (Turner, 1993a: viii). Within this vast literature on citizenship there is a recurring emphasis on the Western European baggage carried by his concept (Fahrmeir, 2008; Hoffman, 2004; Smith, 2002; Turner, 1993).

> 'There can be little question that citizenship has functioned primarily as an expression of Enlightenment culture and its heir, Political Liberalism. It supports familiar liberal concepts such as the primacy of the individual and the autonomy of the moral will. This, so critics argue, has encouraged a general weakening of any strong idea of community as partially constitutive of our moral identity, community, that is, as something more than a mere collection of sovereign individuals' (Curtin, 2002: 293).

The idea that — and the extent to which — citizenship can be applied to societies that are either not Western or not modern is contested (Hoffman, 2004; Turner, 1993).[61] Even within a Western and modern context, there have been structural changes resulting in the demise of full employment and of the nuclear family, the emergence of new norms of flexible labour, poverty and unemployment, as well as exclusion on the basis of gender and ethnicity: these have drawn attention to ideas of social obligation and duty, as well as rights and entitlements (Turner, 1993).

The most obvious advantage of using the concept of citizenship is that it is relatively easy to define. Additionally, two sets of concerns deserve special attention. One of these is that market-centric policies, and more recently austerity, have attacked the welfare state and impeded it in resolving social and political problems. The other is the globalisation of financial capital, which has constrained the economic sovereignty of nation states. For Turner (1993), these precise occurrences raise questions about the validity of citizenship as a notion: the case presented thus for retaining this concept offers compelling groundwork for a study of financial exclusion. Citizenship is a necessary component of thought on social rights and identity, political membership and welfare issue: it also illuminates the discussion about poverty, social commitment, benefits, and welfare.

Given that the objective of this dissertation is to enhance the understanding of financial exclusion in poor countries — settings where the welfare state is largely absent — there is perhaps a need for caution when examining citizenship in the context of welfare. The justification for persisting with such an approach is that the constrained and austere welfare state offers an opportunity to study financial exclusion as directly related to the expansion of the market and the contraction of the state.

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61 In this context, 'modern' is associated with industrial production and a market economy: this may be contrasted with the notion of 'traditional', a binary conceptualisation that is problematised as 'an obsolete dichotomy' by Germond-Duret (2016).

This in contrast to the view discussed in Chapter 1, that financial exclusion is symptomatic of the need for bespoke products for the poor (Collins et al., 2009), in which there is a tacit acceptance of the depoliticised circumstance of poverty and life in the informal economy. Another justification for using the concept of citizenship, with a welfare orientation, is to consider how policies that seek to counter financial exclusion are formed, transferred, and diffused. This refers particularly to what Jamie Peck and Nik Theodore call 'fast policy' to describe the:

> '…social practices and infrastructures that enable and sustain policy "mobility", which enable the complex folding of policy lessons derived from one place into reformed and transformed arrangements elsewhere' (Peck and Theodore, 2015: xvii).

Fast policy is relevant here because its practices underlie how financial exclusion and inclusion policies are shaped. It affects the capacity of the state to influence citizenship and its forms, such as financial citizenship. As such, it speaks to the concerns mentioned earlier about the economic sovereignty of nation states, particularly given the dominance of global capital which is exerted through the expansion of financial markets.

Forms of citizenship and the vocabulary of rights

Financial citizenship is a form of citizenship: other forms include sexual citizenship and ecological citizenship. A fairly recent tendency, of social and political movements to use a vocabulary of rights and recognition to frame struggles, is reflected in the materialisation of various forms of citizenship. Sexual citizenship, for instance, is a claim to a set of rights and also the articulation of a notion of sexual rights: these may be understood as 'a set of rights to sexual expression and consumption' (Richardson, 2000: 107, in Lister, 2002). Ecological citizenship takes a somewhat different approach because of its calls to encompass the 'more-than-human community' (Curtin, 2002: 302): this imparts resistance to the idea that *people* are the beneficiaries of citizenship and that natural resources are extrinsic goods to advance such benefits for current and future generations.

Aside from forms, citizenship may be seen in the light of approaches, including liberal and republican citizenship and also in the light of histories including ancient and modern (Isin and Turner, 2002). Modern citizenship is the outcome of these approaches and their histories, and has a focal point in the idea of political freedom. This reflects an aspiration to protect individual rights and also to create a system of self-governance. Liberal ideas of citizenship privilege self-protection, whereas republican ideas focus more on self-rule: political freedom remains the central tenet nevertheless (Seubert, 2014).

Of exceptional influence in the literature on modern citizenship is the typology offered by the British sociologist T.H Marshall who noted that civil rights to property

and protection were gained through political pressures exerted by the middle and, eventually by, the working classes; these were followed by near-universal rights of political participation and eventually by social rights to income, housing, healthcare, and education (Marshall, 1950).[62]

This is a valuable typology for a conceptualisation of financial citizenship because a social right to finance may be likened to those claimed in the past, for instance, for housing and education. Similar claims are made in the discussion on microfinance and financial inclusion in poor countries. Muhammad Yunus, the founder of the Grameen Bank, has on various occasions asserted that credit should be a right, much like basic human rights to food, shelter, and health; because access to credit is so potent for poverty reduction, it should be a right itself (Gershman and Morduch, 2015; Financial Times, 2008).

Such a viewpoint is an extension of the Right to Development, which became a part of the 1948 Universal Declaration when it was adopted by the United Nations in 1986.[63] The Right to Development sought to facilitate cooperation at the national and international level to achieve the 'purposes of the United Nations' (Sengupta, 2000: 558). Alston (1984), however, expresses scepticism about the push for the United Nations to recognise more rights because these would undermine existing human rights without necessarily expanding on what is already covered.[64]

The claim that credit is a right thus has merits but also deficiencies. For instance, Gershman and Morduch (2015: 16) are wary of the deleterious nature of 'rights creep' as it devalues more direct approaches to poverty reduction such as:

> '...access to public hand-outs, facilitating transfers between family members, being permitted unfettered migration, reducing inflation, and promoting GDP growth that generates better jobs' (Gershman and Morduch, 2015: 16).

Additionally, as mentioned earlier, not only is there sparse empirical evidence showing that access to credit is indeed transformative, there is also a substantial literature professing the opposite. Particularly, that access to credit can constrain poverty reduction, particularly through indebtedness and the inability to efficiently utilise secondary loans.[65]

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62 A key moment in this context is the American President Franklin Delano Roosevelt Sr.'s 1944 address, in which he details the economic rights, including to, food, clothing, housing, health, education, and employment as comprising economic security (Sengupta, 2000).

63 The Universal Declaration on Human Rights was adopted in 1948 and the Right to Development was adopted in 1986: the historical processes underlying these events are discussed in Alston (2005) and Sengupta (2000).

64 In subsequent research Alston (2005) is more optimistic about the Right to Development noting that the Millennium Development Goals offer an opportunity for the human rights community to engage extensively with the development agenda.

65 'Harm need not be caused by over-indebtedness. It may simply occur when borrowers prove unable to reap positive financial returns on their investments.' (Gershman and Morduch, 2015: 17).

These are major deficiencies of course, but there are merits too when access to credit is likened to a right. One of these is the prominence given to the state to administer and enforce such rights. Another related advantage is the attention drawn to structural obstacles, both formal and informal, that block access to credit for large segments of the population.

Financial access and the state

The role of the state in promoting access to credit, or microfinance, or policies of financial inclusion, is largely absent from the literature, with the exception of some contributions from scholars of political economy. Their analyses observe that financial inclusion —a movement that commenced with rural microcredit initiatives and included the push for microfinance — seeks to meet needs created by state failure in areas such as a health, education, infrastructure and safety nets (Sandberg, 2015; Soederberg, 2012; Mader, 2011; Campbell, 2010; Weber, 2002). This literature is mindful of the neoliberal credentials of financial inclusion and sees the poverty reduction agenda of financial inclusion as a feeble substitute for state directed social spending. An alternative perspective on the state takes its weaknesses as given, a view shared by Muhammad Yunus. For instance, discussing microfinance in the United States:

> 'Welfare law doesn't exist in Bangladesh, because most poor and developing countries don't have welfare … but once you do it in the United States, it applies to Europe. Europe has lots of problems with welfare and so on, and historically they're supposed to protect the people at the very bottom, the safety net kind of thing, but you have to realise that it is not in the best interest of the people to keep them imprisoned in welfare' (Yunus, cited in Financial Times, 2008).

This view is an extension of the one which stresses that corruption and bad governance are salient features of state directed development strategies. Alice Sindzingre and Howard Stein observe how institutional approaches to development, which focus on institutional transformations, particularly related to international organisations, tend to highlight notions of 'bad governance' and the 'rediscovery' of corruption' (Sindzingre and Stein, 2002: 5) as a way of pinning the blame for disastrous policies in the Global South. As a result, the responsibility for ineffective reform and aid is pinned on the recipient country rather than the donor organisation or its conditionalities. What then might be the role of the state in upholding the right to credit? A possible answer — based on examples of other rights — is as a provider of credit:

> 'Declaring healthcare to be a human right imposes on government the responsibility to provide public hospitals when private markets and charities fail to fill gaps. When it comes to credit, the government, it follows, should become the lender of last resort for the poor' (Gershman and Morduch, 2015: 24).

The idea of the government as a lender is contested. Antagonism towards state subsidised loans to poor households was a response to the rural credit programmes run

by Global South governments in the 1970s. Acknowledging the high transaction costs faced by banks, such programmes sought to provide assistance and to weaken the hold of moneylenders on local economies (Hudson, 2014). But these programmes were severely criticised for defaults owing to a lack of collateral, and also because interest rates were too low to incentivise deposit mobilisation (Adams et al., 1984); additionally many of the subsidised loans went to politically connected or non-poor and hence low risk borrowers resulting in a regressive redistribution of incomes (Adam and Von Pischke, 1992). The problem of high transaction costs is discussed in the economic literature as one of asymmetrical information: this concept is studied in the light of microfinance by Haldar and Stiglitz (2013) and Arnott and Stiglitz (1991). High costs are attributed to what economists describe as moral hazard and adverse selection, respectively. Moral hazard occurs here when borrowers take risks knowing that they are protected against the risk because another person will bear the cost. Adverse selection in this context is when borrowers have information that lenders do not have about repayment capacity. The invention of the joint liability microcredit model seemingly overcame the problem of high transaction costs and also those that arose because of government loans: it thus appeared to obliterate the need for subsidised credit from the state.[66]

Given such claims that state directed lending is both ineffective and unnecessary, could other actors, namely the international community, NGOs, and even private institutions, be tasked with the responsibility of providing credit? The example of the Grameen Bank might suggest that this is possible, but this draws the argument into the complex territory of the relationship between human rights and non-state actors. This is the subject of an extensive literature: some examples include Clapham's (2006) exposition of the human rights obligations of non-state actors, O'Neill's (2000) argument about the need to assign obligations to an explicit duty bearer, and also Alston's (2005) concerns about the operational implications of upholding rights.

Aside from the provision of credit there is another role for the state: eliminating the structural obstacles, both formal and informal, to credit access. Such a role is partially captured in the financial repression argument (McKinnon, 1973; Shaw, 1973) in which weak financial development is caused by crony capitalism, explicit or implicit caps on interest rates, and other forms of government involvement that limit the supply of funds for lending. On the position that financial repression is not 'best practice' there is widespread institutional agreement.[67] This consensus is attributed to the rise of the central banking model which Gerald Epstein (2006; 1) calls the 'neo-liberal policy

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66 This is no longer the dominant model of inclusive finance as it has largely been replaced by commercialised approaches: this shift is discussed in the context of Grameen II by Hume (2008) and Dowla and Barua (2006).

67 Much of this is captured in the literature on central bank independence, for instance Fernández-Albertos (2015) and Eijffinger and de Haan (1996).

package'.[68] As a result, there is on the part of these financial institutions at least, a formal commitment, to eschew policies that might limit access to credit.[69]

Outside of the financial sector however, there is room for governments to uphold the proposed right to credit by removing legal barriers such as those that require women to have the signature of her husband on paperwork, or that prevent her from owning property; furthermore, requirements to present documentation that is hard to obtain may also be done away with (Gershman and Morduch, 2015).

Additionally, the state may play an active role in addressing issues of discrimination, particularly those that arise from cultural norms. Here, the right to credit might be asserted through the right to not be discriminated against: this shows a clear connection with the existing principles of human rights as they pertain to equality and justice. Gershman and Morduch (2015) thus take the view that though it is doubtful that a rights based approach to microcredit is an effective one for poverty reduction, there is still substantial merit in enforcing the right to non-discrimination in financial access.

Financial citizenship as a response to exclusionary finance

If credit is not a right, then what is financial citizenship? Or worded differently, is the notion of financial citizenship a useful one if it is not viable to endorse and enforce credit as a right? In concise form, the answer is yes: financial citizenship does indeed exist, even in the absence of credit as a right, so the puzzle is how financial citizenship can be offered to those who do not have it. Also noteworthy is that the discussion on financial exclusion — both in rich and poor countries — extends beyond credit and emphasises financial access as central to activities such as the receipt of welfare payments and remittances.

Financial citizenship is, within national settings, a relative concept. Leyshon and Thrift (1996) for instance, contrast the financial excluded with the 'super included', who are the target market for a wide variety of products designed specifically for them. So, the problem of financial citizenship is not whether or not it exists, but what can be done to reduce the contrasts between the super included and the financially excluded. These contrasts exist because of structural obstacles, some which have to do with the exclusionary nature of contemporary finance. These structural obstacles, which are discussed in the table below, may partially be tackled directly by the state, whereas others require financial systems to acknowledge that 'they have some 'state-like responsibilities which reach beyond consumer sovereignty into basic human rights' (Leyshon and Thrift, 1995: 336).

68 Epstein (2006) questions this 'package' because central banks such as the BoE, and the Federal Reserve have historically implemented policies that would today be called financial repressive .
69 Reinhart and Rogoff (2011) find that financial repression has, after the financial crisis of 2008, again become a concern: national governments are preoccupied with the reduction and management of debt, and the need to keep debt servicing costs low.

Elaine Kempson and Claire Whyley's very important study of the various forms of exclusion is based on secondary as well as primary data on households in the United Kingdom: in particular, there is an analysis of 'self-exclusion' as it is unclear 'whether the people who lack financial products are excluded from access or whether they self-exclude' (Kempson and Whyley, 1999: 1). Based on this, and on their insights on the variegated nature of financial exclusion, three premises now inform policies to address financial exclusion, not just in the United Kingdom, but in countries of the Global South as well. These three premises are: (1) that people currently on the margins of financial services should be integrated into mainstream provision, (2) that the private sector should be encouraged to develop new products and services to meet unmet needs, and, (3) that public-private partnerships should be used to create new markets, address regulatory issues, offer subsidies where needed, and involve non-profit and local bodies in delivering financial services to the excluded (Kempson and Whyley, 1999).

Kempson and Whyley's (1999) report shines a light on the close connection between financial exclusion and social exclusion. As shown in the table below, those most likely to be marginalised are from low income households, often the poorest in the country, and containing single parents, the elderly, or those from migrant backgrounds. These observations echo, and also expand upon, the concerns articulated in the mid 1990s by geographers (Leyshon and Thrift, 1996; Dymski and Veitch, 1996; Pollard, 1996; Dymski, 1995).[70] These same concerns also appear in the financial inclusion policies of New Labour: the introduction of simple and accessible products such as basic bank accounts (BBAs) and Post Office Card Accounts (POCAs) — which allowed certain benefit payments to be deposited automatically — was the result of the Tony Blair Labour government's early financial inclusion agenda (Berry and Serra, 2012).

Table 3.3: Types of financial exclusion

Type of Exclusion	Description
Access Exclusion	Physical absence of bank branches at certain locations prevents customers from using services.
Condition Exclusion	Potential customers excluded for failing to conform to defined product preconditions, such as failing a credit scoring test.
Price Exclusion	Products priced out of the reach of some consumers.
Marketing Exclusion	Undesirable customers avoided by aiming marketing campaigns at potentially profitable socio-demographic groups
Self Exclusion	Customers do not even apply for certain financial products, either because they have been refused in the past, they assume that they will be denied, or they are unaware of products that they might apply for.

Sources: Kempson and Whyley (1999) in Leyshon et. al (2008)

70 Primarily the claim that discriminatory practices of 'redlining' in large cities of the United States are the outcome, at least partly, of insufficient financial investment.

Such initiatives have been problematised on various grounds. For instance, though BBAs appeared to flourish immediately after being introduced — with over 6 million accounts opened in two years (Berry and Serra, 2012) — this success coincided with the closure of bank, building society and Post Office branch closures, and a rise in the numbers of fee-charging cash machines (Collard, 2007). Also troublesome is the underlying opinion — the view of the Labour government — reflected in products such as BBAs and POCAs:

> '...the financially excluded are to some extent legitimately excluded by providers, given their higher risk profiles, meaning that less risky (although less functional) products will encourage providers to offer a more limited form of financial inclusion' (Berry and Serra, 2012: 9).

This view is the foundation for a 'particularistic' form of inclusion, which has social and gendered implications because it perpetuates assumptions that the individuals using such products have lower financial abilities and are different (Midgely, 2005): the post office as a primary location for the financial activities of such individuals implies that products such as POCAs, instead of those from mainstream institutions, will be used by the elderly, the disabled, and single parents, all of whom are more likely to be women.

Critiques such as these are directed at symptomatic responses to financial exclusion. They emphasise that alternatives to mainstream provision carry marginalising tendencies. While such alternatives are inclusive in design they do not offer financial citizenship. The crucial question, which has not yet been addressed here, is: what causes financial exclusion? Gary Dymski presents a straightforward answer, which pins the blame squarely on the financial system:

> 'Social exclusion in the financial realm—that is, 'financial exclusion'—refers to the failure of the formal banking system to offer a full range of depository and credit services, at competitive prices, to all households and/or businesses' (Dymski, 2005: 440).

This is the basis for the literature that applies the notion of financial citizenship to explore how individuals — and also households and communities — encounter the financial system and its discriminatory tendencies. Within this scholarship, there are broadly two streams that occasionally overlap. One of these examines financial subjectivity as the outcome of the growing influence of finance on day to day interactions; the other stream probes the discriminatory nature of the financial system in the light of the principles and processes upon which it is based.

The former subset of the literature is sceptical about financial citizenship because the financial citizen is as a constructed product of governmentality. The literature on governmentality and its manifestations is, of course, vast' but in this context, it refers to 'indirect techniques for leading and controlling individuals without

at the same time being responsible for them' (Foucalt, 1979, cited in Lemke, 2001).[71] Initiatives such as financial coaching, education, and literacy are relevant here (Loomis, 2018; Langley, 2007). In a similar light the notion of 'homo subprimicus' — which is an extension of the Foucaldian concept of homo economicus — is offered to view financial citizenship as 'a subjectivizing force' (Kear, 2013: 937). Associated with this is the observation that 'the failure to adopt desired financial practices is framed as a deficit of ethical behaviour' (Pathak, 2014: 97); this relates to critiques of 'responsibilisation' which indicates a reversal of citizenship:

> 'Responsibilisation essentially reverses the basic logic of how citizenship has developed for centuries, that is, the granting of new rights in return for responsibilities that we already had – in recent years, new responsibilities have been created to reflect the rights we already have' (Berry and Serra, 2012: 18).

Within this subset are also a number of studies that examine how households engage with personal finance and debt given structural changes in the financial landscape: particularly those driven by policies of austerity. Some of this research builds on earlier work on the nature of subjectivity (Lai and Tan, 2015); otherwise, there is a focus on the implications of specific practices of financial institutions (Appleyard et. al, 2016; Coppock 2013; Appleyard, 2012).

Financial infrastructural withdrawal — as in widespread bank branch closures — is a direct consequence of disintermediation, associated with the diminishing need for banks to rely on depositors (French and Leyshon, 2010). Additionally, stratification practices that segment markets exploit the inability of lower income clientele to find competitive alternatives and hence complicate access to financial services (Dymski, 2005). And, not only has data technology facilitated financial institutions in circumnavigating intermediaries (French and Leyshon, 2010) it has also eased clientele segmentation based on credit-scores issued by private agencies (Leyshon and Thrift, 1999). The exclusionary nature of such practices hardens the lines between financial inclusion and financial citizenship (Dymski, 2005). These practices, as is shown later in this thesis, manifest themselves in poor countries as well.

Table 3.4: Conceptualising bifurcated banking structures

Concept	Context
Exploitative greenlining (Newman and Wyly, 2004)	To problematise the ways in which 'market completion' advanced by processes such as the expansion of the sub-prime for mortgage markets, is not egalitarian.
Exploitative inclusion (Sokol, 2013)	Mortgages, credit cards and other credit–debt instruments are at the centre of debt-based circuits of value: these rely on a logic of the extraction of value from debtors by creditors.
Precarious inclusion	Financial stratification processes in doorstep lending lead to

71 Lemke (2001) has provided a detailed account of governmentality as presented through Foucault's analysis of two forms of neoliberalism in his lecture of 1979 at the Collège de France.

(Appleyard et al., 2016)	access to credit which can lead to debt problems.
Adverse incorporation (Aitken, 2015)	Fringe finance directed at vulnerable populations can deepen forms of economic disenfranchisement.

Compiled by author

The context of poor countries has received some attention from scholars of shadow banking but almost none from scholars of financial citizenship. This gap is addressed in this thesis through two assertions: that inclusive finance impedes financial citizenship, and that inclusive finance is a form of shadow banking. The first assertion is drawn directly from the various objections to a binary conceptualization of inclusion-exclusion: these are summed up in Henry et al (2017) and include Newman and Wyly's (2004) 'exploitative greenlining' Sokol's (2013) 'exploitative inclusion', Appleyard et al's (2016) 'precarious inclusion' and also Aitken's (2015) 'adverse incorporation'. This chapter complements such conceptualisations by accounting for the role of shadow banking in impeding full financial citizenship: the financial citizenship lens is thus augmented and applicable also to poor countries. These conceptualisations are summarised in Table 3.2.

This research on the practices of financial institutions has a direct connection with another subset of research on financial citizenship: that on the principles and processes that direct how financial institutions operate. For instance, Gabor and Brooks (2017) outline how new technologies — particularly those that evaluate potential customers in the Global South through the use of digital data — have transformed the nature of inclusive finance. Berry (2015), sees the financial inclusion agenda advanced by successive UK governments as an extension of the financialisation of the state and an instance of when 'the state has sought to abdicate its role in shaping economic structures'. This builds on earlier work by Berry and Serra (2012) which discusses how public policy on financial inclusion has been oriented to changing financial behaviour in individuals, presumably as an alternative to welfare policies. Other studies draw attention to how processes such as globalisation and financial crises have driven shifts, in the business models of financial institutions, which have changed how they seek clientele (French et al. 2011; Dymski, 2005; Leyshon et. al, 2008; Leyshon and Thrift, 1995).[72] Of particular relevance is the decline of traditional models of intermediation: the idea that this trend has implications for financial citizenship because of its fixation with segmented markets is discussed by Dymski (2005) in the context of financial globalisation.

As shown above, the decline of intermediation has caused a rupture in the social contract of banking. A colossal shift has thus occurred in the way that the financial system operates

72 Chapter 2 of this dissertation discusses the respective banking models of OTH and OTD.

3.6 THE SOCIAL CONTRACT AND BIFURCATED BANKING FOR THE POOR

Segregated or bifurcated monetary systems motivate substantially different monetary experiences for the poor (Baradaran, 2017) and these disparities point to a need to revisit the relationship — or the social contract — between banks, society, and the state. As Rethel and Sinclair (2012) note in 'The Problem with Banks', an idealised form of financial institution may be described as a 'Jimmy Stewart' bank; after the actor's role in the 1946 Frank Capra film.[73] Such a bank is one in which customer deposits fund the homes and businesses of their neighbours: the bank thus serves an altruistic purpose which arises from a configuration in which such institutions function as 'self conscious market authorities' and in which 'long-term business relations trump short-term profit maximization' (Rethel and Sinclair, 2012: 26). This is one of four possible configurations which vary, depending on (1) whether institutions see themselves as market players or market authorities, and (2) the temporal horizons — long term or short term — on which they choose to operate. Rethel and Sinclair (2012) emphasise the role of 'rules of purposes' which constitute new identities and ideas: these are called constitutive rules and exemplified in the shifting self-identification of banks from market authorities to market players.

Related scholarship on contemporary practices in banking locates this shift in self-identification, in the breakdown of a social contract in banking (Baradaran, 2017; Ricks, 2010; Dymski, 1993). The work of the American legal scholar Mehrsa Baradaran is particularly valuable here, as it includes commentaries on the social contract of banking, as well as on the phenomena of segregated banking in the United States. The confluence of these approaches provides useful tools to study the phenomenon of bifurcated banking.

The social contract of banking describes an implicit arrangement in which the government or state offers banks a safety net in the form of protection from runs, liquidity shortages, and investor irrationality: in exchange, banks commit to operating safely and meeting the collective and individual borrowing needs of the communities for economic expansion (Baradaran, 2011). In a heterodox economic depiction of this arrangement — which acknowledges the role of banks in money creation — the two functions of banks are: (1) money creation for the functioning of the economy and (2) lending to productive enterprises to support economic activity (Chick et al., 2013).

In a context that pre-dates the 2007-9 global financial crises (GFC), Dymski (1993) observes how in the United States, especially in the 1980s, debt and speculative finance was increasingly used for leveraged buy-outs and commercial real estate; this exacerbated socio-economic inequality, especially as banks, were incentivised to

73 The film, 'It's a Wonderful Life' is based on the short story and booklet 'The Greatest Gift' authored by Philip Van Doren Stern.

'redline' some communities, particularly black Americans.[74] This is a violation of the social contract because when banks shift their emphasis to speculation and to servicing institutional clients, they eschew their primary function of lending to productive enterprises that are unable to access non-bank finance from securities markets and other institutions.

The role of the shadow banking industry in the global financial crises reveals another instance of a rupture in the social contract (Ricks, 2010). In this case, the safety net extended by the authorities, in the form of access to central bank liquidity and federal deposit insurance, was used not only by the depository institutions for which it was intended but also by shadow banks, which are characterised here by practices of maturity transformation. The solution to instability arising from shadow banking is not, as has been suggested, in (1) extending the safety net to or (2) placing stronger constraints on shadow banks, but to 'disallow financial firms outside the banking social contract from engaging in maturity transformation' (Ricks, 2010: 14). Put differently, this is an argument for ending shadow banking insofar as the practice relies on money market funding. Related steps to strengthen the social contract include mechanisms such as term funding arrangements — financing arranged to meet specific needs over a period — through which cash parking becomes a utility rather than an investment vehicle, and the imposition of fees to raise costs for the issuers of funds (Ricks, 2010).

To revisit the social contract, 'the proper end is ensuring that the nation's banks do what the public needs them to do and not the other way around' (Baradaran, 2013: 1284). For the regulators, this entails giving concerns about profitability a secondary role, and seeing 'public benefit' as comprised of safety and soundness, consumer protection, and access to credit, instead of efficiency and competition. These features of public benefit are pillars of a social contract. Baradaran (2011) describes the period between 1933 and the mid-1970s as one of growth and stability. Fresh regulations associated with the New Deal ensured that the banks stayed away from riskier activities, such as underwriting and proprietary trading.[75] And, the government actively fostered an institutional architecture to assist poor and middle class households in buying homes and accessing low-cost credit.[76] But all of this changed drastically, beginning in the 1980s when increased competition from foreign banks and technological advances caused banks to lose market share and profitability. The 'New Deal social contract' was thus undermined and legislators proceeded to steadily deregulate banks, and make them more powerful and profitable.

> 'Ultimately, this period of deregulation resulted in an asymmetrical erosion of the social contract with banks. The revisions abrogated many of the safety and soundness regulations and public-serving obligations imposed on banks but did

74 This term refers to practices that link access to capital and financial services to neighbourhood characteristics such as race and ethnicity. A more detailed explanation is offered in section 3.4 of this Chapter.
75 For instance the Glass-Steagall legislation of 1933
76 For instance the Federal Home Loan Bank System and Congressional Acts such as the Federal Credit Union Act and National Housing Act, as well as a government charter for Fannie Mae.

not take away the government safety net, such as FDIC insurance and access to the Federal Reserve discount window' (Baradaran, 2011: 1309).

Deregulation resulted in a massive and rapid expansion of the financial sector but is notable also for an abandonment of 'the conceptual vision of banks as inextricably bound to the state' as banks successfully sought to be treated more like private corporations and less like public utilities (Baradaran, 2011: 1310). Under this configuration, banks effectively deserted less profitable low-income customers in favour of wealthier clients and high-yield investments: the ensuing vacuum attracted fringe finance in the form of payday lenders and check-cashing services.

Bifurcation as discrimination

These trends are examined in Baradaran's (2017; 2015) more recent work, on black banks and segregated banking in America. This presents an opportunity to connect the notion of the banking social contract with bifurcated banking. To a considerable extent, this echoes the concerns of Gary Dymski, as well as others who examine the geography of urban American cities to study racial discrimination in credit markets and housing markets (e.g, Dymski, 2006; Dymski and Veitch, 1995). Of particular importance is the incidence of 'disparate impact' when commercial practices disproportionately harm a racial minority with no justification through a legitimate business need (Marsden, 1994 cited in Dymski, 2006) or 'situations in which procedures that are racially neutral on their face lead to ex-post racial disparities unrelated to economic fundamentals' (Dymski, 2006: 218). [77]

Loan and housing markets exert disparate impact through several mechanisms. The process of redlining, as lenders and real estate agents deem certain areas unsuitable or undesirable for transactions on the basis on perceived risks, is at the very core of institutionalised disparate impact. For instance, as Dymski (2006) observes, the loan underwriting practices over the 1950s and 1960s of the Federal Housing Administration used explicitly racial criteria.

> 'So redlining was not a phantasm of overzealous activists: it had been official government policy. The relation between racial discrimination and redlining was then as follows: the former disadvantages an agent independent of her location; the latter disadvantages agents in a location independent of their individual characteristics' (Dymski, 2006: 218).

Behavioural economic models used to study the phenomenon of disparate impact offer commentaries on the persistence and resilience of redlining practices. Many of these take as a starting point a study by Gary Becker (1957; 1971) which claims that

77 Marsden (1994) lists this as a form of racial discrimination along with 'overt impact' and 'disparate treatment': the former refers to an intentional behaviour from an identifiable 'perpetrator' with an explicit intention whereas the latter refers to behaviour without an explicit intent but which has non-neutral outcomes and an identifiable perpetrator. These forms of racial discrimination may be contrasted with 'disparate impact' which does not involve an identifiable perpetrator.

discrimination in the market place by any group reduces not only their own real incomes also those of the minority. Racial bigots inevitably pay more because of their preferences, they will eventually tire of these preferences when the market pricing mechanism makes it clear that bigotry entails a premium. [78]

But Dymski (2006) counters this view on the basis that it assumes that only some lenders and agents are bigoted: in a situation where all lenders and agents are bigoted, racial minorities must compete for lower-quality homes and thus pay a higher price for them. Additionally, the use of an informational asymmetry framework (Stiglitz and Weiss, 1991) shows that housing discrimination can exist even when the racial bigots of Becker's model do not exist: when banks cannot make decisions about individual creditworthiness they might redline an entire community to reduce risk.

Is there an economic rationale for associating higher risk with a racial minority community? Suggested explanations are based on assumptions of neighbourhood externalities and information costs (Guttentag and Wachter, 1981; Lang and Nakamura, 1993 cited in Dymski, 2006). Because the feasibility of lending depends on the total volume of loans being made in a geographical area, lenders will be drawn to areas where others are already operating, and also when the race and economic fundamentals of borrowers are correlated, lenders can 'rationally' use the racial composition of an area as a low-cost proxy for creditworthiness.

For the black community in the United States, one response to this form of discrimination has been black banks. In her expansive study of black banks and the racial wealth gap, Baradaran (2017), notes how banks established specifically for the black community faced persistent failure: not only did they tend to be financially unstable but they were also incapable of resolving the economic problems underlying racial wealth inequality.

Black banking has its origins in the small military banks which had been formed during the Civil War in the 1860s to hold the wages of black soldiers. A particularly important example in this regard is that of the Freedmen's Bank which was seen by the public as trustworthy because it was backed by Abraham Lincoln's government: but it was actually run as a private investment bank with management personnel actively engaged in speculation. This strategy was facilitated by the black community's willingness to use the institution as a 'piggy bank' whilst the management sought to inculcate the values of thrift and capitalism. As Baradaran (2017) emphasises, the most salient feature of capitalism is in the ability of capital to proliferate through credit; but the Freedmen's Bank did not allow the black community to avail this feature as it did not lend to depositors. Eventually, the bank collapsed after incurring massive losses because its management used customer deposits to finance the westward expansion of the railroad or what has been called the 'first postwar asset bubble' (Baradaran, 2017: 27). For many in the black community, the collapse of this institution caused financial

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78 'The Economics of Discrimination' was the subject of Becker's doctoral dissertation at the University of Chicago and was published as a book in 1957 with a second edition in 1971.

ruin and led to a deep mistrust of state institutions as well as banks in general. But the case for black banking prevailed not only because many black leaders — some who had worked in the bank as tellers, clerks and bookkeepers — saw the potential for success, but also because the legitimisation of Jim Crow laws and segregation effectively eliminated the black community from public life in America.[79]

Baradaran (2017: 87) observes that in this racially segregated setting 'not only was it impossible for black banking to be separate and equal, they could not even be separate and profitable'. There were many structural reasons for this: for instance, even though the number of black businesses increased exponentially between 1917 and 1930, because these were almost always individually owned and closed down when the founder died, they offered only a weak infrastructure for the production and accumulation of capital. Also, because the black community could not receive credit or insurance from a white bank or purchase a home from a white realtor, the cost of accumulating capital was always higher for them. And prohibitions made it necessary for black businesses to find black customers whereas white businesses could sell their goods to anyone: as a result, black businesses competed with other black businesses as well as white businesses and thus struggled to achieve economies of scale.

Of particular interest is the disadvantage blacks faced in home ownership. White banks did not generally lend to blacks, and even when they did the interest rate was much higher than usual. The portfolios of black banks came to be engorged by home loans: this placed the banks in a precarious situation because the nature of segregation was such that when blacks purchased property its value fell and thus compromised loan collateral. This curious phenomenon added an economic impetus — in addition to a racist one — to the vociferous efforts of whites to keep blacks out of their neighbourhoods, as the fear of a neighbourhood declining and being 'swallowed up by the ghetto' (Baradaran, 2017: 91) was a pressing concern.

The successes of the Civil Rights movement which gained enormous traction in the 1960s meant that the black community was granted equality in the form of legal and political rights; economic equality, however, remained elusive. When President Nixon took office in 1969, a radical black movement faced a strong white backlash: Nixon's political savvy response included 'opposing all forms of legal race discrimination while rejecting any government efforts at integration' (Baradaran, 2017: 165). Black banking thus came to be a crucial feature of 'black capitalism': this was presented as a programme of the government to address the black community's demands.

But black capitalism could not resolve the problem of capital for black banks. The circular linkage between capital and bank profitability means that the more profitable a bank, the more capital it can attract to become even more profitable. Because black banks had no choice other than to make riskier loans, they had higher costs, lower profits and could not attract capital for investment. Additional constraints were regulatory: for instance, in order to be classified as a black bank, the majority of

79 The relevant court rulings are: Williams v. Mississippi, 170 U.S. 213 (1898) Plessy v. Ferguson, 163 U.S. 537 (1896).

shareholders had to be black. This limited the opportunity to raise capital as the potential pool of investors for black banks was relatively small. Another problem was deposit volatility because black banks tended to see deposit withdrawals at a higher and frequent rate relative to white banks: to offset risks, volatile deposits needed to be backed by government securities which offered a low return and cut profitability. And initiatives such as a government programme to channel government deposits to black banks were unhelpful because these deposits had to be fully matched by investments in United States government securities.

The problem of capital in a segregated banking system is, as Baradaran (2017) demonstrates, particularly one of circulation: funds deposited in a black bank eventually leave the black banking system:

> 'Black banks were still exporting funds from the ghetto. Their over-investment in government securities meant that they were using their customer deposits to finance mortgages outside their communities. During the era of secondary mortgage markets, the outflow of deposit funds into other people's mortgages was accelerated by the mortgage-backed security. Now, banks anywhere were investing the mortgages everywhere. For black banks, this process was a newer and less obvious way for them to serve as financial sieves — dispersing funds from the ghetto to the broader economy' (Baradaran, 2017: 245).

Black borrowers had, for generations, been allowed only limited access to loan markets, so it is unsurprising that this community became the worst victims of the subprime era: according to some estimates over 53 per cent of total black wealth was destroyed because of the financial crisis in 2008 (Baradaran, 2017: p 249) . Since the crisis, black banking has with some exceptions, been in a state of decline. [80]

The story of black banking reveals gaping fissures in the social contract of banking. The need for black banks, especially in a post Civil Rights context, was created because mainstream banks chose not to lend to the black community. In doing so, they violated the contract by refusing to fill their collective and individual borrowing needs for economic growth and productivity. And then subsequently, by exploiting structural inequalities to sell sub-prime loans, banks destroyed already scarce capital and broke their commitment to operating safely.

Segregation, inclusion, and predation

Do the examples presented above have wider applicability? An example of this is in the resemblance between black or segregated banking in the United States, and inclusive finance in Pakistan. Perhaps an obvious commonality is the emphasis on self-help and entrepreneurship. Two similarities stand out in particular: one of these is the asymmetrical capacity of segregated or bifurcated systems to create wealth, and other is

80 These are a result of the '#BankBlack' or 'Black Money Matters' movement which has been endorsed by several prominent celebrities (Christian Science Monitor, 2016).

the extractive nature of parallel systems. These are illustrated below through the example of housing finance which demonstrates how uneven processes of wealth accumulation occur because of the propensity of the financial system to multiply capital.

In modern banking systems, as Baradaran (2017) contends, this multiplication is from the practice of fractional reserve banking in which banks may lend out more than they hold in deposits. [81]

> 'This is the "magic" of fractional reserve banking. Every time a loan is made, a deposit is *created.* To repeat, banks create money, or bank deposits, by making loans. This money multiplier effect is what makes banks the engines at the center of the economy — the new money is "created literally out of thin air' (Baradaran, 2017: 94).

Despite being equipped to create money, black banks were nevertheless unable to become meaningful wealth generators for the black community. In a segregated system, deposits placed in black banks would quickly — through the mechanisms of loan creation — find themselves in white or mainstream banks. This had much to do with the structure of an economy in which sellers, particularly of property, were almost invariably white; additionally, particularly when segregation was strict, white banks did not lend to black individuals or enterprises, and white individuals and enterprises did not make deposits in black banks (Baradaran, 2017). So while black banks contributed to wealth creation in the broader economy, this was done in a manner which reproduced the inequalities of the overall structure.

In Pakistan, mortgage finance has not yet become an important vehicle for wealth accumulation: data on housing finance is available from Findex.[82] This measures housing loan penetration or the percentage of the adult population with an outstanding loan to purchase a home.[83] For Pakistan, this is a meagre 2.3 per cent relative to 36.7 per cent for the United States, and 34.3 per cent for the United Kingdom; for India and Bangladesh the corresponding figures are 2.5 and 2.9 per cent respectively (Badev et al., 2014). Weak access to housing finance is commonplace in poor countries: this is attributed to various tendencies such as regulatory restrictions on bank lending for real estate (Badev et al., 2014) and the paucity of long term fixed rate funding instruments (Nenova, 2010). Housing finance in Pakistan also faces the broader limitations of the property market including the lax enforcement of foreclosure laws, lack of standardisation in land titling, heavy stamp duties, and shortages of affordable housing (Nenova, 2010).

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81 Baradaran (2017) places some emphasis on the role of the money multiplier in wealth creation: this comes across as inconsistent with her view on the production of money which she ascribes to banks when they create deposits by making loans and thus sees as endogenous. In such an arrangement the money multiplier has a residual and not a causal role in wealth creation (see Palley, 2015; Lavoie, 1984). This confusion does not undermine her key argument that the lending activities of black banks benefitted the broader economy more than the black economy: the inability of black banks to grow may be attributed the limited opportunities their clients had to engage in production or economic activity.

82 The Global Financial Inclusion Index: this is constructed with survey data gathered across 148 countries.

83 The standard measure for this is mortgage debt as a percentage of GDP but data for this is available only for a limited number of countries.

All of these reasons are relevant for mainstream as well as microfinance banks, but for the latter, housing finance is a particularly elusive product because of mandatory loan limits. The State Bank of Pakistan's prudential regulations (SBP, 2014) cap loan size at PKR 1,000,000.[84] This is a very small amount and because of this limit, house financing products, even when offered, tend to be for home improvement —for example, through the installation of solar panels — rather than for home purchase or construction.[85]

An interesting parallel may be drawn here between the United States and Pakistan: in both countries, bifurcated banking intensifies inequalities through the market for housing finance. Whereas in the United States much of this occurs because skewed ownership patterns deplete the money creation potential of black banks, in Pakistan, the lack of access to housing finance disproportionately affects the poor too (World Bank, 2017). A symptom of this is the proliferation of *katchi abadis* or slum dwellings which are structurally deficient, lack access to basic infrastructure including piped water and a sewerage network, and also lack titles or permits. Data for 2009 shows that *katchi abadis* are the home for 46.6 per cent of the urban population in Pakistan (World Bank, 2017). The lack of access to housing finance not only limits who can purchase property, it also creates shortages in the stock of affordable housing and leaves those without access to mainstream finance with no option other than the slum (World Bank, 2017).

Inclusive finance in Pakistan is thus unsuited to resolve the problem of affordable housing and its emphasis has tended to be on enterprise and consumer lending: this is the standard approach for lending through inclusive finance. But this focus has been, and continues to be, troubled again by loan limits — which are too small to create firms that operate formally and seek economies of scale— and by high interest rates that can lead to worrying levels of indebtedness (Bateman and Chang, 2012). These asymmetries reflect the uneven nature of wealth creation and capital accumulation when financial systems are segregated or bifurcated.

3.7 SUMMARY

The objective of this chapter has been to introduce a conceptual tool for the study of: (1) bifurcated banking and financial services, as highlighted in Chapter 1, and (2) the financialisation of development strategy, as explicated in Chapter 2. The conceptual tool of shadow financial citizenship describes the grey area in what is presented here as a continuum between financial exclusion and full financial citizenship. When inclusive finance is presented as a remedy to financial exclusion or to the circumstance of being

84 Prior to 2017 the loan size limit was PKR 500,000 but this was amended through the AC&MFD Circular No. 03 0f 2017
85 The equivalent of less than USD 7000 based on average PKR-USD conversion rates in 2018, and even less in 2019 because of sharp rupee devaluation.

‘unbanked’ or even ‘underserved’, shadow financial citizenship emerges because of exclusionary practices. This is so because these exclusionary practices that obstruct financial citizenship are embedded in the financial landscapes of poor countries. These practices arise from the shadow banking and inclusive finance nexus that is a focal point of this thesis.

The next section applies a shadow financial citizenship lens to banking in Pakistan to examine inclusive finance as shadow banking. This is done by first presenting the institutional context for inclusive finance in Pakistan (Chapter 4), and then highlighting how the two explanations offered for shadow banking — the supply side (Chapter 5) and demand side (Chapter 6) view respectively — are relevant in the Pakistani context of inclusive finance, this discussion is followed by a comparative study of two microfinance banks in Pakistan to draw attention to how the specific practices and processes of institutions advance shadow financial citizenship.

PART TWO

4. BIFURCATED BANKING IN PAKISTAN: ORIGINS AND STRUCTURES

4.1 INTRODUCTION

As mentioned in the previous chapter, inclusive finance as shadow banking plays a causal role in advancing bifurcated banking. Inclusive finance, as contended earlier, has been entrapped by shadow banks and encumbered with shadow banking practices: so when used to counter financial exclusion or the circumstance of being 'unbanked' or 'underserved', shadow financial citizenship emerges. This is so because the exclusionary practices that obstruct financial citizenship are embedded in the financial landscapes of poor countries. This claim may be reworded: the financial landscapes of poor countries are shaped by shadow banking networks and practices, in the form of inclusive finance, these drive exclusionary practices, and result in a bifurcated banking system. The remainder of this thesis will, through the use of a case study examples, examine the setting in which these networks and practices establish themselves.

The common objective of the Chapters 4 - 8 then is to empirically study this setting by identifying it within the financial topography of Pakistan and the institutions — national and international — that shape how inclusive finance is offered. The present chapter draws attention to the nature of commercialised inclusive finance in Pakistan. The next chapter, Chapter 5, highlights the features of bifurcated banking which are driven by shadow banking networks and practices, and characterise shadow financial citizenship. Chapter 6 draws linkages between these practices and the strategies of two large microfinance banks in Pakistan. Chapter 7 is a discussion on how shadow financial citizenship is shaped by recent development approaches that emphasise the need for both private capital and patient finance.

The remainder of the present chapter proceeds as follows. Section 4.2 contains an overview of Pakistan's banking sector, particularly the role of financial deregulation, liberalisation, and privatisation in the current state of inclusive finance. Section 4.3 describes the institutional architecture of commercialised inclusive finance in Pakistan. Section 4.4 offers concluding remarks.

4.2 DUALISTIC FINANCE IN PAKISTAN

An empirical setting for this discussion is the financial sector of Pakistan. Bifurcated banking here — and also in other poor countries — is the outcome of a separation of mainstream and inclusive finance. The role of the regulators offers a context for examining two key trends that have occurred in Pakistan's microfinance market. One of

these is the transition from informal finance to formal finance; another is the commercialisation of microfinance under the umbrella of a state backed financial inclusion programme. Nevertheless, even in a formal, commercial iteration, inclusive finance tends to be closer — both in terms of clientele and lending strategy — to informal finance than to formal finance. This is unsurprising given that the origins of financial inclusion are in the Grameen model which was designed with the explicit purpose of providing an alternative to existing systems of finance: formal and informal.

> 'Founded by Muhammad Yunus in 1983, the Grameen Bank pioneered a simple model of credit whereby small groups of poor women are able to secure small loans at reasonable rates of interest. The model is meant to serve as an alternative to both formal systems of banking that demand collateral and exclude the poor and informal systems of finance that prey on the poor' (A. Roy, 2010: 3).

The closeness of inclusive finance to informal finance is not coincidental: many of the issues associated with inclusive finance which are discussed in Chapter 1, are attributed to informality, which is itself associated with poverty. The following sections draw attention to how inclusive finance was — in the form of its antecedents — designed explicitly for those who live and work in the informal economy. A crucial outcome of this formulation has been to reinforce the separation between formal and alternative forms of finance.

Phases of development and colonial legacies

The banking sector in Pakistan, which became independent from British colonial rule in 1947, has passed through a number of distinct phases. A focus on informal finance and its perception as a 'competitor' to formal banking is relatively recent, and is an outcome of the microfinance movement that existed in the 1980s, but gained considerable traction when financial liberalisation commenced in Pakistan.

T. Roy (2016) observes how the policymaker's unease, in the late-colonial period, around informal finance and related local phenomena obliged them to conduct a large scale banking enquiry in 1929-30. However, following independence from British rule in 1947, the state took steps to outlaw indigenous banking in India completely (T. Roy, 2016). In Pakistan, simultaneously and newly independent, the situation appears to have been slightly different. Indian policymakers had managed to bring down the share of informal financiers — who tended to be professional moneylenders — in rural credit to less than 36 per cent, from 80 per cent over the 1951 and 1971 period (Binswanger and Khandker, 1992). For Pakistan, Manig (1996) shows that in 1972, 89 per cent of credit was drawn from informal sources, who were principally friends and family. This divergence in informal credit use was in all likelihood, the outcome of multiple factors, including the shape of government policy.

A comparative analysis is outside the scope of this chapter but it is likely that the rate at which interest tended to be charged for such informal transactions in South

Asian economies is of relevance. Manig (1996) noted that most informal credit in Pakistan — owing to Islamic practices combined with the embedding of credit relations in other economic and social interactions — was being offered without interest. This is corroborated by data which indicates that formal lenders charge an interest rate of 19 per cent while informal lenders charge 23 per cent (Irfan et. al, 1996): it is telling that money lenders, which are included in the calculation for informal rates, drag up the average considerably as they charge interest ranging from 48 per cent to 120 per cent. Relatively low informal rates in Pakistan could explain why a supply-led approach, one in which the state actively promotes formal finance in order to replace informal finance, was more likely to be efficacious in India than in Pakistan.

In Pakistan, the stance of the government is also reflected in its early involvement in key initiatives such as the OPP and AKRSP, which have pioneered the microfinance movement; respectively in the urban and rural context. The OPP (Orangi Pilot Project) and the AKRSP (Aga Khan Rural Support Programme) share commonalities with the original Grameen vision of Dr. Muhammad Yunus. This is so because of their mutual roots in the Comilla Model, associated with the Dhaka — and subsequently Karachi— based social scientist, Dr. Akhtar Hameed Khan. Originally developed at the Bangladesh (formerly Pakistan) Academy of Rural Development, the Comilla Model sought to integrate several public and private resources to build an institutional base for various development programs.[107] The OPP was thus initiated as a grassroots development project, emphasising 'self-help' as the primary means of developing the 'katchi abadis' — informal sector settlements — of urban Karachi (Zaidi, 2001). Similarly, the AKRSP was established in 1982 by the Aga Khan Foundation with a specific geographical focus: development interventions in the Northern Areas of Pakistan (Khan, 2010). For both of these initiatives, microcredit was one component of the development interventions the organisation sought to deliver; other components included health, education, and sanitation. Interestingly, the microcredit component was eventually absorbed by the financial sector, on the pretext of financial liberalisation.

The regulation of liberalisation

When colonial rule ceased in the Subcontinent, the Reserve Bank of India was the de facto central bank for both newly independent countries. The Pakistan banking industry felt disadvantaged by this arrangement so a separate central bank, the State Bank of Pakistan, was formed in 1948 (SBP, 2016). Shortly thereafter, in 1949, a publicly owned commercial bank, the National Bank of Pakistan, was formed as well. The State Bank of Pakistan Act was introduced in 1956 and the Banking Companies Ordinance in 1962. These would undergo amendments decades later to facilitate the liberalisation of the banking industry, following rounds of nationalisation in the 1970s and then privatisation in the 1990s (Burki and Ahmad, 2010).

107 This followed the emergence of Bangladesh as an independent nation state in 1971.

Studies on Pakistani banking and finance tend to make a sharp distinction between the pre-1990s and post-1990s financial system given the upheaval associated with the IMF structural adjustment program that commenced in 1988 (Naqvi, 2018; Zaidi, 2015; Sayeed and Abbasi, 2015). Pre-1990s Pakistan had the financial system of a developmental state, in which nationalised financial institutions were directed to allocate credit to designated sectors (Naqvi, 2018). The Bank Nationalisation Act of 1974 allowed the government to merge all domestic banks into five state owned commercial banks. Under this arrangement, the banking sector became instrumental to a state-led development policy based on channelling credit to specific economic sectors (Khalid and Nadeem, 2017; Burki and Ahmad, 2010). Measures such as credit ceilings were used to impose separate credit limits for public sector and private sector enterprises. These limits were based on weights in the economy, their investments targets, and anticipated value-addition as projected in the Annual Development Plan. The state thus sought to direct banking activities towards broader socio-economic objectives and also to protect depositor funds. To this end, the central bank set annual targets for commercial banks, for production loans, tobacco marketing, and production and development loans for small farmers. There were also targets for fixed investments and loan refinancing for activities relating to locally manufactured machinery and agricultural.

Such interventions caused banks to lose on efficiency grounds (Khalid and Nadeem, 2017). This is reflected in patterns of excessive bank funding of budgetary deficits; suboptimal governance structures in predominantly state owned banks; weak loan recovery because of political motivated lending; heavy financial sector taxation; and excessively high lending rates and low deposit rates. Nevertheless, private credit in relation to GDP ratio grew continually and investment growth was strong because of directed lending approaches.[108]

Particularly over the 1980s, widespread corruption in staffing and loan disbursements led to the nationalised banks becoming bloated and inefficient with poor asset quality (Burki and Ahmad, 2010). Reports of this, combined with growing disdain in policy circles for interventionist state models, set the tone for market based approaches to financial development.[109]

Financial liberalisation in Pakistan commenced in 1994 when the Bank Nationalisation Act was amended.[110] A Privatisation Commission was also established in the same year. A number of domestic and foreign banks were given permission to operate and preparations were made for the government to divest ownership in the

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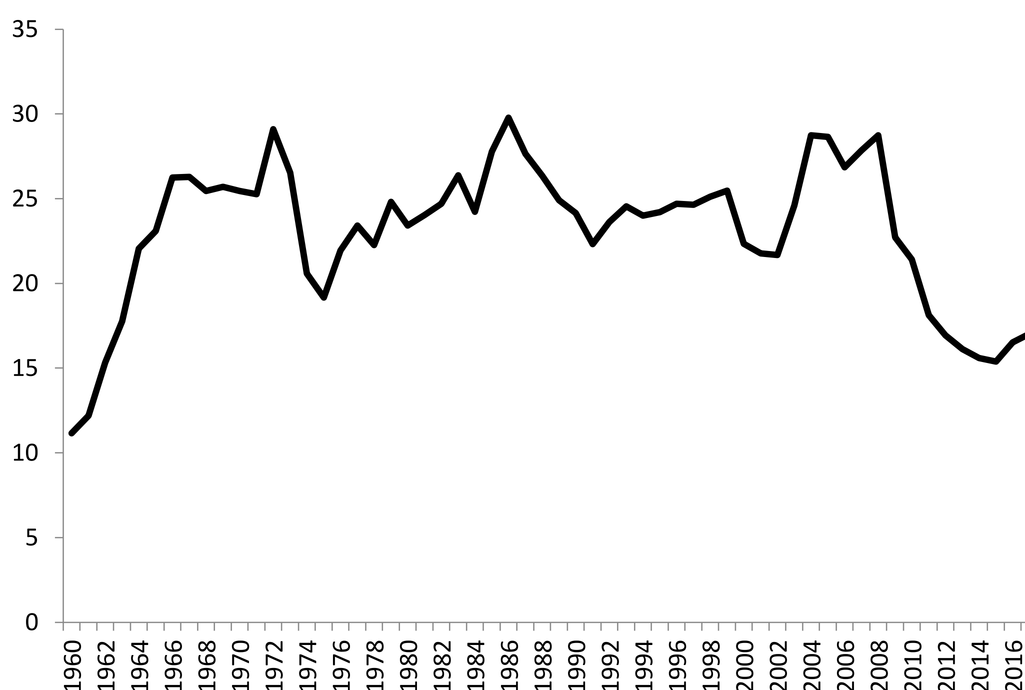
108 The direct lending approach used as part of interventionist strategies reflects a wider trend in the developing world including across the border, in India. Its appeal is linked to the successes of the East Asian economies, particularly South Korea, Japan, and Taiwan (Kohli, 1997).

109 Kohli (1997: 2667) observes: 'The clearest policy statement on the future of these programmes, which is to be found in the World Bank (1989), dismisses directed credit programmes as an ineffective policy measure for achieving growth and redistributive objectives. It argues instead for financial reform by moving towards a market-based allocation of resources so that investments with high rates of return are financed, leading to an increase in the average productivity of investment and rate of economic growth'.

110 Zaidi (2015) notes that the Pakistani economy was radically transformed after 1988: he attributes this largely to the Structural Adjustment Programme that was implemented in the same year but also to geopolitical events such as the end of the Cold War.

nationalised banks. In 1997, backed by a USD 300 million World Bank loan, these institutions launched voluntary golden handshake schemes to eventually release 21,966 employees over a 2 year period (Burki and Ahmad, 2010) Other important features of the reforms included the removal of interest rate ceilings and efforts to create a mechanism for determining a market rate of interest (Hanif, 2002) as well as the closure of over 2000 bank branches over a 6 year period (Burki and Ahmad, 2010). The thrust of these reforms — a component of structural adjustment — was on what was characterised as a repressed financial system: the main criticisms of this were that excessive, inefficient, and corrupt lending practices were draining government finances and causing high percentages of non-performing loans (Naqvi, 2018).[111] As a result of liberalization, numerous domestic and foreign banks began operations in Pakistan and the government divested ownership in publicly owned banks.

Figure 5: Private sector credit off take as percentage of GDP since the 1960s



Source: data.worldbank.org

The State Bank of Pakistan (SBP) became an independent central bank in 1994 and in subsequent years, through various parliamentary amendments, was given full authority to regulate the banking sector, conduct an autonomous monetary policy, and also to curtail government borrowing. [112] The SBP's adoption of the Basel Accord may be seen as a corollary of the privatisation process (Butt, 2017) but also as a response to the risks from a mushrooming of small, privately owned banks in a newly liberal and open

111 This terminology of financial repression is associated with the same work of McKinnon (1973) that is discussed earlier in this thesis.
112 The concept and history of central bank independence, as an approach to enhance financial stability, is detailed in Walsh (2010).

financial sector (Abbas and Malik, 2008).[113] Table 4.1 describes the implementation of Basel Accord regulations in Pakistan: in particular, the SBP's emphasis on raising minimum capital requirements has shaped the financial landscape by compelling young banks to merge or to be acquired by foreign institutions.[114] The adoption of Basel III — which responds to the deficiencies identified in financial regulations during the 2007-9 global financial crises — is currently underway in Pakistan and introduces new regulatory requirements on liquidity and leverage. This additional stringency has raised concerns about access to financial services for those not currently within the mainstream banking network: tighter requirements for financial institutions to provision reserves constrain resources made available to groups outside the formal financial system (de Sousa, 2015).

Table 4.1: Implementation of the Basel Accord in Pakistan

	Overview	**Commentary**
Basel I	Implemented by SBP in two stages: 1994 covered credit risk whereas a subsequent version in 1997 included criteria for the calculation of risk weighted assets for market risk as well.	Flurry of new private banks launches create need for effective and stringent regulatory environment to manage risk taking appetite of the banking sector.
Basel II	SBP raises minimum capital requirements for banks in 2005 in anticipation of Basel II. New guidelines focus on risk based capital (CAR) against credit, market and operational risks.	Mergers and acquisitions occur to meet requirements of MCR and CAR which can be achieved either by fresh capital injection or retention of profits.
Basel III	SBP implements Basel III in phased manner staring from December 31, 2013 to December 31, 2019 wherein CAR (capital at risk) + CCB (capital conservation buffer) requirements are to be increased from 10 per cent to 12.50 per cent in a gradual manner.	Concerns about financial inclusion as updated framework specifically implies that such initiatives are threatened by the credit risk coming from small lenders.

Sources: SBP (2017), Butt (2017)

At present there are thirty commercial banks operating in Pakistan. The majority of these, twenty or so, are classified by the SBP as local private banks and this category includes a handful of Islamic banks. The other categories are foreign banks and publicly owned commercial banks: five institutions fall into each category respectively. The SBP also regulates the separate category of institution known as 'specialized banks' which perform variegated functions including industrial development, agricultural lending,

113 A concise overview of the Basel framework, initially described as a 'multinational accord to strengthen the stability of the international banking system and to remove a source of competitive inequality arising from differences in national capital requirements' is available from the BIS: https://www.bis.org/bcbs/history.htm. Originally intended for advanced capitalist states and later extended to developing countries, the suitability of such an approach in the context of Pakistan, to manage banking stability is questioned by Butt (2017).
114 This pattern reflects the groundwork for Basel II which was formally implemented in 2007 to overcome the issue of regulatory capital arbitrage having become common under Basel I. The role of securitisation was central to such practices and noted as early as 1999 by the BIS: https://www.bis.org/publ/bcbs_wp1.pdf

and small and medium enterprise lending. Microfinance banks are also a separate category regulated by the central bank: they are also not classified as commercial banks by the SBP.

Commercial and mainstream banking in Pakistan

Commercial banks dominate the banking sector. The largest five commercial banks are responsible for over 52 per cent of the industry's bank assets, 52 per cent of deposits, and for 49 per cent of loans.[115] The largest ten commercial banks are responsible for 75 per cent of assets, 77 per cent of deposits, and for 73 per cent of loans. For CY18, total assets, loans, and deposits of the banking sector in 2018 stood at approximately PKR 20 trillion, PKR 8 trillion, and PKR 14 trillion respectively, compared to PKR 10 trillion, PKR 4 trillion, and PKR 8 trillion respectively in CY13. (SBP, 2018).

Table 4.2: Breakdown of Pakistani commercial bank lending activities

	PKR mn	per cent
Corporate Sector	6,030,582	71%
SMEs Sector	504,979	6%
Agriculture Sector	324,291	4%
Consumer sector	535,461	6%
Commodity financing	863,976	10%
Staff Loans	126,997	1%
Others	138,522	2%
Total	8,524,808	100%

Source: SBP (2018)

Table 4.3: Consumer lending breakdown

	PKR mn	per cent
Credit cards	40,917	8%
Auto loans	210,388	39%
Consumer durable	866	0%
Mortgage loans	94,937	18%
Other personal loans	188,353	35%

Source: SBP (2018)

Table 4.4: Lending by Pakistani commercial banks: scope and scale

	CY14	CY15	CY16	CY17
Loan to deposit spread (basis points)	603	524	505	485
Highest to lowest interbank rate spread (basis points)	350	165	55	70
Advance to deposit ratio (per cent)	48.2	46.4	46.6	50.1

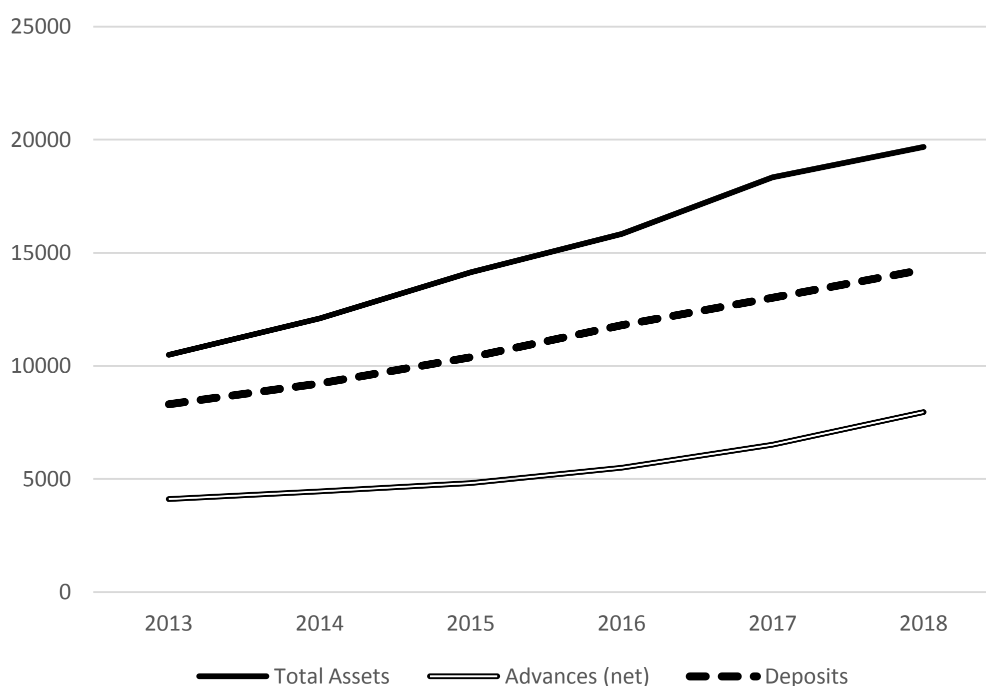
Source: SBP (2018)

115 This includes specialized banks and foreign banks but not microfinance banks.

The overwhelming focus of commercial bank lending is on the corporate sector. SME finance is mostly in the form of working capital loans and the data in Table 4.2 reflects the activities of less than 200,000 firms (SBP, 2018). The agricultural sector accounts for 21 per cent of GDP and 60 per cent of total employment according to the SBP (2015), but as seen above, receives only 6 per cent of total lending. The data shown below in Tables 4.2 and 4.3 captures only about 40 per cent of total bank assets.[116] SBP (2015) data shows that 122 per cent of bank credit is held in government securities and that as a result, 0.4 per cent of bank borrowers receive 65 per cent of all bank loans.

Aside from a heavy focus on corporate and government lending, other salient features of Pakistan's banking sector include fairly tight regulation in light of the Basel Accords, and another is heavy government borrowing. Additionally, there are visible trends in the sector of growth and profitability even though spreads between lending and deposit rates are neither high nor low relative to other countries. World Bank data indicates that the average spread in 2017 for lower middle income countries is 6.1 per cent whereas for upper middle income countries it is 5.4 per cent (World Bank, 2018). [117]

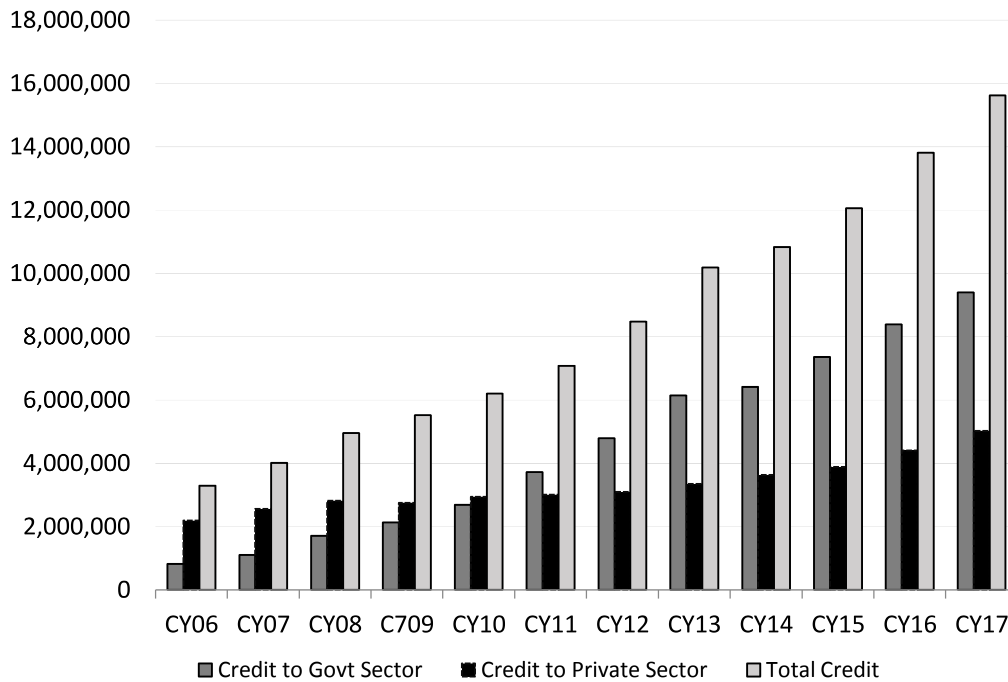
Figure 6: Assets, Advances, and Deposits of the banking system (PKR million)



Source: SBP (2018)

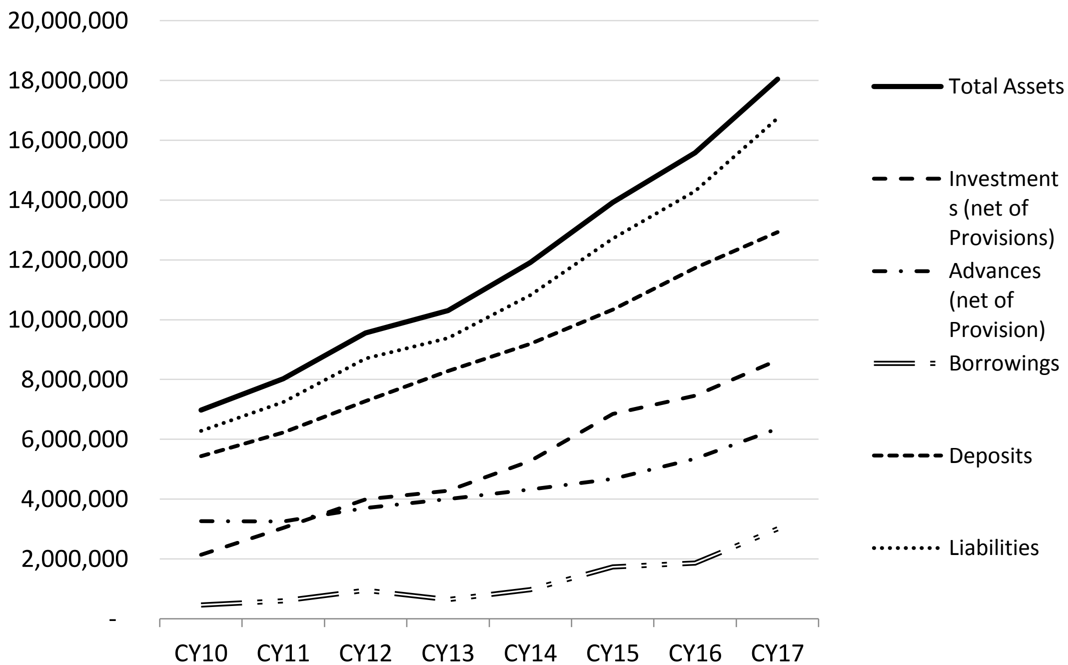
116 Total bank assets amount to PKR 19.7 trillion and of this, advances amount to just under PKR 8 trillion.
117 Pakistan falls into this lower middle income classification of the World Bank which includes a diverse group of countries including Bolivia, Egypt, India, Kenya, and Vietnam. The upper middle income countries classification also contains a diverse group of countries including China, Iran, and also Russia and other members of the former Soviet Union.

Figure 7: Private and government sector lending by banks (PKR million)



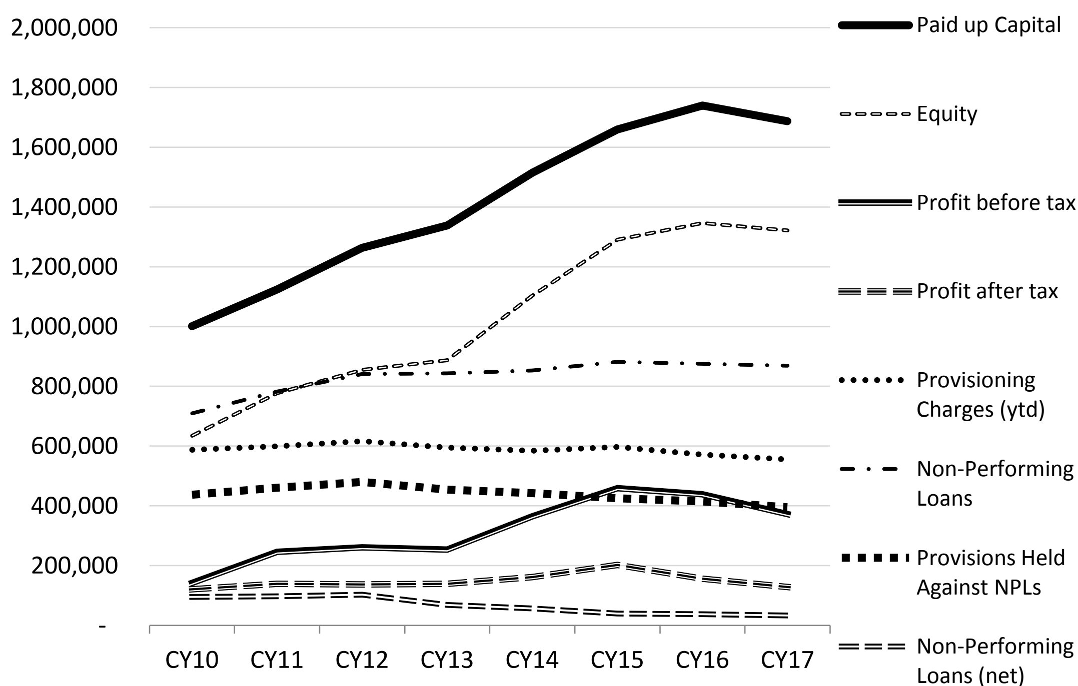
Source: SBP (2018)

Figure 8: Assets and liabilities (PKR million)



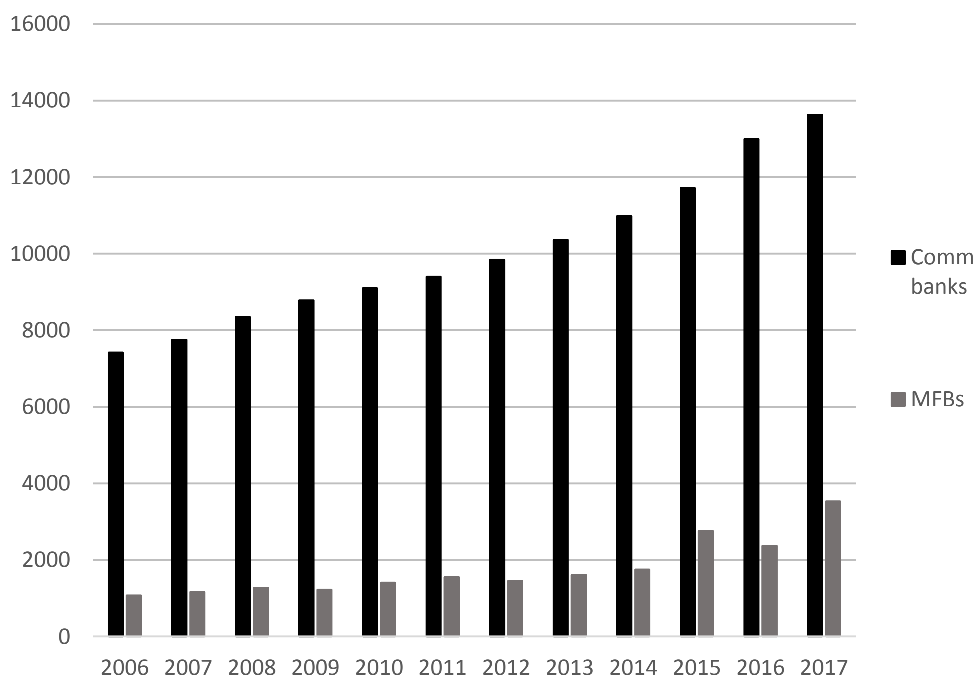
Source: SBP (2018)

Figure 9: Other key banking sector variables (PKR million)



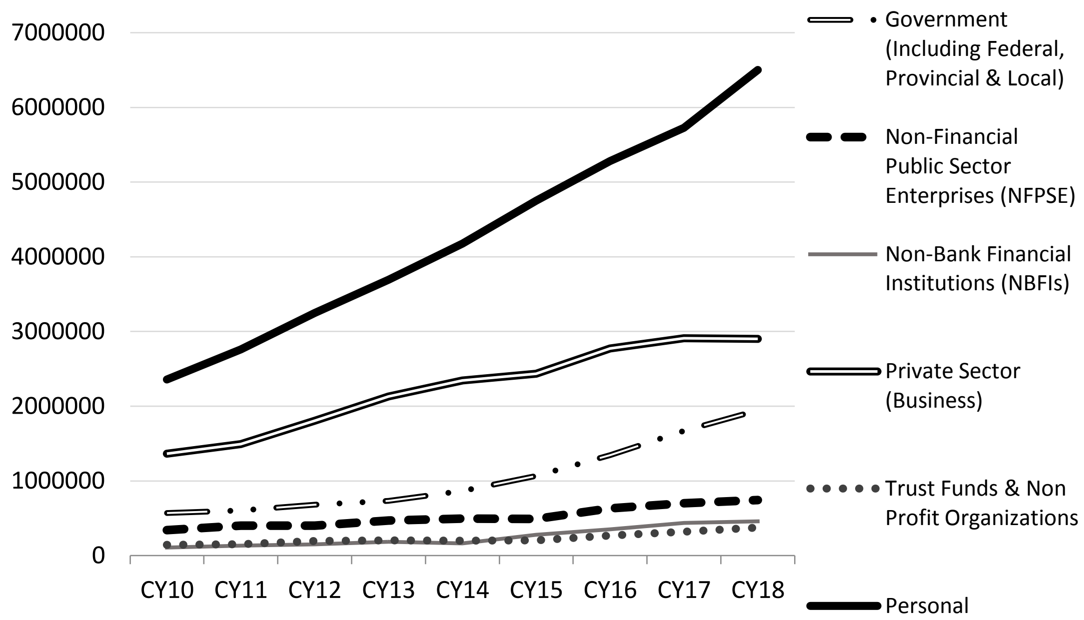
Source: SBP (2018)

Figure 10: Number of bank branches (commercial vs. microfinance banks)



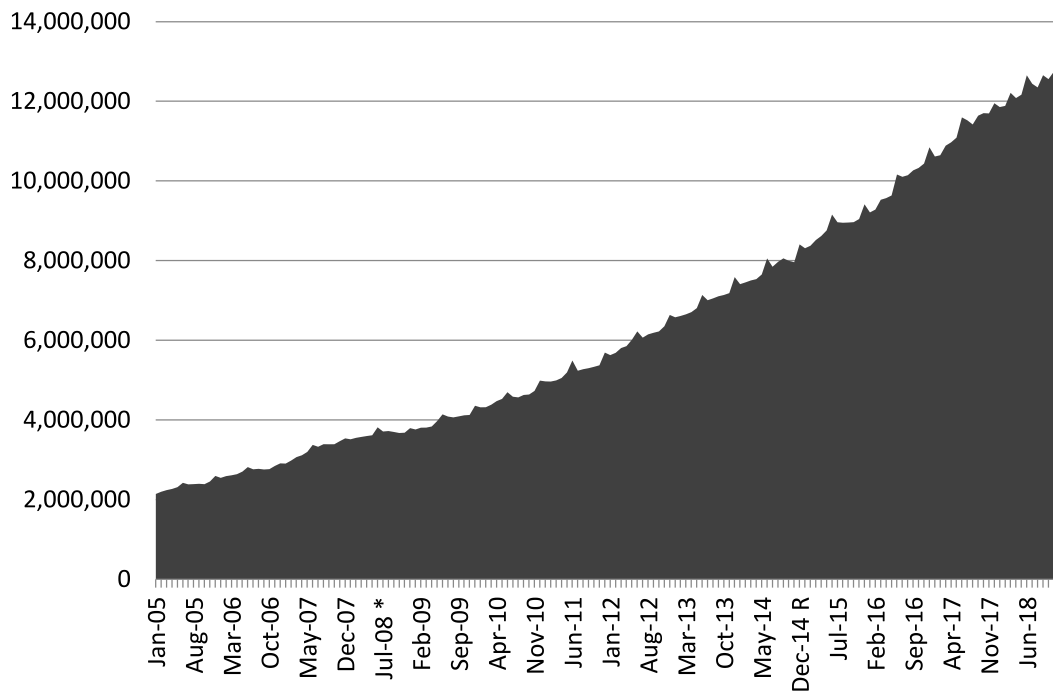
Source: SBP (2018), PMN (2017)

Figure 11: Resident deposits (PKR million)



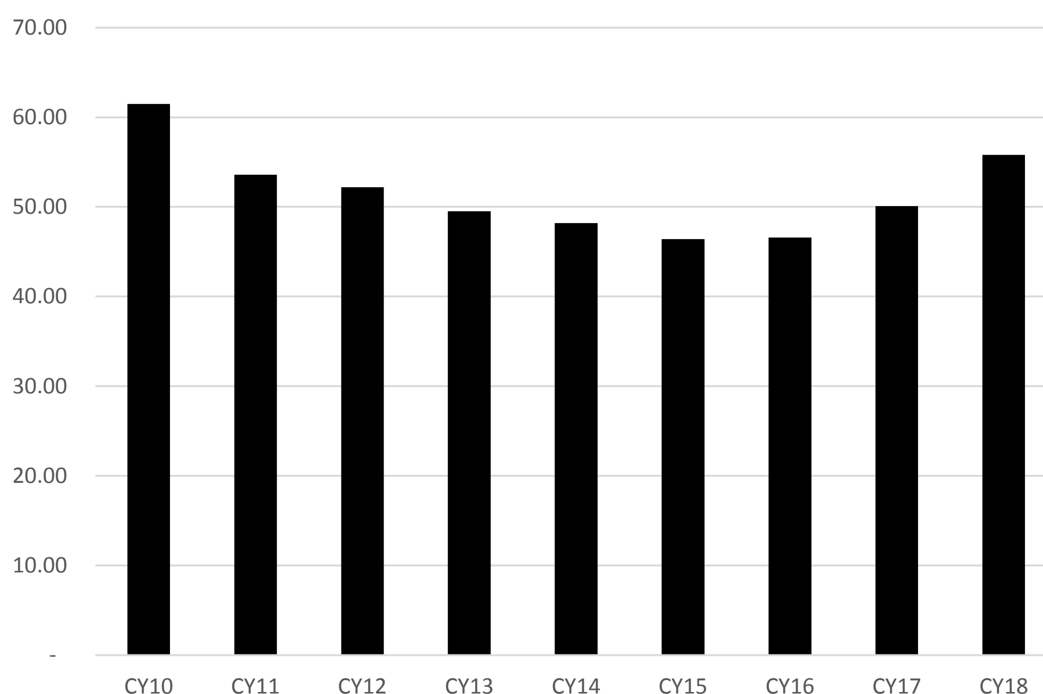
Source: SBP (2018)

Figure 12: Total deposits in banking system



Source: SBP (2018)

Figure 13: Ratio of advances to deposits (per cent)



Source: SBP (2018)

4.3COMMERCIALISING INCLUSIVE FINANCE

The same environment of reform that resulted in a closely regulated commercial banking sector was also the setting in which microfinance was incorporated into the financial landscape. The earliest discussions on a possible role for microfinance in Pakistan's development are reflected in the IMF backed PRSP papers of the 1990s: this is discussed in more depth in Chapter 7.

The commercial banking sector became involved in microfinance during the late 1990s when the government of Pakistan, with a loan from the Asian Development Bank sought to provide regulated microfinance services by asking commercial banks to acquire stakes in a newly established microfinance institution. The Khushhali Bank Ordinance was passed in 2000 to support the creation of Khushhali Bank under the Asian Development Bank's Microfinance Sector Development Program and also the Government of Pakistan's Poverty Reduction Strategy (ADB, 2008). The Microfinance Institutions Ordinance 2001 and also prudential regulations for microfinance banks were subsequently introduced to address the incorporation, regulation and supervision of microfinance banks in Pakistan (ADB, 2008).

Since then, teething issues aside, microfinance in Pakistan has strengthened its hold as a noticeable feature of banking in Pakistan. At present, there are three categories of microfinance lenders: MFBs (microfinance banks), MFIs (microfinance institutions), and RSPs (rural support programmes), and two regulators. The central

bank, the State Bank of Pakistan, is the regulator for one of these categories: microfinance banks/ MFBs. The Securities and Exchange Commission is the regulator for the other two categories: microfinance institutions/ MFIS, and rural support programmes/ RSPs.

Mainstreaming inclusion

MFBs are licensed and regulated by the SBP for the purpose of providing microfinance services. More specific details are available in the prudential regulations which describe 'microfinance services' as 'mobilizing deposits from the public and providing credit to poor persons and microenterprises' (SBP, 2014).[118] MFIs and RSPs are not permitted to take deposits. Since 2016, these non-deposit taking institutions are regulated by the Securities and Exchange Commission of Pakistan or SECP, which is an autonomous body. The current mandate of the SECP includes the regulation of the corporate sector and capital market, as well as the supervision and regulation of insurance companies, non-banking financial companies, and private pension schemes. Additionally, it is responsible for overseeing various external service providers to the corporate and financial sectors, including chartered accountants, credit rating agencies, corporate secretaries, brokers, and surveyors. Noteworthy in this structure is that the dominant form of microfinance in Pakistan is of a commercial nature; most of it is offered by MFBs which are deposit taking institutions regulated by the central bank; and additionally, the nature of wholesale funding through apex funds emphasises sustainability even within the non-deposit taking institutions that operated on a non-profit basis in the past.

Table 4.5: Gross Loan Portfolio share by institution type

	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Microfinance Banks	57%	60%	58%	61%	68%	70%
Microfinance Institutions	23%	22%	24%	23%	20%	20%
Rural Support Programmes	20%	18%	18%	16%	12%	11%

Source: Pakistan Microfinance Network (2017)

Table 4.5 and Table 4.6 show the role of each type of institution in the domestic landscape for inclusive finance. The ascendancy of commercial microfinance may be heavily attributed to the support of the central bank and also of international, development focused, organisations. The backing of the central bank for the microfinance, and subsequently the financial inclusion movement has been unwavering

118 The definition of a poor person is 'an individual who has meagre means of subsistence but is involved in a livelihood activity and has an ability to repay debt from an annual income (net of business expenses) up to Rs. 500,000/' (SBP, 2014; p4).

since the early 2000s, when the first licenses for MFBs were issued. In 2006, the SBP took measures to encourage commercial banks to offer microfinance services, which could otherwise be offered by microfinance banks operating under a separate legal and regulatory framework: at the time Pakistan was one of only a handful of countries to have special prudential regulations for microfinance (SBP, 2006).

Table 4.6: Share of active borrowers by institution type

	2012	2013	2014	2015	2016	2017
Microfinance Banks	39%	40%	42%	39%	42%	46%
Microfinance Institutions	34%	35%	31%	38%	37%	36%
Rural Support Programmes	27%	25%	27%	23%	21%	18%

Source: Pakistan Microfinance Network (2017)

In 2007-2008, the SBP enlisted the support of the UK Department for International Development, along with the Government of Pakistan to launch the FIP (Financial Inclusion Programme) to 'provide equitable and efficient market-based financial services to the otherwise excluded poor and marginalized population including women and young people' (SBP, 2008: 6). Among the salient features of FIP were; one, a strategy that sought to engage the wider banking sector, particularly commercial banks, in enhancing access to financial services; and two, a planned shift from 'reliance on subsidies to market based, sustainable and inclusive financial services' through the use of commercial bank debt, syndication arrangements, and term finance certificates, as well government backed credit guarantee schemes (SBP, 2008).

In addition, schemes such as PRISM or Programme for Increasing Sustainable Microfinance and grant-supported initiatives such as the Institutional Strengthening Fund and the Financial Innovation and Challenge Fund have also made the microfinance sector more open to private capital. This has been done particularly through large components of capacity building funds in such initiatives (PMN, 2008).

The SBP Microfinance Credit Guarantee Facility (MCGF) has been particularly successful in this regard by channelling wholesale funds from the commercial banks to the microfinance sector (SBP, 2017a). This facility operates through a risk sharing mechanism to provide wholesale funds — sourced from commercial banks — to microfinance banks and institutions. These funds are used for on-lending to the poor and marginalized groups. Amendments in the MCGF framework also allow microfinance providers to mobilise nonbank financing from capital markets, further diversifying sources of financing for micro borrowers. By providing partial risk cover for commercial bank financing of MFBs, the MCGF has also been used to facilitate access to capital markets for MFBs. This may be called in the event of default by the MFB. The issuance in 2013 by Tameer Microfinance Bank, of commercial paper — in the form of term finance certificates amounting to PKR 1 billion — is attributed to this arrangement

under which the issuance is partially secured against the MCGF. The central bank notes that the guarantee scheme has successfully demonstrated the viability of microfinance for commercial lenders (SBP, 2017). It is noteworthy however, that the need for the MCGF appears to have been lessened by the recent launch of the PMIC investment company fund, which is discussed in the next section.

Overseas asset managers began to take especial note of Pakistani microfinance in 2009 when the central bank allowed microfinance institutions to raise debt in four major foreign currencies: GBP, USD, EUR, and JPY (SBP, 2009). As a result, MFBs are able to receive direct funding — to finance their loan portfolios — from several difference types of organisations, including international financial institutions', donor agencies, and microfinance investment vehicles. As per central bank stipulations, the disbursed foreign currency loan funds are to be immediately converted into PKR and credited to the borrowing entity's PKR account maintained with an 'authorized dealer' or commercial bank. But as noted by the PMN (2009), because of limited hedging instruments and a volatile currency exchange rate, foreign currency loans are an expensive source of funds for on-lending.[119]

An alternative impetus for overseas engagement with Pakistani microfinance has been the need for equity injections, as MFBs approach their capital limits. The central bank requires that MFBs maintain a 15 per cent capital adequacy ratio (CAR) compared to 8 per cent for commercial banks. The regulatory framework is structured to facilitate foreign investment to meet the growing equity needs of MFBs: foreign equity investors are allowed to repatriate 100 per cent of profits, and may also hold a 100 per cent equity stake (PMN, 2009).

A comparison of the microfinance sector across two — non-consecutive — years shows how the macroeconomy has a key role in shaping funding strategies, especially for MFBs as they are deposit taking institutions. Data and analysis from the Pakistan Microfinance Network for 2010 indicates that tight monetary conditions, in which the interbank rate hovered around 13 per cent per annum, pushed microfinance banks to mobilise deposits: this was done in order to move away from other, more expensive sources of funding which were not viable in a high interest rate environment. (PMN, 2010). In comparison, more recent evaluations show that MFBs have over recent years come to rely more on deposits and less on other sources of funding such as commercial bank wholesale loans, and subordinated debt to meet their capital requirements: this may be attributed to a loose monetary policy environment in Pakistan (PMN, 2017).[120]

Commercial funding models have created a co-dependence of traditional banks and microfinance banks which operates through the borrowing and deposit taking activities of both types of institutions. The liabilities side of microfinance bank balance sheets shows how these institutions borrow from commercial banks, and also accept their

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119 Over the five year period between May 2018 and May 2019 the USD has gained approximately 40 per cent relative to the PKR.

120 The State Bank of Pakistan's policy rate was at a historic low of 5.75% in 2017. Since then it has tightened considerably and was pushed up to 10.75% in the Monetary Policy Statement effective 1st April 2019.

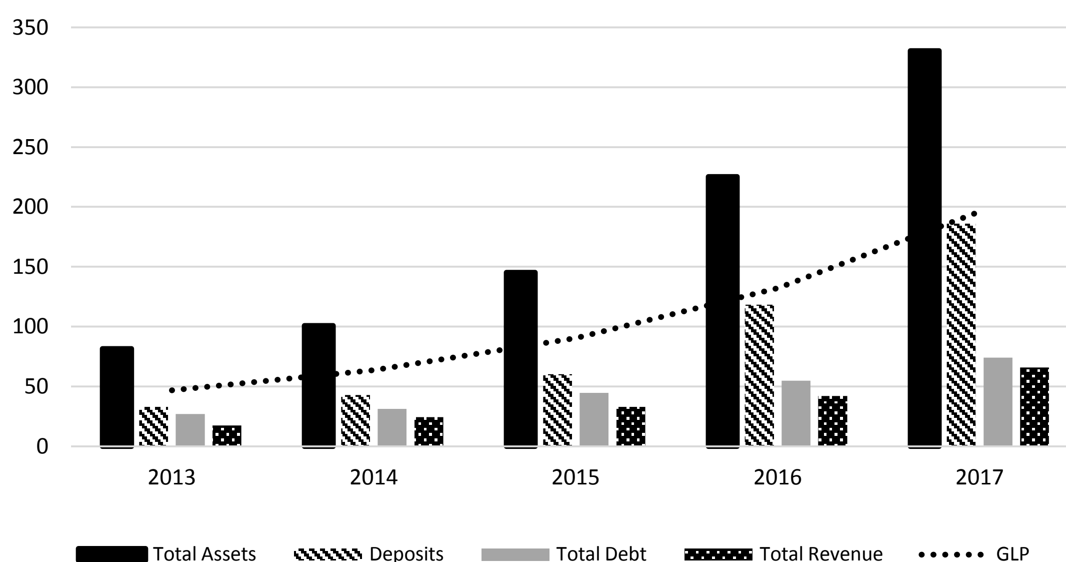
deposits. The restriction on commercial banks in Pakistan on unsecured loans above PKR 5 million places constraints on this relationship and has limited the capacity of microfinance banks to borrow funds for on-lending from commercial banks (Akhuwat, 2015; SBP, 2015a). Microfinance banks appear to have partially overcome this funding constraint by offering attractive deposit rates to individuals as well as institutions. For instance, the most recent annual report of Telenor Microfinance Bank (TMB) shows that of the PKR 3.7 million held in deposits, nearly one third is from institutional investors, that is, corporations, banks, and other financial institutions (TMB, 2017: 66). Table 3 shows how high deposit rates also entail high lending rates. For liquidity management, microfinance banks also place demand deposits in commercial banks, and also lend to commercial banks through reverse repo — with government treasury bills as collateral — and through call money operations.

Table 4.7: Lending and deposit rate ranges (based on weighted averages)

	Microfinance Banks[121]	**Commercial Banks**
Lending rates	20% -30% (APR)	7% to 22% (APR)
Deposit rates	Up to 13% per annum	Up to 7.27% per annum

Compiled by author based on KPMG (2017), PMN (2017) and various microfinance company websites

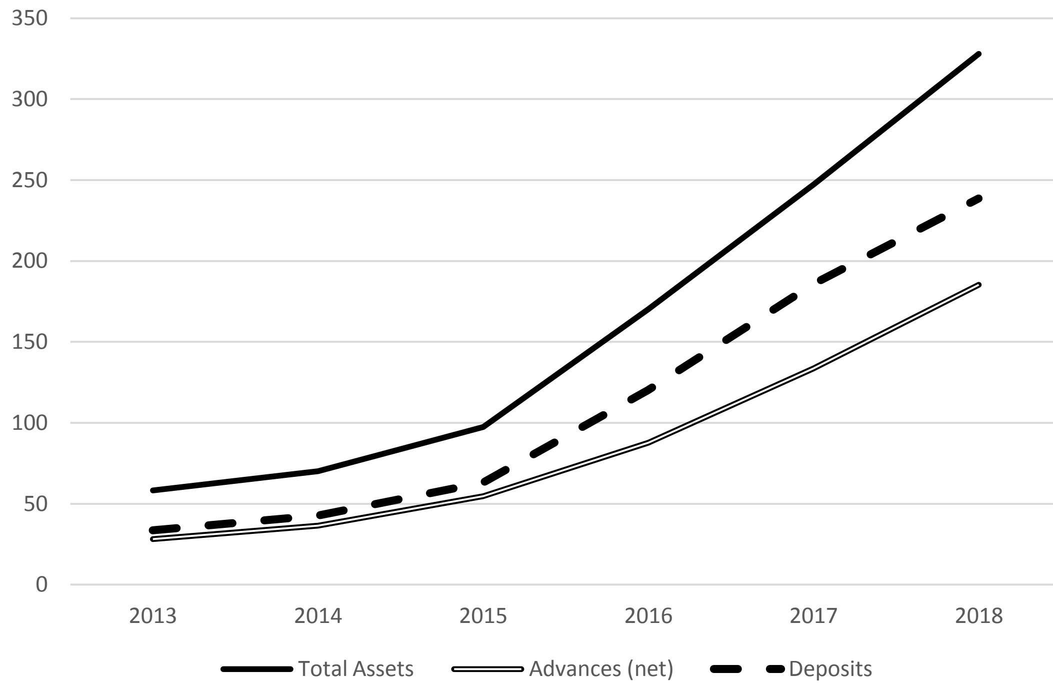
Figure 14: Funding microfinance (sectoral analysis)



Source: PMN (2017)

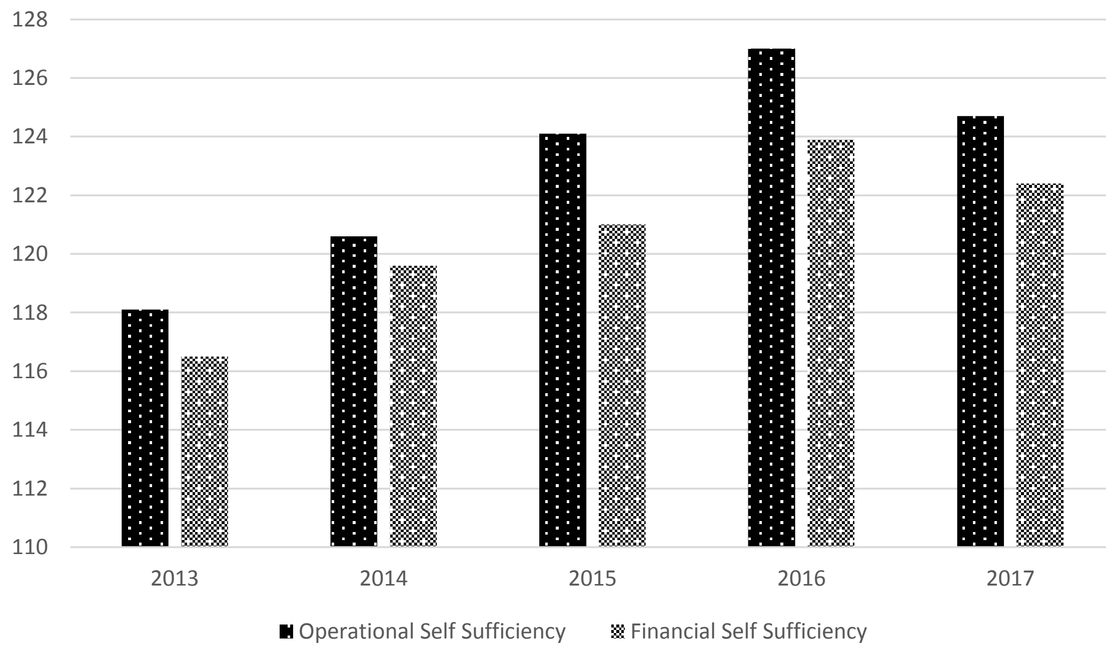
121 There is limited transparency on MFB rates and these figures are based on estimates extrapolated from annual report data on cost of funds and net interest margins.

Figure 15: Assets, Advances, and Deposits of MFBs (PKR million)



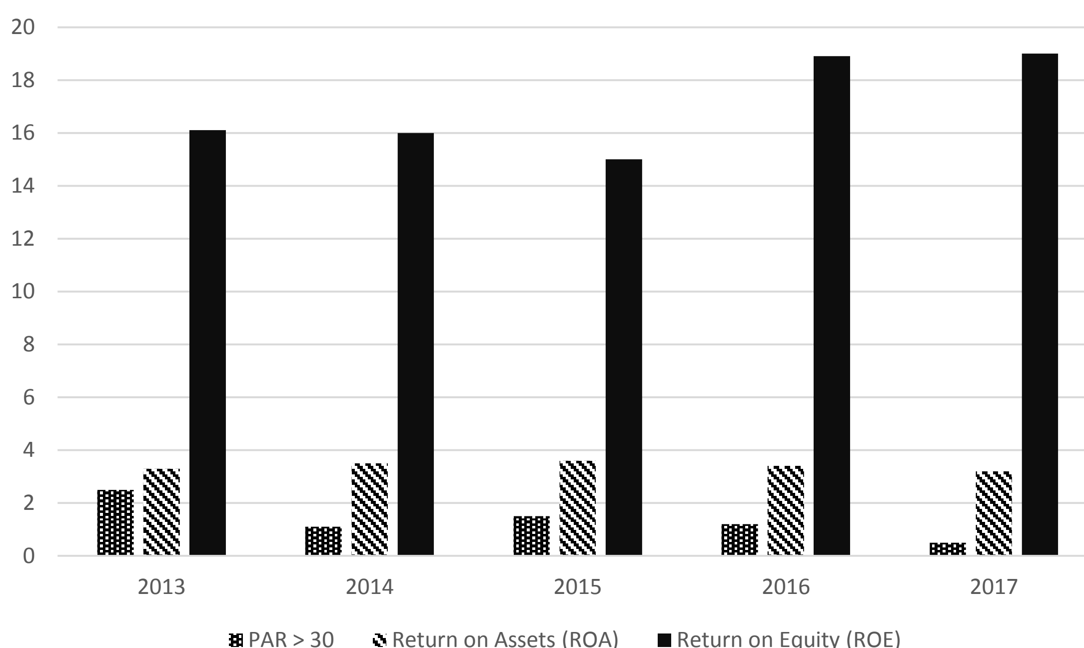
Source: SBP (2018)

Figure 16: Sustainability ratios



Source: PMN (2017)

Figure 17: Financial ratios



Source: PMN (2017)

The overall strategy to prioritise commercial sources of funding appears to have been fruitful based on the industry's standard measures for sustainability: operational self-sufficiency (OSS) and financial self-sufficiency (FSS). Here the OSS is used to reflect the sustainability of the microfinance sector based on profits reported by institutions but with no adjustment for implicit and/or explicit subsidies whereas the FSS captures the involvement of cheap credit as well as non-pecuniary subsidies such as rent, transport, training etc. (CGAP, 2002). Both measures in Pakistan have been consistently above one hundred percent since 2012, and have also been widening relative to each other since 2014 (PMN, 2017). This widening captures the role, primarily, of cheap credit, indicating that despite success in commercialising microfinance, financial expenses for the sector are often based on rates below the market cost of funds. This observation is a basis for drawing the role of apex funds — and the World Bank — into this discussion.

The role of the apex

A crucial component of the microfinance funding landscape in Pakistan is the apex fund. This is a wholesale mechanism that channels funds, with or without supporting technical services, to retail microfinance institutions in a single country or integrated market (Levy, 2002). Apex funds may be seen as an example of the 'blended finance' strategies described earlier, in Chapter 2.[122] Apex funds altered Pakistan's microfinance

122 These are 'financing mechanisms that link a grant element, provided by ODA, with loans from publicly-owned institutions or commercial lenders', representing a major shift which not only moves ODA from the public to the private sector but also replaces it with private finance (Bonizzi et al., 2015; Van Waeyenberge 2016).

landscape in 2000 when the Pakistan Poverty Alleviation Fund (PPAF) commenced operations as autonomous not-for-profit company. This organisation had been in existence since 1997 but underwent regulatory changes following official approval in 1999 for a 5 year World Bank project.

> 'The World Bank funded Pakistan Poverty Alleviation Fund Project was designed to reduce poverty and empower the rural and urban poor in Pakistan. The project provides access to much-needed microcredit loans and grants for infrastructure and capacity building. As such, the PPAF project aims to help the rural poor in Pakistan get out of a cycle of misery, and get into a virtuous cycle of opportunities' (World Bank, 2005).

The total project cost was USD 107 million: the Government of Pakistan committed to USD 10 million as equity and a World Bank credit of USD 90 million was to be provided through the International Development Association, the Bank's concessionary lending arm, as a single-currency loan repayable in 35 years with a 10-year grace period. The remainder was to be in the form of community contributions. This project came to be known as PPAF 1 concluded in 2005. It was followed by PPAF 2 which began in 2006 and concluded in 2011, and PPAF 3 began in 2009 and concluded in 2016: the respective tranches for these programmes from the World Bank were USD 238 million and 250 million.[123]

Related to the PPAF programme is the PRSP or Poverty Reduction Strategy Papers. These documents are a part of the IMF's late 1990s strategy to target poverty reduction through more participatory approaches which required countries to prepare regular reports — updated every three years or so — in collaboration with various stakeholders and partners, including the World Bank and IMF (IMF, 2004). The Government of Pakistan released an initial or 'I-PRSP' in late 2000 and a full PRSP in 2003 (IMF, 2004). The World Bank sponsored Pakistan Poverty Alleviation Fund was established in the year 2000 as a special purpose vehicle designed to channel funding to broad based programs in community physical infrastructure and capacity building interventions, as well as microfinance: as such it came to function as the country's apex fund or what CGAP (2002) describes as 'a second-tier or wholesale organization that channels funding (grants, loans, guarantees) to multiple microfinance institution (MFIs) in single country or region'. Eventually, as microfinance and financial inclusion became increasingly embedded in the strategies of the central bank of the Ministry of Finance (NFIS, 2015), the microfinance lending portfolio of the PPAF was shifted to a newly established private sector investment company: the Pakistan Microfinance Investment Company or PMIC.

123 Specific details of the implementation and results of the various PPAF funded projects are available from the World Bank (2018a).

Table 4.8: Typology of debt and equity funders for inclusive finance

	Subtype	Further subtype	Definition	Example in Pakistan
Development Finance Institution/ International Financial Institution	Bilateral	None	Owned by a government to raise private capital to finance projects with development objectives.	KfW (Germany), CDC Group (United Kingdom), PROPARCO (France).
	Multilateral	None	Owned by two or more governments to finance development projects through private capital.	IFC (International Finance Corporation), ADB (Asian Development Bank)
Government	Development Programme	None	Government or other public program with development objectives.	Prime Minister's Interest Free Loans Scheme (Pakistan)
	Government Agency	None	Administration, departments, or agencies of any sovereign entity	Luxembourg Ministry of Foreign and European Affairs (Luxembourg)
	Multi /Bilateral Development Agency	None	Bilateral or multilateral aid agencies, owned by governments	JICA (Japan), DFID (United Kingdom)
	Regulator	None	Domestic central banks	State Bank of Pakistan
Financial Institution	Commercial Bank	None	Bank or other regulated financial institution where private entities are majority shareholders	United Bank Limited, HBL
	Public Bank	None	Bank or other regulated financial institution where the government is a majority shareholder.	National Bank of Pakistan, Bank of Punjab
	Microfinance Investment Intermediary (MII)	Holding company	Provide financing and technical assistance to MFIs.	FINCA, AKAM
		MIV	Microfinance Investment Companies are independent investment entities open to multiple investors.	Triple Jump

		Other MII	Various investment entities with a large microfinance component to investment strategy.	ResponsAbility, Triodos, Acumen
Other	Private Corporation	None	Registered legal entities except government and financial institutions. Often tech companies seeking synergies.	VEON
	Individual	None	A person or persons	United International Group (Pvt) Ltd.
	Foundation	None	Non-profit corporation or other non-profit entity	Bill & Melinda Gates Foundation, Aga Khan Foundation
	NGO	None	Nongovernmental organization	National Rural Support Programme

Adapted from Sapundzhieva (2011)

The start of the Pakistan Microfinance Investment (PMIC) in 2016 may be seen as a major advance in the commercialisation — and globalisation — of microfinance funding. This launched an entity for the sole purpose of providing wholesale funding for microfinance by allowing PPAF to spin off its microfinance operation and establishing a new company in partnership with the Karandaaz Foundation, and KfW. The Karandaaz Foundation is a non-profit organisation backed by DFID and the Bill and Melinda Gates Foundation, whereas KfW, based in Frankfurt — originally Kreditanstalt für Wiederaufbau — is a German government-owned development bank. The objective of PMIC is to attract funding from 'development agencies, financiers, commercial banks and capital markets' using a commercial — profit focused — structure (PMIC, 2017).

The PMIC is equipped to offer financial instruments and products to tend to the specific needs of deposit taking as well as non deposit taking institutions offering inclusive finance. These products include syndicated loans, Tier II financing, capital market instruments, securitization, transactional advisory services and complementary products /services such as partial or first loss credit guarantees, etc. that may be bundled with other investment banking products (PMN, 2017). The PMIC has thus opened a sizeable channel connecting the domestic microfinance industry to global fund managers.

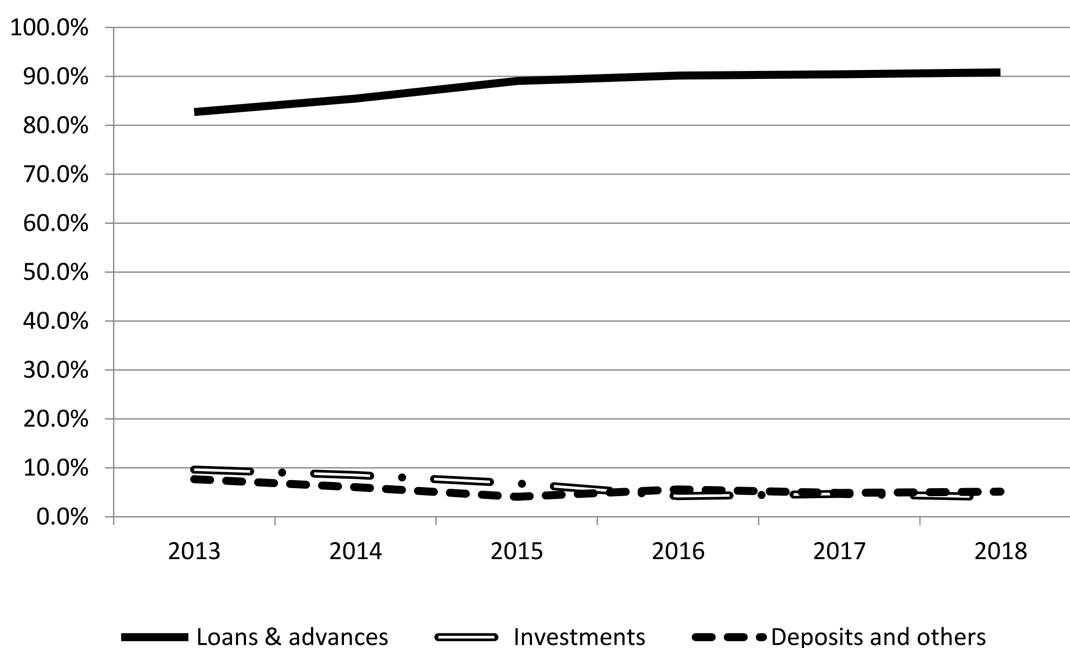
Despite being a private sector investment company, the PMIC plays a central role in official government policy for financial inclusion. This is evident from the emphasis on micro, small, and medium enterprise lending in the National Financial Inclusion Strategy which was launched in 2015 and which explicitly mentions the

creation of PMIC for the objective of enhancing commercial funding for both, MFBs/ MFIs. The emphasis placed on commercial funding has allowed financial inclusion policies in Pakistan to align neatly with the wider transformation in financing development, which is discussed earlier in this thesis, and also later in Chapter 7.

Two models of banking in Pakistan

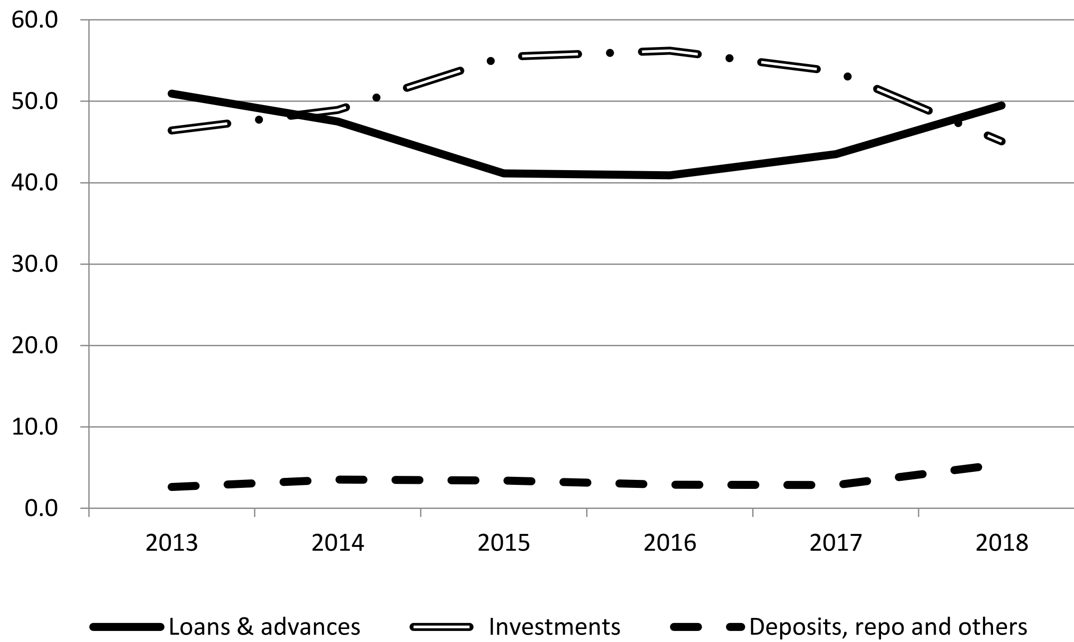
The establishment of the PMIC thus draws on the apex structure that preceded it, and has created an infrastructure for two distinct models of banking. One of these is used by mainstream or commercial banks in which client deposits are used to create loans for the private as well as public sector. The other model is used by deposit taking microfinance banks which use not only client deposits but also funding from financial institutions — which may be either public or privately owned but are nevertheless market based —to create loans.

Figure 18: Interest earned for MFBs (per cent)



Source: SBP (2018)

Figure 19: Interest earned for mainstream banks (per cent)



Source: SBP (2018)

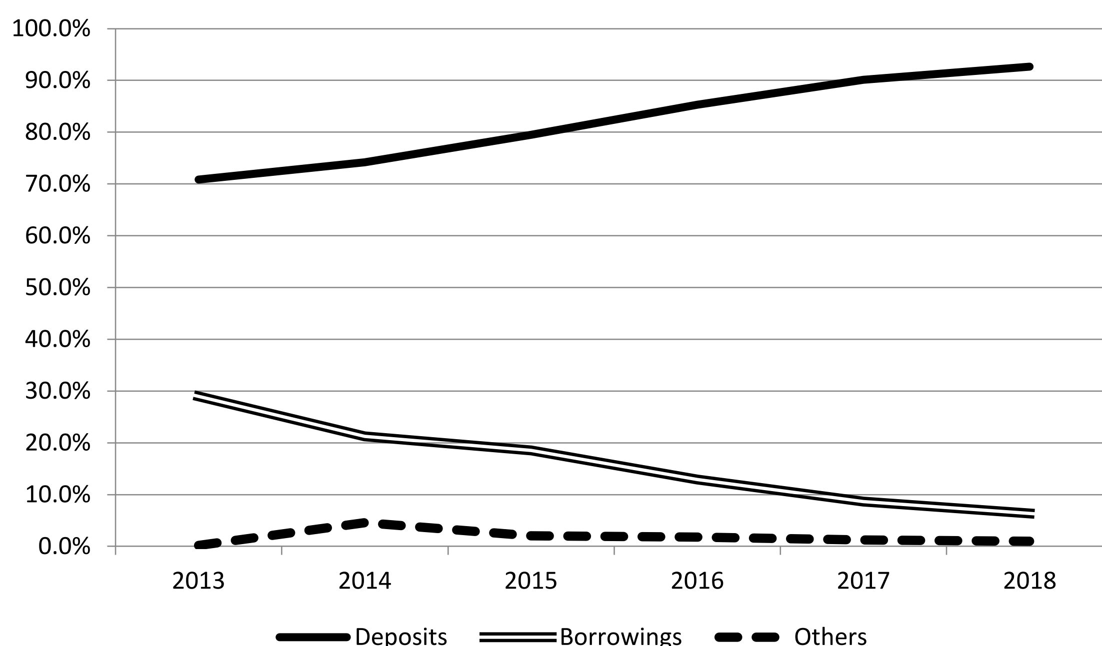
In theory, under such an arrangement, microfinance banks could rely exclusively on funding from institutions such as mainstream banks and wholesale funds to fund their lending portfolios. Similarly, mainstream banks could rely exclusively on deposits to fund their lending portfolios. But in practice, this does not occur so neatly. This reality is demonstrated through the respective interest earning and expense patterns of mainstream and microfinance banks.

As shown in Figure 18, for MFBs the main source of interest earnings are from loans: in recent years, particularly between 2015 and 2017, this has ranged from 89 per cent to 91 per cent of total interest earnings. Interest is also earned, for MFBs, from investments in the form of government securities which are held not only to earn interest but also to meet regulatory capital requirements. A relatively small amount for interest is also earned from the deposits placed by MFBs at other banks and financial institutions which are often used to meet statutory liquidity requirements. Here it is worth mentioning that interest earnings represent approximately 83 per cent of total income for MFBs.

Earnings from fees and other incomes are responsible for the remainder of revenues. For mainstream banks, as shown in Figure 19, the main source of interest earnings is not always lending. Recent patterns show that the key driver of revenues is often investments. This is symptomatic of the dependence of the Pakistani state on budgetary support from the banking system. To meet fiscal revenue shortfalls, the Pakistani state regularly borrows from financial institutions. This is done through the issuance by the Government of Pakistan of two types of interest earning instruments:

market treasury bills or MTBs for short term borrowing, and Pakistan Investment Bonds or PIBs for longer term borrowing. Financial institutions may buy or sell these instruments in the secondary market or during regular auctions conducted by the central bank.[124] Another source of earnings from interest is from deposits and repo operations. Deposits are placed with other financial institutions, as is the case for MFBs, to count towards statutory liquidity requirements. Interest earnings from repo or repurchase agreements are earned when banks trade government issued securities to manage their liquidity needs on a day to day basis. [125] The role of government securities and borrowing in the Pakistani banking sector is discussed in a shadow banking context in the next chapter, given how mainstream banks often invest in such instruments rather than lend to the private sector.

Figure 20: Interest expensed for MFBs (per cent)

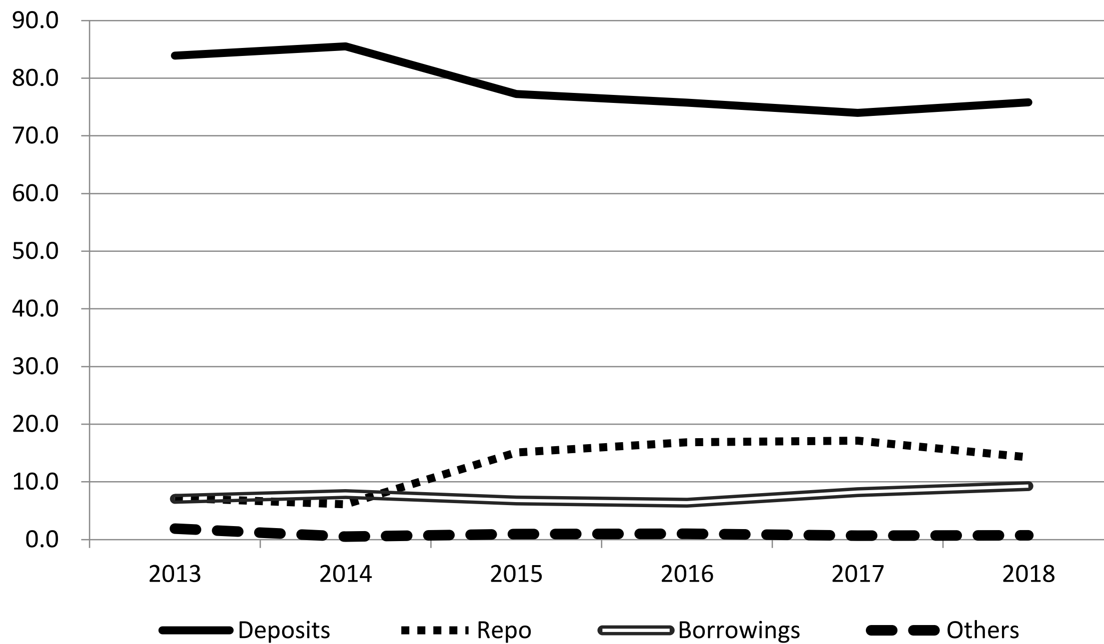


Source: SBP (2018)

124 Investors also have the option to participate in a 'non competitive bid process'. See https://www.sbp.org.pk/dmmd/Guidelines/MTB.pdf

125 Repurchase/ Repo is a repurchase agreement is the sale of a security with a commitment by the seller to buy the security back from the purchaser at a specified price at a designated future date. Basically a repurchase agreement is a collateralised loan, where the collateral is a security. Reverse Repurchase/ Reverse Repo or Reverse Repurchase is an agreement for the purchase and resale of a security at a specific price and a specific future date. It is the mirror image of a Repo transaction. Provider of funds does Reverse Repo transaction. See https://www.sbp.org.pk/DFMD/FM-intro.asp

Figure 21: Interest expensed for mainstream banks (per cent)



Source: SBP (2018)

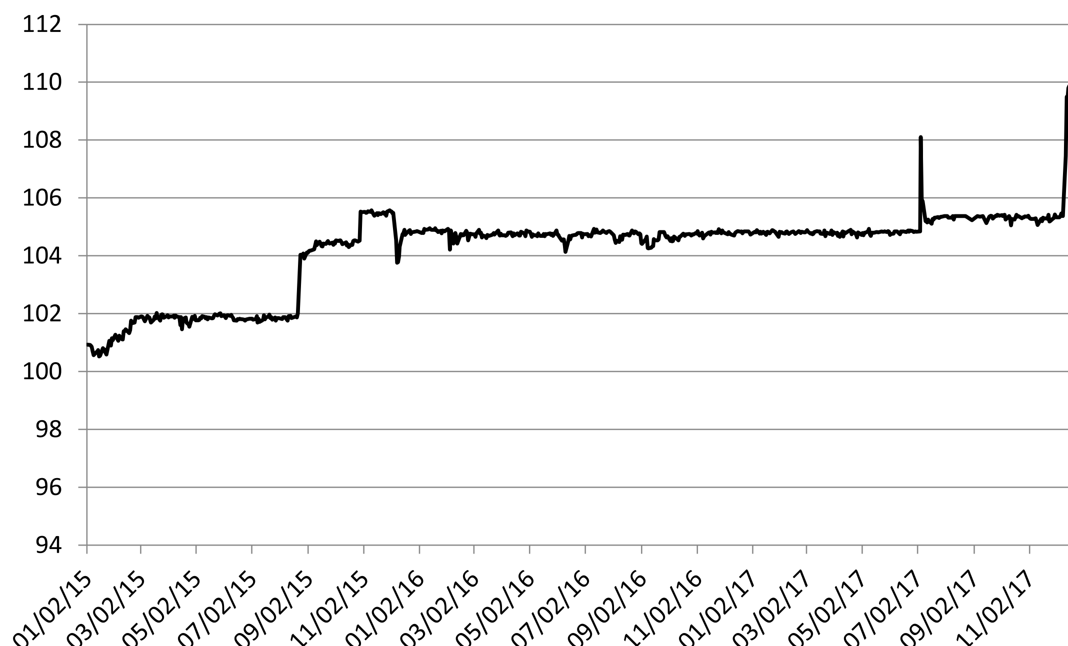
For MFBs the main source of interest expense is deposits, as shown in Figure 20. Here it is worth noting that MFBs, relative to mainstream banks, tend to give clients a much higher return on deposits in order to generate funds for on-lending. This practice of offering expensive deposit accounts is discussed in the context of two specific MFBs in Chapter 6. Recent patterns demonstrate how MFBs have emphasised deposits over borrowing — from apex or investment institutions — as a source of funding. This may be attributed, as shown in Figure 22, to weakness and anticipated volatility in the Pakistani rupee relative to the US dollar which makes the domestic microfinance industry less appealing for overseas investors. A relatively small share of interest expense is also spent on other costs related to borrowing such as advisory and processing fees.

For mainstream banks, as shown in Figure 21, the main source of interest expense is also deposits. The next largest source of interest expense is repo activities, and the category of 'borrowings' shown in the figure reflects repo activities in which securities offered remain on the asset side of the balance sheet while an equivalent amount is placed on the liabilities side.[126] Borrowings also capture interest expenses

126 Based on the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as are notified under the Companies Act, 2017, in Pakistan the securities sold subject to repurchase agreements ('repos') remain on the balance sheet; the counterparty liability is included in borrowings from financial institutions. Securities purchased under agreements to resell ('reverse repos') are recorded as lendings to financial institutions. The difference between sale and repurchase price is treated as interest / mark-up / return and accrued over the life of the underlying agreement using the effective interest method.

from subordinated loans. 'Others' captures expenses related to various other banking activities, including foreign currency and export refinancing.

Figure 22: Pakistani rupees (PKR) per US dollar (USD)



Source: http://fx.sauder.ubc.ca

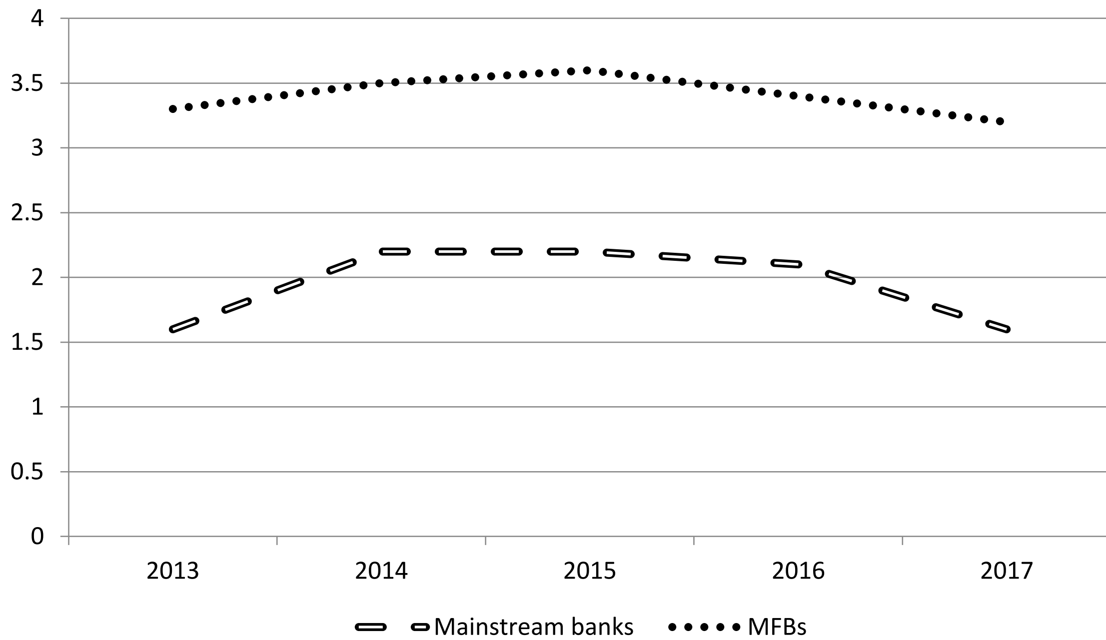
Calculations of return on assets and return on equity highlight the profitability implications of these differing models. [127] Return on assets or RoA reflects how efficient a financial institution is at managing its assets by using liabilities and equity to generate profits. Return on Equity or RoE reflects how efficient a financial institution is at using assets to generate profits.[128] These measures are most practical when used to make 'apples to apples' comparisons between similar institutions and are thus a crude way to compare the overall profitability of the two banking models discussed here. Nevertheless, they offer useful insights on the role of leverage in contemporary Pakistani banking.

Based on RoA, mainstream banks are relatively more profitable than MFBs. Additionally, as Figure 23 indicates: trends in growth and decline have been similar for both types of institution. Lower RoA ratios for MFBs may be attributed here to weak portfolio quality in the case of MFBs: for mainstream banks between 2013 and 2017, net NPLs as a percentage of net advances range from 3.4 per cent to 1.2 per cent, with marked improvement in recent years (SBP, 2018). For MFBs the corresponding range is 0.1 per cent to negative 0.4 per cent, with overall declining in recent years (SBP, 2018).

127 RoA is calculated by dividing a company's net income by total assets and RoE is calculated by dividing net income by shareholder's equity. See www.investopedia.com

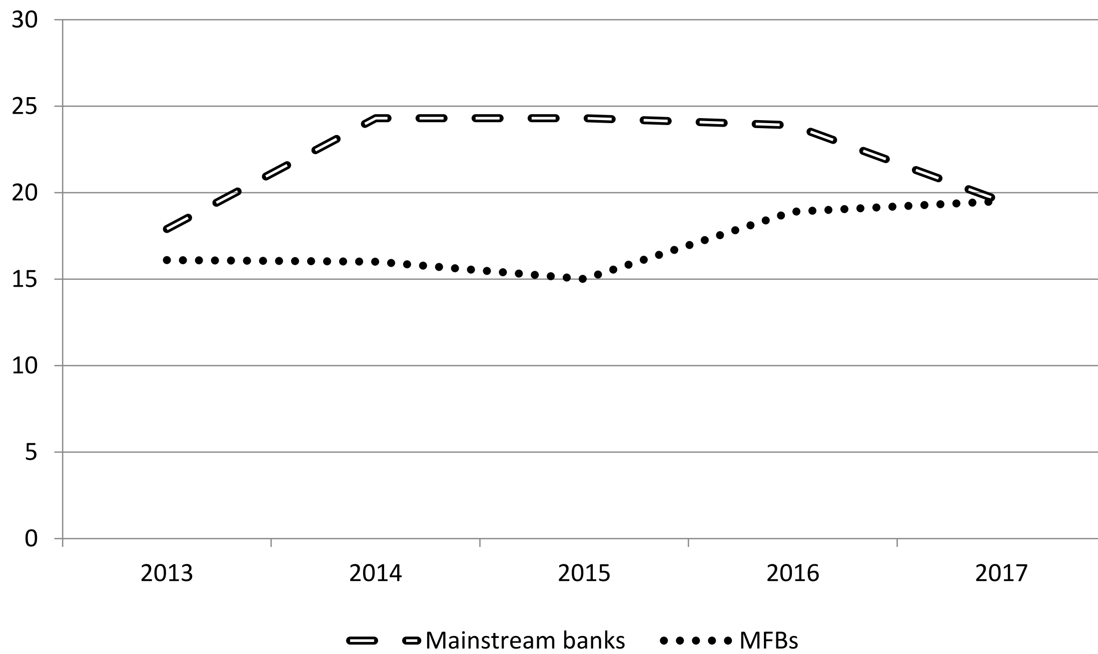
128 Santos and Pennacchi (2018) discuss the benefits and disadvantages of measuring performance through RoE and also observe how banks have come to use RoE more frequently since the 1970s as the banking industry faced increasing competition from nonbank financial institutions, such as money market mutual funds .

Figure 23: RoA compared for mainstream vs. MFBs



Source: SBP (2018), PMN (2017)

Figure 24: RoE compared for mainstream vs. MFBs



Source: SBP (2018), PMN (2017)

A comparison of RoE tells a slightly different story, as shown in Figure 24. A higher RoE for MFBs relative to mainstream banks might be taken here as a commentary on deposit

taking activities. RoE appears to decrease for MFBs as they enlarge their deposit bases and increase for mainstream banks as they reduce their deposit bases.[129]

Some key observations may be made based on the above. One of these is that deposits are a core part of the operating models of both types of bank. For mainstream banks, these deposits drive profitability through investments in government paper, whereas for MFBs these deposits are used to create loans. Related to this is another observation: that MFBs are more inclined to lend to the private sector whereas mainstream banks are more inclined to lend to the public sector in the form of fixed income investments.

4.4 SUMMARY

Pakistan's financial system is an example of bifurcated banking partially because of the linkages between informal finance and inclusive finance. These have their origins in the colonial period, but the separation has been retained even after the implementation of banking sector reforms to privatise, deregulate, and liberalise financial institutions. A commercially oriented microfinance sector is a component of these reforms. While the commercial model is equipped to function with a combination of deposits and wholesale funding from commercial banks, it has the scope to utilise funding from other sources as well. This approach has its roots in the apex fund model designed by the World Bank. Apex funds — as the example of Pakistan shows — came to be the gateway for shadow banks to absorb inclusive finance.

The apex fund model thus provided the infrastructure for wholesale borrowing to become a core facet of the microfinance banking model. However, as shown above, microfinance banks continue to emphasise deposits as a source of funding for on-lending. As such they use an approach that is similar to that used by the mainstream banking sector, which instead of using a model of intermediation in which deposits create loans, opts instead to generate interest income from government paper instead of private sector credit. This fixation of mainstream banks with investments instead of loans is revealed in low private sector credit offtake numbers. Inclusive finance may thus be seen as a response to the reluctance of mainstream banks to lend to the private sector. It thus provides a gateway for global shadow banking networks to meet shortages created by mainstream bank behaviour.

Inclusive finance as shadow banking is the driving force behind bifurcated banking. While the notion that inclusive finance is different from mainstream finance is not a novel one, it is centred overwhelmingly on how microcredit is expensive in relation to loans made by mainstream commercial banks. Such comparisons are premised upon inclusive finance as a lending product and highlight how relative inequities in pricing and rates characterise inclusive finance. Rates and pricing are

129 An alternative inference could be that both types of institution improve their RoE as they increase borrowing, and vice versa, with shifts linked to changing MCR imposed by the regulator.

discussed in more depth in Chapter 8, which examines the costs of mobile money and payment services. But before that, Chapter 6 shows how inclusive finance as shadow banking extends beyond credit, particularly given its technological dimensions, and also its predilection for financial innovation. Technology is used primarily to extract value from digital footprints, whereas financial innovation is used to extract yield from debt. These practices cause inequities in privacy and surveillance, and inequities in eligibility and requirements respectively.

5. BIFURCATED BANKING: GAPS AND RESPONSES

5.1 INTRODUCTION

The previous chapter highlights the various factors behind the ascendancy of a commercialised model of inclusive finance in Pakistan. This is shown to exist in parallel with a closely regulated commercial banking sector. The bifurcated nature of Pakistan's banking system, examined here through a framework of shadow financial citizenship, is revealed in the synchronised existence of separate banking systems.

There are two components to this discussion of shadow financial citizenship; one is the process whereby inclusive finance becomes shadow finance; another is the nature of financial citizenship offered by such shadow financial institutions. The case of Pakistan demonstrates how shadow banking practices shape inclusive finance because of the disinclination of mainstream banks to lend to private enterprises that are not large corporate firms. This reticence has underlying causes and has created a need for alternative arrangements to meet the borrowing needs of the public. The resulting system is bifurcated and the alternative arrangements cannot offer full financial citizenship.

This study has, up until now, been centred on these alternative arrangements as they pertain to credit, loans, and borrowers. The current chapter expands on this discussion by observing how digital technology has become a core part of inclusive finance in Pakistan. This is reflected in the emphasis placed on strategies such as branchless banking and mobile money in the NFIS or National Financial Inclusion Strategy, which was prepared by the central bank in collaboration with other stakeholders. These strategies may be considered in the light of structural, macroeconomic, and other factors which demonstrate the capacity of inclusive finance to respond to constraints arising from the administration of the Basel Accord, FATF guidance, and practices of budgetary financing in Pakistan. Given this context, inclusive finance may be likened to shadow banking because it facilitates regulatory arbitrage and avoidance. Regulation here overlaps with structural and macroeconomic constraints, as well as the rules associated with FATF Guidance and the Basel Accord.

The remainder of this chapter proceeds as follows. Section 5.2 studies the NFIS or National Financial Inclusion Strategy of 2015 which is presented in a document collaboratively prepared by the central bank, the Securities and Exchange Commission, and the Ministry of Finance. The NFIS is centred on a set of approaches to improve financial access for those in Pakistan who are currently 'unbanked' or 'underserved': these are identified and critiqued for their role in shadow financial citizenship. Section 5.3 examines the structural and macroeconomic factors that constrain private sector

lending and thus create the need for inclusive finance. Section 5.4 offers a framework to identify the nature of shadow financial citizenship in Pakistan. Section 5.5 offers concluding remarks.

5.2 FINANCIALISED DEVELOPMENT AND THE REGULATION OF MICROFINANCE

The NFIS or National Financial Inclusion Strategy 2015 document is the cornerstone for a number of policies that seek to advance financial inclusion by creating, facilitating, and reforming institutions. Backed and circulated by the Ministry of Finance, the State Bank of Pakistan, and the Securities and Exchange Commission, this initiative presents a vision for financial inclusion in Pakistan so that 'individuals and firms can access and use a range of quality payments, savings, credit and insurance services which meet their needs with dignity and fairness' (NFIS, 2015: viii). By incorporating financial inclusion into official government policy, Pakistan has taken an approach that was concurrently adopted by several other national governments:

> 'Dozens of national governments have adopted policies to expand financial inclusion. These and other global and national efforts are paying off. New Global Findex data reveal that globally the share of adults owning an account is now 69 percent, an increase of seven percentage points since 2014. These numbers translate into 515 million adults who have gained access to financial tools. The 2017 figures on overall account ownership continue the upward trajectory we've seen since the Global Findex database was first released—with financial inclusion rising 18 percentage points since 2011, when account ownership was 51 percent' (Findex, 2017: v).

This upward trajectory has much to do with the rise of digital financial services and increased efforts to biometrically document large segments of the unbanked. The most recent Global Findex report also points to areas where the need for more concentrated efforts is recognisable.

> 'Still, in most of the world women continue to lag well behind men. Globally, 65 percent of women have an account compared with 72 percent of men, a gap of seven percentage points that is all but unchanged since 2011. Nor has equality in account ownership been achieved in other regards. The gap between rich and poor has not improved since 2014: account ownership is 13 percentage points higher among adults living in the wealthiest 60 percent of households within economies than among those in the poorest 40 percent. And urban populations continue to benefit from far broader access to finance than rural communities. In China around 200 million rural adults remain outside the formal financial system' (Findex, 2017: vi).

In broad terms, the approaches taken in Pakistan are centred on three themes: (1) enhanced access through technological and digital solutions, (2) more efficient savings and lending products through commercialisation, (3) more secure and stable

transactions through the SBP's regulatory oversight along the lines of FATF regulations, and also the Basel Accord for mainstream banks.

The NFIS document thus notes that despite the presence of a sound and profitable banking sector and various — innovative and popular — initiatives, financial inclusion in Pakistan remains low. Just over 10 per cent of adults have a bank account, about 56 per cent of adults do not use any financial products, only 4 per cent or so of adults save with a formal financial institution, and only 3 per cent borrow from a formal financial institution (NFIS, 2015). While there is now rich data available from the Global Findex Database, the overall picture for Pakistan may be summarised thus: the financially included are 'overwhelmingly male' and 'predominantly urban' (NFIS, 2015). The weak state of financial inclusion is described in the NFIS as a part of a broader pattern in which credit to the private sector has been declining recently:

> 'While the total assets and deposits of Pakistan's banking sector have doubled since 2008, private sector credit to GDP has declined from 22per cent in 2009 to just 14.7per cent in June 2014. The decline in credit provided to SMEs has been particularly pronounced, falling from 16per cent of bank lending in 2008 to just 7per cent in June 2014' (NFIS, 2015: vi).

These patterns are attributed to economic and structural factors including macroeconomic weakness from the 2007-9 global financial crises which resulted in deteriorating asset quality and a resultant 'flight to quality'. Additionally, sharp rises in public debt are reflected in the expansion of government securities holdings which provide banks with attractive yields at low risk: so even though bank deposit bases have continued to grow during this period, private credit has declined as a share of total bank lending (NFIS, 2015). Other factors which help explain slow bank lending include the restrictions faced by enterprises because of energy shortages and security concerns, gender barriers which exclude women from the formal financial system, and growing informality in the economy with some calculations showing that the informal economy could be the size of 75 per cent to 91 per cent of the formal economy (NFIS, 2015).

The responses to these issues are highlighted in the NFIS and emphasise solutions that capture the structural and macroeconomic nature of constraints to financial inclusion. But in such policies, a discussion of how these constraints may be overcome is largely absent. Rather than attempt to widen access to mainstream banking, the approach of the NFIS is to present inclusive finance as an alternative approach. As such, it gives tacit support to a system of bifurcated banking.

Universal but digital

For instance, the NFIS notes that universal access to formal accounts need not be limited to traditional savings and transaction accounts but also include digital transactional accounts (DTAs), primarily branchless banking accounts, for which

Pakistan is globally, at present, the fastest growing market (SBP, 2015a). The introduction, in 2008, of the Branchless Banking Regulation catalysed the expansion of financial services available through mobile phone networks. Nearly 80 per cent of Pakistanis aged 15 and over have access to a mobile phone (Rashid, 2015).

The focus on digitisation may be seen in the light of wider, international trends exerted by multilateral institutions working with finance in the Global South. Three organisations are of particular relevance: the Alliance for Financial Inclusion (AFI), the Better Than Cash Alliance (BTCA), and the Financial Action Task Force (FATF). The influence of these institutions ensures that the nature of financial transformation in Pakistan is circumscribed within the directives that they issue. The NFIS exemplifies this tendency.

Much of the NFIS is influenced by the Alliance for Financial Inclusion which was founded in 2008 as a project of the Bill & Melinda Gates Foundation, and is also supported by the Australian Agency for International Development (AusAid). The AFI bases its practices on a 'South-South peer learning approach and truly member-driven governance (AFI, 2017). The Maya Declaration is arguably the AFI's most widely known initiative.

> 'When a country commits to the Maya Declaration, they make measurable commitments in four financial inclusion areas: create an enabling environment to harness new technology that increases access and lowers costs of financial services; implement a proportional framework that advances synergies in financial inclusion, integrity, and stability; integrate consumer protection and empowerment as a key pillar of financial inclusion; utilize data for informed policymaking and tracking results' (Center for Financial Inclusion, 2013: 2).

Launched in 2011 at the Global Policy Forum (GPF) in Riviera Maya, Mexico, it is known as the first global and measurable set of commitments to financial inclusion (AFI, 2011), and counts over 80 countries, including the SBP among its signatories.

Also emphasised in the NFIS is G2P or government to person transactions: this reveals the influence of The Better Than Cash Alliance (BTCA) which was launched in 2012 and is jointly funded by the Bill & Melinda Gates Foundation, Citi Foundation, MasterCard, Omidyar Network, United States Agency for International Development, and Visa Inc. Housed within the United Nations Capital Development Fund, the overriding objective of this organisation is to shift from cash to digital payments: ostensibly, this is a tool to promote financial inclusion and reduce poverty.

> 'The harsh reality is that the only way to make or receive payments for many poor people across the world is by using paper money in the informal sector - which is a barrier to the use of formal financial services. Cash-based transactions are also typically unsafe, expensive, inconvenient, inefficient, and lack transparency for governments, companies, and citizens alike' (Better Than Cash Alliance, 2017: 1).

One focal point here is the issue of corruption; another is the perception that G2P arrangements allow for the attainment of scale through bulk payments (NFIS, 2015) and

may thus function as an 'on-ramp to financial inclusion' (Stuart, 2015). Pakistan's membership of the BTCA makes in eligible for technical assistance and funding to support the transition from cash to digital for G2P payments.

Financial intrusion and the regulation of security

Issues of terror funding and money laundering are of particular relevance in a Global South context, a point noted by the Financial Action Task Force (FATF) which was established in 1989 as a Paris based, intergovernmental policy making body, that 'works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse' (FATF, 2018). FATF's incursion into the inclusive finance movement began in 2011, when the organisation issued a guidance paper to ensure that countries 'meet the national goal of financial inclusion, without compromising the measures that exist for the purpose of combating crime': this paper was updated in 2013 and subsequently in 2017 (FATF, 2018). Central to FATFs position is the notion of 'a proportionate approach to risk': this mirrors the principles adopted by the Bank for International Settlements (BIS) and the World Bank (Aron, 2017).

> 'Clients have access to a range of different account functionalities depending on the extent of identification/verification conducted by the financial institution. Strict pre-set thresholds are defined for the various account levels. Access to the basic, 1st level set of services is provided upon minimum identification. Access to the subsequent account levels and additional services (e.g. higher transaction limits or account balances, diversified access and delivery channels) is allowed only if/when the customer provides the required additional identification/verification information. In the meantime, the accounts have limited services (e.g. caps on daily/monthly withdrawals, deposit limits based on the level of CDD conducted and the customer's risk profile)' (FATF, 2017: 7).

This is reflected in the policy of the SBP on branchless banking (BB). BB accounts are categorised by three levels with level 0 and level 1 BB accounts for individuals and level 2 accounts for individuals as well as firms, entities, trusts, not-for-profit organizations, corporations etc. Know-your-customer (KYC) requirements, and daily and monthly transaction limits vary depending on account type (SBP, 2015a).

A core feature of the inclusive finance via branchless banking approach in Pakistan is the role of biometric technology. The National Database and Registration Authority (NADRA) of Pakistan is recognised as a global leader in the 'application of identification systems and technology to a range of development issues' (Gelb, cited in Malik, 2014). The main objective of this institution, since its inception in 2000, is to issue computerised national identity cards, or CNICs, with a unique thirteen digit number to Pakistanis aged 18 and over. The CNIC is a requirement for conducting transactions of various types with the government as well as the private sector. For instance; voting in elections; applying for a passport or driving license; purchasing vehicles, land, and other assets; purchasing a plane or train ticket; obtaining a mobile

phone SIM card; opening and maintaining a bank account; and conducting financial transactions.

Following an anti-terror drive in early 2015, the Pakistan Telecommunication Authority proceeded to block all mobile phone SIMs that had not been biometrically verified (Craig and Hussain, 2015). As a result, every mobile phone number in Pakistan is now associated not only with a CNIC number but also with a set of fingerprints. This has facilitated Pakistan's commitment to FATF standards as biometric verification eases customer due diligence (CDD) requirements. It is estimated that as much as 98 per cent of Pakistan's adult population is registered with NADRA (Malik, 2014).

> 'The standard of verification used to link a user with their SIM card – biometric data – is one of the highest standards of identity verification available and offers a more robust solution to meet KYC obligations that mitigate integrity risks. It surpasses the current standard used for entry level (Level 0 and Level 1) branchless banking account opening in Pakistan, whereby a CNIC number and photograph is verified against the NADRA database. To date, entry-level accounts have balance and transaction limits to create a product with a lower risk profile and thus allow for these simplified KYC requirements, commensurate with the level of risk' (GSMA, 2015: 6).

The centrality of NADRA and its biometric database to everyday life in Pakistan is at the core of DTA or digital transactional accounts as a financial inclusion strategy.[130] The DTA strategy has been formulated given the presence of a robust national infrastructure which includes a regulatory framework, widespread mobile phone ownership, and an extensive official biometric databank. There are two drivers behind the DTA strategy. One of these is distribution. The existing infrastructure facilitates an expansion of DTAs by addressing the issue of national distribution through the proximity and interconnectivity of ATM and POS machines linked to mobile phone networks. Account opening procedures in such an arrangement are eased by relatively lighter regulatory requirements on KYC procedures using biometric technology. At present, the branchless banking network is thin, particularly in rural areas, but the SBP observes that this problem may be overcome through the participation of third party service providers (SBP, 2015a).

Third party involvement relates to the other driver of the DTA strategy here. Within the approach described above, recruiting more third party service providers is purely an operational matter. Extension of the agent network is dependent on the capability to select, recruit, train, and supervise agents, and to establish alliances with existing retail networks to manage the logistical demands of cash availability and interconnectivity. But this approach does not acknowledge the intrinsic value of data

130 The role of NADRA, a state owned entity, in the NFIS, may be likened to what Kaminska (2015, cited in Gabor and Brooks, 2017: 433) describes as a new arrangement between the state and financial capital : 'In this case, the role of the state is recast to provide 'an enabling environment' for financial capital to flow freely, while allowing the consequences of systemic risks to be transferred to consumers precariously positioned at the 'bankable frontier', while their "digital footprints" are captured and quantified as evidence of potential income streams against which securitised loans can be made that form the basis for tomorrow's financial 'innovations''.

and of the digital footprints created through a combination of biometric verification and algorithmic technology, so that financial institutions may expand their client bases.[131]

Although this application of data technology is not yet commonplace in Pakistan, this is changing rapidly with a small number of microfinance banks already using digital transaction data as well as mobile phone/ GSMA activity for credit scoring. The relatively lighter KYC requirement for branchless banking is a tacit endorsement of this practice. There is considerable space here for third party involvement, a pattern which has been facilitated by the development of a venture capital ecosystem in Pakistan. For instance, Finja, which is described as the 'technology partner & Super Agent' for Finca Microfinance Bank's branchless banking operations has received USD 1.5 million in series A funding , from Vostok, a Stockholm listed company headquartered in Bermuda, specializing in emerging market fintech (Chakraberty, 2017). Another example is Tez Financial Services. Headed by former Citi banker, Nadeem Hussain, Tez — translated as 'fast' in Urdu — is a part of PlanetN, a holding group which makes investments in existing companies and houses an accelerator based loosely on the principles of Y Combinator (Husain, 2016).[132] Credit scoring based on digital data capture is a core strategy of this start up company and entails a suspension of rights to privacy associated with the absence of full financial citizenship. Uneven patterns of digital privacy are a feature of belonging to a class of poor borrowers who are removed — or excluded — from the workings of a closed system.[133]

> 'If you allow to me to access your smartphone and carry out a risk assessment, there are 12,000 data points I can take. Let me give you the easiest one. If your contact list consists of 10 people and your friend's list consist of 1,000 people, your friend has a better credit risk profile, because, he or she is more networked than you are. The same goes for travel; credit risk improves with people who have a regular, as opposed to an erratic pattern, or if your phone is on 24 hours a day versus 12 hours a day, then you are a better risk. These are all data points that have been established by machine learning and algorithms. Once we launch this service and defaults happen, the machine will learn and correct the weightages we give; the algorithm learns as it goes along. The idea is to offer customers Rs 5,000 to 10,000 loans, repayable after a month and eventually after three months. All they have to do is download our app and with their consent we will be able to tell within 10 minutes whether they are eligible for a loan' (Hussain cited in Baig, 2017).

Commercial appeal and the issue of penetration

Commercial iterations of inclusive finance present an opportunity for private finance to take on the guise and role of development finance. Such approaches allow for a

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131 Gabor and Brooks (2017) draw on Kaminska's (2015) observations and note that the FPD or finance-philanthropy-development nexus entails the use of technology to interact with the subjects of inclusive finance by capturing their data and re-using it in a way that can change or condition customer behaviours, or alternatively to provide information flow to the lender for risk-management purposes.

132 Y Combinator is an American accelerator company which provides funding in the form of seed money in exchange for equity to start up companies: among the most successful examples of their investments are Airbnb, Dropbox, and Reddit. See https://yclist.com

133 This is a key characteristic of recent iterations of inclusive finance and theorised byGabor and Brooks (2017).

leveraged approach to development cooperation to attract private flows, including equity stakes, through reduced exposure to risk.[134] Some examples are presented in the table below which describes sources of funding for inclusive finance in Pakistan.

Aside from transactions and payments, the other aspects of inclusive finance are access to savings and loans.[135] Pakistan is an example of a country where commercial models of microfinance are ascendant and where subsidies are seen as undermining sustainability.[136] In such a context, savings relate to the context of deposit mobilisation.[137] Because of the legislative structure permitting deposit taking, only one third or so of Pakistani microfinance providers offer savings products: MFBs are allowed to take deposits but MFIs are only permitted to mobilise deposits by requiring that their client place them in commercial banks (PMN, 2017).

Available data allows for very limited inferences about the extent to which microfinance providers — MFBs and MFIs both — are responsible for mobilising deposits, as it is not possible to identify which commercial bank deposit holders are clients of microfinance institutions.[138] However, the data for MFBs illustrates success in deposit mobilisation with the period 2015-16 experiencing a jump of 88 per cent in the number of depositors who rose to 15.9 million from 10.7 million in 2015: in terms of value, this amounted to 41 per cent, taking the deposit base to PKR 118 billion from PKR 60 billion a year earlier (PMN, 2017).

This surge may be attributed to the recent moves by MFBs to compete with commercial banks for deposit mobilisation, by offering double digit rates on deposits: up to 13 per cent relative to 7 per cent offered by commercial banks. This strategy has been facilitated by the directive, issued in late 2015 by the SBP, permitting MFBs to use the same clearing system used by commercial banks (SBP, 2015b). The outcome of this, for those banks that have opted for this tactical approach, is a decrease in cost of funds, as well as an increase in the ratio of deposits to gross loan portfolio (PMN, 2017). As a result, many MFBs have not only enhanced their efficiency but also their liquidity.

For some analysts of the 'missing middle' phenomenon this improved liquidity offers perceptible opportunities. The term 'missing middle' is generally used to describe the disproportionately small number of small and medium-sized enterprises as compared with the number of micro and large enterprises in many developing countries

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134 Van Waeyenberge (2015) attributes such approaches to the 'private turn in development finance'.
135 Savings were a key pillar of the microfinance movement for two reasons; they had the potential to reduce dependence on subsidies and donors by mobilising funds for on-lending; and they allowed for households to smooth consumption and build assets for collateral for future borrowing (Khandker, 1998).
136 Subsidies need not necessarily preclude saving: the successes of forced or involuntary savings programmes in Bangladesh (Khandker 2000) and Indonesia (Morduch 2000) exemplify how savings can reduce the social cost of subsidisation.
137 Analysing the trade-offs between subsidised and commercial models of microfinance, Murdoch (2000: 620) notes that the subsidisation of credit skewed the incentives for microfinance providers to promote savings because banks were losing money on the lending-side but were amply capitalized by governments and thus had little incentive to mobilize savings. Because deposit mobilization is costly, re-lending the deposits would just lead to greater losses. Instead, saving accounts were weighed down with restrictions and downward pressure was put on interest rates on deposits, generally to keep interest rates paid to depositors below the rates charged to borrowers. 'The result was that real rates on deposits fell to zero or below and savers had little incentive to build up accounts. Ultimately, little saving was generated, and money stayed under mattresses or was moved into nonfinancial assets.'
138 MFBs can accept deposits but MFIs can only direct clients to open deposit accounts at other banks.

(Ayyagari et al. 2005 cited in Shankar 2016). The standard approach to the missing middle presents it as an issue of both access to and lack of finance (World Bank, 2017). The NFIS (2015) takes a more measured stance on this, noting that according to survey data, access to finance is a less important issue for SMEs than lack of electricity, and corruption, respectively. Given the perspective that finance is a crucial issue for enterprises, the SBP has been encouraging MFBs to lend to microenterprises. The objective of such a policy, like that of promoting deposit mobilisation, is to promote competition between MFBs and commercial banks. In practice, such an approach has encouraged a bifurcated banking structure.

Expensive lending and bifurcated pricing

From a regulatory standpoint, microfinance banking differs from commercial banking in two ways: licensing requirements and lending requirements. The lending limit imposed on microfinance banks has been contentious — it was revised upwards in 2012 from PKR 150,000 to PKR 500,000, and then to PKR 1,000,000, through a series of notifications over 2017 and 2019, for selected lenders in order to promote enterprise lending and housing finance.[139] There is also support for issuing separate licenses with higher lending limits to increase coverage (Aslam, 2013).

Lending rates in Pakistan are not regulated by the central bank. Within the global financial inclusion industry, this is regarded as a best practice. Despite concerns about exploitative and predatory lending practices, capping rates is seen as counter-productive and the CGAP finds that interest rate curbs reduce poor people's access to financial services:

> 'Interest rate ceilings make it difficult or impossible for formal and semi-formal microlenders to cover their costs, driving them out of the market (or keeping them from entering in the first place)' (CGAP, 2004: 1).

In Pakistan, high lending rates persisted even in a low interest rate environment with the benchmark policy rate at a 42 year low of 5.75 per cent (PMN, 2017). Microfinance practitioners reiterate that it is misleading to draw causal connections between benchmark interest rates and lending rates as it is operating costs — and not funding costs — that determine loan terms.[140] These rates are primarily due to expenses such as personnel compensation, supplies, travel, depreciation of fixed assets, etc.[141]

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139 http://www.sbp.org.pk/acd/2019/C1.htm

140 It is thus argued that the very practice of making small loans — since that is what the poor require — entails high interest rates because smaller loans have a higher administrative cost per dollar than do larger loans (Rosenberg et. al, 2013).

141 Given this, and also the fact that the alternative to microfinance is very often the unregulated money-lender Sandberg (2015:143) argues that it is governments, commercial banks and the international political community that should be held responsible for high interest rates caused by credit rationing because these may be reduced by creating background institutions and/or making infrastructural improvements which could reduce some of the costs for MFIs.

Despite commercialisation — which has entailed a strong nexus with the mainstream banking sector — the financial inclusion agenda has not made convergence, between the micro and mainstream finance sectors, a priority. Although in many countries microfinance and other services offered under financial inclusion initiatives are regulated they are nevertheless distinct from, and presented as an alternative to, the formal financial sector. This is clear from the CGAP emphasis on 'unbanked' who are excluded from the formal financial sector but offered an alternative in the form of microfinance and IT based payments systems (CGAP, 2018).

What is the potential for an easing of this separation? Efforts in Pakistan to earmark the category described as MSEL or medium small enterprise lending (Aslam, 2013) reflect the realization that larger loan sizes are essential for bridging the gap between the microfinance and commercial banking.[142]

> 'This is too low to make a difference to the growth and expansion of MSEs. Average loan size has remained low because the mission of microfinance was believed to consist in provision of finance to low income persons rather than MSEs' (Aslam, 2013: 6).

Loan size is also directly related to the issue of collateral requirements which constrain lending to any enterprise that is not a government entity or a large corporate. The central bank is acutely aware of such lending constraints which emphasise the need for immovable collateral and has sought to relax collateral requirements. For instance, in 2004 the SBP amended prudential regulations so commercial banks could lend up to PKR 3 million without collateral (Nenova et al., 2009). And in 2012, the SBP amended prudential regulations to allow microfinance banks to accept gold as collateral (SBP, 2012).

Rules on collateral reveal how microfinance banks have a key role in shaping rules and regulations: this was the case when policy changes effectively created new asset streams by expanding the definition of collateral. As observed by Zulfiqar (2013), exuberant lobbying efforts by the microfinance giant TMB resulted in revised prudential regulations on acceptable collateral made by the State Bank of Pakistan to allow gold backed lending. These amendments allowed MFBs to accept gold jewellery as security for loans. This was an extension of new rules that permitted collateralised lending: previously, all microfinance loans were unsecured. This step from the central bank was a response to two realities; one, that Capital Adequacy requirements (CAR) —based on Basel II — were limiting the growth of MFBs (Aslam and Azmat, 2012); and two, in many parts of South Asia, the accumulation of gold is a traditional and preferred form of saving (Chen and Rasmussen, 2012).

Collateral, in both the formal and informal market context, serves a dual function; it protects the lender against risk by allowing for either partial or complete

142 Recent efforts in Pakistan and elsewhere in South Asia to focus on the needs of 'graduates' (Shankar, 2016) are a step in this direction as they offer a shift away from lending to low income individuals; a model that relies on small loan sizes and high lending rates.

recovery in case of default; and it serves to vet prospective clients by linking risk to readiness to repay. In economic theory, this dual function of collateral may be said to address the problem of asymmetrical information, which might occur for example when buyers in a market have much better information than sellers in the same market.[143] Adverse selection, and moral hazard, are the two components of information asymmetry and provide the conceptual justification for collateral.[144] The International Labour Organisation uses a similar vocabulary in its definition of collateral:

> 'Collateral is an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan' (Balkenhol and Schutte, 2001: 7).

In Pakistan, perhaps the most prominent example of collateralisation is that of gold jewellery. Zulfiqar (2013) likens collateralisation trends in Pakistani microfinance, particularly when gold is involved, to Hernando de Soto's concept of dead capital (de Soto, 2000), with lenders justifying their practices as an extension of property rights. The collateralisation of gold is a practice associated with the jewellery owned by Pakistani women. A key theme in such practices is that of drawing the informal sphere into the formal sphere by reviving dead capital.[145] Another, overlapping theme, is that of redressing issues arising from patriarchy in ownership.[146]

Policies to support gold collateralisation arose from the need to balance risk management, following the delinquency crisis of 2008, with expansionary pressures — to deepen and widen this sector — from the SBP which had committed to increasing outreach to 3 million by the end of 2010 and 10 million by 2015 (SBP, 2008). As a result, the viability of reaching targets through the group loan approach came under scrutiny: group or joint liability loans tend to be small enough to circumvent the issue of collateral, aside from social collateral in the form of the group guarantee (Aslam and Azmat, 2012). But when loans are larger — though still capped in size by the regulator — immovable assets are impractical to collateralise and often valued at much more than the loan itself. The need for collateral is thus linked to the push for larger loans because group members are wary of providing guarantees for large amounts: so, small value, liquid movables are considered more often by lenders to secure performance of obligations (Aslam and Azmat, 2012).

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143 The Nobel laureate economists George Akerlof (2002), Michael Spence (2002), and Joseph Stiglitz (2002) have an extensive body of work that shows how informational asymmetries lead to market failure.
144 Studies on microlending byStiglitz (1990) and Ghatak (1999) emphasise how group lending and joint liability models — before microcredit became commercialised — is an effective strategy to evade the need for collateral by using peer monitoring to overcome adverse selection and moral hazard issues.
145 De Soto (2000) sees dead capital as an asset that cannot easily be bought, sold, valued or used to accumulate wealth.
146 In a study for the World Bank, Almodóvar-Reteguis et al. (2012) note that access to land is heavily skewed against women and that this limits their access to finance: it might be addressed by banks through expanding the range of assets accepted as collateral

5.3 STRUCTURAL AND MACROECONOMIC ISSUES

Initiatives to draw microfinance banks into MSEL highlight the sense of urgency undoubtedly felt by a central bank confronted with declining — in real terms, relative to previous decades — private sector credit offtake (SBP, 2015a).

While the total assets and deposits of Pakistan's banking sector have doubled since 2008, private sector credit to GDP has declined from 22 per cent in 2009 to just 14.7 per cent in June 2014. The decline in credit provided to SMEs has been particularly pronounced, falling from 16per cent of bank lending in 2008 to just 7per cent in June 2014. (SBP, 2015a: vi)

More recent data indicates that improvements have been small, with private sector credit at 16.2 per cent in June 2017 (SBP, 2017b). This weakening and its persistence are ascribed to a number of factors. Khalid and Nadeem (2017) attribute the initial decline to knock on effects from the global crisis of 2008, which coincided with security concerns, political instability, and energy shortages in Pakistan: five years of double digit interest rates followed, with counter-cyclical monetary policy vetoed because of parched FDI inflows and a balance of payments crisis from a feeble external sector. The outcome is the familiar scenario of an unfavourable balance of payments — necessitating IMF led demand compression and stabilisation policies —eventually compromising deregulation and liberalisation by quashing market mechanisms for interest rate determination (Khalid and Nadeem, 2017).

The rollback of the state

Aside from exogenous factors, there are other reasons for the austere position that lenders find themselves in. A general argument is that it was the liberal reform process of the 1990s — fixated with buttressing regulatory frameworks and enhancing institutional stability — that compromised financial inclusion, primarily by cost-cutting strategies that resulted in downsizing and branch closures (Khalid and Nadeem, 2017). Though the SBP was conscious of the need to keep the banking sector accessible and took regulatory steps such as preventing banks from refusing to open accounts for prospective clients; provision of free services by banks for the opening and maintenance of regular savings accounts; and, some exemptions on minimum balances; between 2004 and 2015, the total number of small accounts fell by 3.1 million (Zaidi, 2015: 406). This is depicted in numbers by Pakistan's position in IMF 2015 rankings of financial development: in efficiency the country is ranked 52 but in access to institutions it is 130 (Svirydzenka, 2016). The issue of limited private sector credit offtake is brought into sharp focus when regional comparisons are made: Pakistan not only has one of the lowest proportions of adult population with access to a transaction account, but also has one of the highest ratios of currency to deposits (Khalid and Nadeem, 2017).

These trends may be associated with a key feature of liberal reforms in Pakistan: the rollback of the state which commenced over the 1980s and 1990s.[147] This resulted in sharp reductions in government ownership of the banking sector and also the abandonment of direct, or priority lending strategies. The absence of an official push factor has made it possible for lenders to dodge the comparatively riskier prospect of SME lending. The state in Pakistan controls only 20 per cent of banking assets: this is low compared to other emerging economies — including China, India, Egypt, Sri Lanka, Vietnam and Bhutan, Brazil, Argentina, Indonesia, Bangladesh, Russia, and Turkey — where the public share ranges from 30 per cent to 50 per cent (World Bank, 2012). The policy of mandatory lending to sectors identified by the state is still practiced in a number of countries; India's priority sectors receive over 40 per cent of bank loan portfolios; Brazil's directed lending amounts to over 50 per cent of total credit; and in both Thailand and Indonesia, 20 per cent of lending is allocated to SMEs (Khalid and Nadeem, 2017).

Strong government borrowing and weak bank lending

Why else have commercial banks been so reticent about customer base expansion? This can be at least partially attributed to fiscal patterns: the low tax base, at less than 11 per cent of GDP, compels the government to rely on borrowing for deficit funding (Ministry of Finance, 2017). Private businesses account for 40 per cent of bank credit and only 0.4 per cent of all borrowers are responsible for 65 per cent of all bank loans (State Bank of Pakistan, 2015). In the absence of effective measures to widen and also deepen the tax base it is unlikely that commercial banks — which are currently earning heavy spreads by investing in risk free treasury bills — will shift their focus to the private sector — but away from the corporate sector — particularly for those in lower income segments.

Also noteworthy here is the relationship between government borrowing from commercial banks and banking spreads. In developing economies the state tends to be insensitive to the cost of such borrowing to finance its budget deficit when it has no recourse to other sources: this is an outcome of a shallow secondary market for lending, suggesting the need for policies to enhance domestic debt markets alongside liberal reforms (Choudhary et. al, 2016). Governments may also borrow directly from the central bank. These borrowings finance deficits require the central bank to print money which creates inflation in the economy and generates seigniorage revenues for the government.

> 'Developing countries resort to such practices because (i) their governments tend to have limited fiscal space and as such rely on such practices as a short-term arrangement, (ii) credit market frictions encourage banks to place their funds in

147 Two recent papers emphasise the intense nature of deregulation, liberalisation, and privatisation in Pakistan. Naqvi (2018: 1065) analyses the shortcomings of financial reform, observing that the Pakistani financial sector 'performed its function better under state direction'. Munir and Naqvi (2017: 1695) draw attention to the Pakistani case for how 'the suboptimal outcomes of the privatizations went largely unchallenged'.

> risk-free assets and (iii) direct central bank financing of fiscal expenditure is deemed inflationary' (Choudhary et. al 2016: 4775).

This 'Dominant Borrower Syndrome' is interrogated by Choudhary et al. (2016) who find that persistent government borrowing from commercial banks has limited the sector: the widening of interest rate spreads, lower private sector credit — despite a policy rate that has fallen by over 550 basis points over four years— and a weak transmission of monetary policy have been created by lack of impetus for credit intermediation, given an ample supply of zero-risk weighted assets in the form of government paper. But this explanation, which rests on the macroeconomic assumption of crowding out, is somewhat simplistic. It is more reasonable to infer that stringent capital requirements — as necessitated by the Basel framework — deterred banks from lending to the private sector, especially where high default risk was a feature of incomplete collateral and/or uncertain cash flows.[148]

The issue of weak lending in Pakistan cannot then accurately be described in the relatively simplistic terms of government involvement; which might be excessive and cause crowding out, or be inadequate and fail at direct lending strategies. Instead, a shadow banking lens explains the need for and shape of inclusive finance.

5.4 SHADOW BANKING IN PAKISTAN

Inclusive finance is like shadow banking because it entails credit intermediation that involves entities and activities outside the regular banking system.[149] Some of these entities and activities are mentioned above and whilst MFBs are indeed deposit taking institutions, the discussion above, as well as figures in the previous chapter, demonstrate how these deposits form only a part of total MFB liabilities. Particularly relevant here is what is known as the regulatory arbitrage view which ascribes shadow banking to the need for financial institutions to avoid regulations.

Given the perspective detailed above, in which inclusive finance is the response to weak lending, two phenomena are of especial relevance; (1) regulations to enhance financial stability have pushed commercial banks to eschew lending outside the corporate and public sector; and (2) a lack of depth in domestic debt markets has created an interest inelastic demand from the state for bank borrowing. The effect of these two phenomena has been to constrain mainstream banks from meeting the borrowing, and other banking needs, of the public. Inclusive finance has emerged in its contemporary shape as a response to these constraints for two reasons.

One reason is that because inclusive finance is offered by specialised institutions associated with only a small share of financial sector assets, the lack of complex

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148 This link between Basel regulation and constrained lending is an empirically documented tendency discussed in a shadow banking context by Toporowski (2017).

149This particular description of shadow banking is attributed to Adrian et al. (2013).

operations, and limited interactions with international markets it is not affected by Basel restrictions.[150] Additionally, FATF directives on KYC or know-your-customer requirements are explicitly designed to support digital transactions in the form of branchless banking or mobile money: these specific requirements allow customers to use banking services with limits on the frequency and cash amount of transactions. FATF outlines this CDD or customer due diligence approach as 'tiered' or 'progressive' (FATF, 2017: 7).

Another reason is that inclusive finance is offered as a solution to the problem of the mainstream bank fixation with servicing the government and large corporate institutions. It is for this reason that inclusive finance finds itself at the core of policies not just for meeting the consumption needs of the poorer segments of society, but as reflected in the 'missing middle' and MSME contexts, for driving small and medium enterprises. (Shankar, 2016; Aslam, 2013).

5.5 SUMMARY

This chapter draws attention to salient features of inclusive finance in Pakistan which underlie bifurcated banking. This association between regulation and bifurcated banking is highlighted because within the current regime for the global governance of finance, regulatory measures such as lighter KYC requirements emphasise the difference between inclusive finance and mainstream finance, but do not seek to overcome the inequalities that arise from it. At the same time the heavy emphasis on making inclusive finance initiatives commercially attractive to avoid the need for donor support, create incentives to facilitate financial intrusion to create value through data.

The strategic focus on harvesting data is enabled by a set of international institutions which enlist the most recent iteration of the global assemblage — of products, services, and knowledge — that constitutes the inclusive finance model.[151] For the Pakistani case, this approach has been facilitated by the presence of a large and powerful national biometric database. Chapter 6 will draw attention to how biometric usage in Pakistan is an enticement for mergers and acquisitions in the domestic inclusive finance industry.

This chapter also draws attention to the commercialisation of penetration: under this process, microfinance banks have sought to bring down interest rates and widen their client base through innovative approaches to collateral. As such, clients of inclusive finance are required to present collateral in forms very different from those required or permitted in mainstream finance.

And in addition to digital finance and collateralisation, another set of salient features of inclusive finance which drive bifurcated banking in Pakistan pertain to MSEL

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150 Goldberg and Palladini (2010:10) note that this would not be the case if the size of the microfinance sector is large in relation to the overall financial system or if the microfinance institution is a part of a large regulated financial institution.
151 Inclusive finance is shown to have a predilection for technological approaches that seek to extract asset streams, given that 'All data is credit data' (Aitken, 2017: 274).

or micro and small enterprise lending. Policy focus here, particularly from the central bank, draws on the contention — advanced heavily by the World Bank and other multilateral development banks — that many poor countries, including Pakistan, are afflicted with a 'missing middle' in credit offtake. This problem is characterised by the absence of credit options for firms which are too large for inclusive finance but too small for mainstream finance.

These trends in the Pakistani inclusive finance industry allow for a distinction between commercialisation and financialisation. Whereas earlier attempts to base microfinance on commercial models focused on autonomy from subsidies and public ownership, newer iterations are centred on utilising diverse sources of funding which involve 'pools of cash' seeking yield. This shift from commercialised to financialised approaches to inclusive finance is reflected in the growing diversity of funding mechanisms for microfinance, as well as for other forms of inclusive finance such as branchless banking. These funding mechanisms have been a gateway for shadow banking that is drawn to the asset streams associated with inclusive finance.

These observations, combined with those made in the previous chapter, are the building blocks for the inequities that characterise shadow financial citizenship: these three core inequities are (1) inequities in rates, (2) inequities in requirements, and (3) inequities in surveillance. These are discussed in more depth in Chapter 6 which is a study of specific microfinance institutions and their role in advancing shadow financial citizenship.

6. SHADOW FINANCIAL CITIZENSHIP: PRACTICES, PROCESSES AND PRODUCTS

6.1 INTRODUCTION

The previous chapter demonstrates how shadow banking practices occupy a core role in global development strategies and hence drive shadow financial citizenship by bifurcating banking. The current chapter builds on this analysis and links it with the specific examples of two deposit taking microfinance banks: Telenor Microfinance Bank (TMB) and the First MicroFinance Bank (FMFB). As shown earlier, inclusive finance in Pakistan — which is closely regulated by the central bank and driven by a government led financial inclusion agenda — has experienced a managed immersion in the broader financial sector. Microfinance banks (MFBs) are deposit taking institutions with a heavy share —nearly 70 per cent — in the gross loan portfolio of the overall microfinance sector which includes commercial as well as non-commercial and non-profit organizations (PMN, 2016). This form of microfinance shares similarities with commercial banks but offers distinctly different products and services.

The practices, processes, and products associated with TMB and FMFB — respectively, a bank owned by a mobile phone carrier and a subsidiary of a faith based organisation — highlight the disciplining effects of global finance. Partially expressed as 'mission drift', a notion mentioned in the introductory chapter of this thesis, these effects are also reflected in the nature of inclusive finance, given its tendency to bifurcate banking. The conceptual tool of shadow financial citizenship is applied to interrogate the role of inclusive finance in bifurcated banking. More specifically, the objective of this chapter is examine how the practices of two specific inclusive finance institutions bifurcate banking through the products and services that underlie their respective business models.

To achieve this objective, the two institutions are probed for their role in producing shadow financial citizenship, which is shown to be characterised by; high service charges for loans; the compulsion to provide fungible collateral; and the insidious forfeiture of digital privacy. These features may be cast as a set of inequities: in rates, requirements, and surveillance. How did these characteristics come to be essential features of inclusive finance? To address this question it is necessary to ask what drives shadow financial citizenship? MFBs are components of the shadow banking system because of the microfinance proclivity to receive blended finance from public, private, and also philanthropic sources. Additionally, tight but dynamic regulation has made inclusive finance institutions the target of mergers and acquisitions involving global investment firms and development finance institutions.

The remainder of this chapter proceeds as follows: Section 6.2 examines how shifts in funding inclusive finance have shaped the industry to become a destination for inflows of foreign capital, from private as well as public sources, Section 6.3 draws attention to the transformation of two Pakistani deposit taking microfinance banks — FMFB and TMB — which began operations as a charitable initiative, and a subprime lender respectively, Section 6.4 is an analysis of the financing structures of these institutions and notes how strategies centred on collateral and fintech are advanced by shadow banking and raise concerns about the reproduction of inequalities, section 6.5 builds on these observations to highlight the politics of shadow banking in the makeup of shadow financial citizenship, and Section 6.6 concludes.

6.2 SHADOW BANKING FOR 'SUSTAINABILITY'

The shareholder patterns of Pakistani microfinance banks reveal that of the eleven deposit taking institutions in this sector, only one of these entities — which operates regionally and is newly formed by a provincial government —is not owned by a financial institution. This reflects the overwhelmingly privatised, commercially oriented nature of microfinance in the country. Its superiority over a subsidised, altruistic model has been accepted by Pakistani policymakers (1) because international donors focus on engaging with public and for-profit financial institutions for the purpose of reducing financial exclusion; and (2) because the performance of the sector depends not just on individual financial institutions but on the broader governance of the sector as well as economy.[152]

The above points have consistently been reflected in the Pakistani regulatory emphasis on diversified funding sources. State Bank of Pakistan (SBP) apprehensions about non-profit and public sources of funding are mentioned in their 2006 Financial Stability Review: given heavy dependence on grants and subsidies there is a need to enhance deposit mobilisation for long term sustainability (SBP, 2006)

CGAP's engrossment with sustainability is reflected in their Microfinance Consensus Guidelines which stress consistency in measuring the performance and 'financial viability of microfinance institutions' (CGAP, 2003). Additionally, following the most recent global financial crisis, there was apprehension that reduced liquidity would adversely affect the cost and availability of funding for microfinance (Littlefield and Knelding, 2009). Aside from grants and guarantees, funding for microfinance may come from one or more of three sources; one of these is debt with borrowings either from larger banks and investors, or through the issuance of bonds; another is from deposits, which are described as savings products from customers; and a third source is from equity investments or ownership stakes, for a share of profits.

The matter of growth in Pakistan microfinance is frequently framed as a problem of funding. The Microfinance Growth Strategy 2020, from the think tank,

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152 These are general arguments in favour of commercial microfinance and are attributed to Copestake (2007).

Pakistan Microfinance Network (PMN), forecasts sector requirements of additional equity, debt and deposits of up to USD 3 billion to target 10 million borrowers (PMN, 2015). One approach to addressing this gap has been aggressive deposit mobilization; another has been to attract equity from local and foreign sources, recognizing that donors increasingly eschew subsidized funds.

This demand for equity is often portrayed as a growth opportunity for investment and development assistance. This portrayal has inspired a holding company model in addition to other arrangements: A typology of funding sources is available in Chapter 5. Table 6.1 supplements the literature on commercialisation and on how the microfinance industry has become a magnet for capital inflows. This has implications for financial citizenship because microfinance banks shape themselves to attract shadow finance.[153]

Table 6.1: Microfinance bank ownership patterns

MFB and Year of Inception	Origins	Transitions and Stakeholders
Khushhali Bank 2000	Component of ADB backed Microfinance Sector Development Program (MSDP) and also state backed poverty reduction strategy. Owned initially by 16 Pakistani commercial banks, mostly state-owned.	Acquired by a consortium of national and international investors in 2012, thus ending its quasi-public status. UnitedBank Limited 29.7 %, Incofin Investment Management 24.4 %, Equator LLC 14.3 %, Triple Jump B.V 9.9 %, ResponsAbility S.A 19.9 %, Bank AlHabib Ltd. 1.8 %
First MicroFinance Bank 2002	Created through a structured transformation of the credit and savings section of the Aga Khan Rural Support Programme's (AKRSP), an integrated development programme operating since the 1980s in Northern Pakistan.	51% stake acquired by nationwide bank, HBL, in 2016. Both companies have been owned by the AKFED since HBL was privatised in 2004. FMFB is now a subsidiary of HBL which is owned by the AKFED (51 %), CDC (5 %), IFC (3 %) as well as other institutions and individuals. HBL (50.5 %), AKAM (21 %), AKFED (11 %), IFC (8.5 %), JICA (8.5 %).
U MicrofinanceBank 2003 (Telecom owned[154])	Founded as Rozgar Microfinance Bank and granted banking license in 2005.	Becomes U Microfinance Bank after acquisition by PTCL in 2012 and also transitions from operating at district level to nationwide. Shareholders include PTCL which[155] is owned by the Government of Pakistan (62 %), UAE owned Etisalat (26 %), and the public.
Telenor Microfinance Bank 2005 (Telecom owned)	Commenced operations in 2005 as Tameer Microfinance Bank. Partnered with Telenor Pakistan to jointly launch Easypaisa: Telenor was thus incorporated into Tameer's equity structure in 2008.	Became Telenor Microfinance Bank in 2012 after being acquired by Telenor Pakistan a subsidiary of Telenor Group which eventually raised its stake to 100 % by buying out minority shareholders including the IFC. In 2018 Telenor sold a 45 % stake of TMB to Ant Financial: a tech affiliate company of the Chinese Alibaba Group.

153 'Shadow finance refers to all financial transactions that take place outside regulated and transparent financial markets.' (Bolton et al., 2012).
154 The reasons for heavy telecom involvement in the Pakistan microfinance sector are explained in section 4, p 22.
155 Pakistan Telecommunication Company Limited.

Apna Microfinance Bank 2005	Backed by Network Leasing Co which has an established micro leasing program since 1995.	Ownership structure changes after Network Leasing Co. Merger with KASB Bank. KASB Bank was acquired in 2015 by Bank Islami. In 2012 a Group of Investors (GOI) acquired a 91 % stake from various shareholders: now owned by various individuals and associated companies of the United International Group.
Pak Oman 2006	Sponsored jointly by the Sultanate of Oman with 67 % shareholding and the Pak Oman Investment company wit h 33 % shareholding.	Lanka ORIX Leasing Company, Sri Lanka's second largest non-banking financial institution by asset size, acquires a 50.1 % equity stake in 2017. Pak Oman Investment Company (16.7 %), Sultanate of Oman (33.3 %), Lanka ORIX Leasing Co. (50.5 %).
FINCA Microfinance Bank 2008	Incorporated as a majority owned subsidiary of Kashf Holdings Private Limited after the Kashf Foundation spun off its high-end, individual loan portfolio to establish the bank.	In 2013 FINCA International, a global microfinance network, acquires majority shareholding in Kashf Microfinance Bank Limited. 86 % stake owned by FINCA International. Other shareholders include Kashf Holdings, IFC, Triodos Bank, and Acumen Fund.
Advans 2012	Created in 2012 as Advans group's sixth greenfield project.	Owned by Luxembourg based Advans (70 %) and Netherlands (30 %) based FMO.
Mobilink Microfinance Bank Limited 2012 (Telecom owned)	A subsidiary of Global Telecom Holding S.A.E	Re-branded to Mobilink Microfinance Bank Limited in May 2016 Owned fully by Russian-backed, Amsterdam-headquartered VEON
Sindh Microfinance Bank 2015	Wholly owned subsidiary of Sindh Bank, which is owned by the provincial government.	100 % shareholding by Government of Sindh through provincial finance department.
NRSP Microfinance Bank 2011	Created through a spin off the mega NGO, NRSP's microfinance operations.	NRSP is the major shareholder with minority shareholding from IFC 16 %, KfW 16 %, and the Acumen Fund 16 %

Source: Annual reports and company websites

6.3 FMFB AND TMB: SHADOW BANKING EVOLUTIONS

A key objective of this study is to consider the nature of bifurcated banking when inclusive finance is a form of shadow banking. As shown earlier, in a bifurcated banking system, inclusive finance is characterised by high interest rates, collateralised lending, and digital intrusion. Two microfinance banks in particular, FMFB and TMB, exemplify how the commercialisation of microfinance has shaped inclusive finance as separate from the mainstream banking system. The empirical examples used in this current chapter exemplify the concept of a shadow financial citizenship, utilised here as an analytical lens to probe the nature of bifurcated banking.

The obvious contrasts between FMFB and TMB are thus: the former was launched through the Aga Fund Foundation, which is a faith based philanthropic organization, whereas the latter was started by a group of bankers as a privately owned business. Both institutions have consistently been among the five largest microfinance institutions in Pakistan since at least the last decade. The example of FMFB is used

because as a pioneer in the field, this institution provided the blueprint for how a small, rural focused lender may transform into a nationwide banking organisation and benefit from global financial networks. Despite this, it manages to retain the image of a poverty focused initiative, resistant to decision making on the basis of profit alone (Zulfiqar, 2013). The example of TMB demonstrates how a for-profit, American subprime inspired, financial institution came to be in close and direct competition with an institution of very different origins. The similarity of the services offered by TMB and FMFB highlight the disciplining effects of global finance: this not only reveals 'mission drift' but also the homogeneity of shadow financial citizenship.

Microfinance through blended finance

The story of FMFB's origins and outlook understandably reflect the strategies of its parent organisation, the Aga Khan Development Network (AKDN), a global network of development agencies focused on Asia and Africa. Two of these agencies, the Aga Khan Agency for Microfinance (AKAM), and Aga Khan Fund for Economic Development (AKFED), have been involved in Pakistan's financial sector even before the liberal reforms of the 1990s. Up until 2015, AKAM owned a 42 per cent stake in FMFB. AKFED, following a Government of Pakistan privatisation drive, had since 2003 owned 51 per cent of HBL, the largest privately owned bank in the country. In 2016, HBL acquired a controlling stake in FMFB: as a result, both HBL and FMFB are subsidiaries, directly and indirectly respectively, of AKFED.

An achievement of the AKDN that has not yet been studied extensively is the role of this institution in promoting blended finance for development. The recent traction gained by blended finance strategies is associated with the OECD and the SDG 2030.[156] The World Economic Forum and OECD describe blended finance as the strategic use of development finance and philanthropic funds to mobilise private capital for development through which it is not only possible for private investors to make an attractive return on their capital but also for public and philanthropic organizations to make their limited resources do more, particularly when their funds are directed to 'emerging and frontier markets' (World Economic Forum, 2015). This echoes what has been the strategy of the AKDN for decades: it is exemplified in the view of the Aga Khan that 'Public, or State owned, enterprises can never be a complete substitute for private enterprise in building a nation's economy and in bridging the development gap' (Aga Khan, 1983).[157]

His Highness the Aga Khan — Prince Karim Aga Khan IV —the founder and chairman of the AKDN is also the 49th hereditary Imam or Spiritual Leader, of the Shia Ismaili Muslims. His personal wealth, by some estimates, is USD 800 million (Forbes, 2009) and some of this is directed to AKDN activities. However, the bulk of funding is

156 Sustainable Development Goals for 2030
157 Speech by His Highness the Aga Khan in Nairobi, Kenya, 7th October, 1982: http://www.akdn.org/speech/his-highness-agakhan/private-sector-economic-development

from other sources, including partnerships with national governments, multilateral institutions and the private sector, income from user fees and endowment funds, and donations from corporations and individuals, including large amounts from the Ismaili Muslim community: surpluses are reinvested and the annual budget for non-profit development activities is USD 925 million and this is deployed in over 30 countries with the organization employing over 80,000 people mostly based in developing countries (AKDN, 2018b).

The activities of the AKDN, its various agencies, and its funding organisation, the Aga Khan Foundation, have been the subject of numerous studies, given that the organization supports and conducts research, education and cultural programs, as well as welfare and humanitarian aid projects in developing as well as developing countries. Dewji (2018) notes, using the example of Canada, how such activities entail a close relationship with a national government, and Clarke (2007) observes how shifts in donor agenda change how faith based organisations engage in international development.

The specific initiative which is behind the birth of FMFB is the Aga Khan Rural Support Programme (AKRSP) which began promoting microfinance in Northern Pakistan using a savings oriented village organisation model in 1982. By 2000 more than USD 10 million had been saved by members and over USD 2 million disbursed in credit each year. The State Bank of Pakistan's Microfinance Ordinance of 2001 allowed for the First MicroFinanceBank Ltd. of Pakistan to commence operations in May 2002 by absorbing AKRSP's credit and savings portfolio and launching a program of urban microcredit in various cities, growing to a nationwide 25 branch network within a few years. The International Finance Corporation (IFC) acquired a 24 per cent shareholding stake in 2002 (The First MicroFinanceBank Ltd, 2003).

The AKRSP-FMFB transition might come across as a classic instance of commercial motives taking precedence over social ones. However, a more nuanced depiction of this transformation would account for the inception of the Aga Khan Agency for Microfinance (AKAM), launched in 2005 as ‘a non-profit Swiss foundation to formalise and develop microfinance activities of the AKDN’ (AKDN, 2018a). This move reflects a perceived need to separate microfinance from other interventions, recognising that finance is one of a set of tools to attain developmental goals. This is corroborated by Khan (2010), who partially attributes the formation of FMFB to the sentiment that leaving commercial lending to a separate entity — a private financial institution — would enable the AKRSP to resume focusing on rural development. Hussein and Plateau (2006:342) report that between 1995 and 2000, the AKRSP had to raise the number of field officers responsible for loan auditing and performance evaluation from six to thirty-one: an indication of how cumbersome lending practices had become for the NGO. Additionally, as noted by Khan (2008), there was growing discontent among members of village organisations about the loss of savings — under the AKRSP's joint liability structure — because of defaulting co-members.

Through the support of AKDN, FMFB was able to establish itself as a bellwether for the nascent industry. Less than a year after inception, FMFB was in the process of implementing technological solutions — with heavy support from IFC sponsored external consultants — to manage loans and deposits (The First MicroFinanceBank Ltd, 2003). Other first year achievements included a funds transfer program for remittances (The First MicroFinanceBank Ltd, 2003). The appeal of the worker-remittance market also drove mobile money ventures such as EasyPaisa in Pakistan, just as it did for example, M-Pesa in Kenya (Mitha, 2011). Particularly noteworthy is the drastic variation of the AKRSP approach used by FMFB: inviting urban borrowers, who already had geographical proximity to mainstream bank branches, into the microfinance net. This became the strategy for many subsequent entrants to the industry, including TMB.

The appeal of sub-prime Pakistan

The birth story of TMB contains less altruism. Five bankers — former colleagues at various Citigroup global offices — partnered to launch Tameer Microfinance Bank in 2005. The explicit intent was to meet the financial needs of the economically active urban poor in Pakistan: the commercially viable strata of the financially excluded. The initial investment was USD 10 million, of which USD 6 million came from one of the founders, Nadeem Hussain, Tameer's first CEO: the IFC also invested USD 1 million in Tameer. Technical assistance came from the Bethesda, Maryland based consulting firm, Development Innovations Group, in the form of strategies and systems for growth and outreach, operational procedures, financial products, staff recruitment, training, monitoring, evaluation systems etc.[158]

Tameer's approach to microfinance was seen as innovative and bold: 'It was the first microfinance bank in Pakistan to offer real-time online banking at branches, open 24-hour service branches, and to make use of capital markets to fund the microfinance bank.' (McCarty and Bjaerum, 2013) Initially, Tameer's strategy was to replicate the American subprime model and to target urban, women borrowers using a cash-flow oriented, low collateral model based on a system of neighborhood checks: this approach proved troublesome, particularly in the megacity of Karachi where weak law enforcement and coercive behaviour from ethnic political activists caused loan officers to engage in a number of questionable practices including 'ghost loans' and 'Ponzi schemes'. This is corroborated by Zulfiqar's (2013: 109) fieldwork: she notes that Tameer's reliance on local community 'agents' curtailed outreach because of defaults and operational losses, with lost ground salvaged only after the Norwegian telecom giant, Telenor acquired a majority stake of 51 per cent in 2008. In 2016 this was increased to 100 per cent, and the bank changed its name from Tameer Microfinance Bank to Telenor Microfinance Bank.

158 Based on personal communications with senior executives of TMB, but also Husain (2016), Zulfiqar (2013), and annual company reports.

TMB under Telenor retained some of their more innovative approaches to inclusive finance, including through controversial products such gold-collateralised loans. More recent initiatives have tended to emphasise fintech, particularly given the success of Easypaisa. This flagship product thus came to be Tameer's gateway into fintech and also the motivation underlying TMB's third round of M&A, in early 2018. This time Telenor was the seller, and not the buyer, and China's Ant Financial — the fintech arm of e-commerce conglomerate Alibaba — purchased a 45 per cent stake in a transaction announced as a 'strategic partnership' (Financial Times, 2018) that sought to capture the value created in digital footprints, particularly of the poor.

6.4 FINANCING STRUCTURES AND STRATEGIES

The three key activities of — or services offered by — microfinance banks in Pakistan are lending, deposit taking, and payments or remittances. How these services are offered relates closely to the financing structure of the bank offering them: this relationship is at the centre of shadow financial citizenship. More specifically, lending and deposit taking strategies are influenced by funding arrangements; either from deposits, debt, or equity. The cost and availability of funding is a key determinant of how high rates on loans are, the extent and nature of collateral required, and how high deposit rates should be. Expensive loans and also the tendency of loan agreements to require collateral reproduces inequalities not only associated with poverty but with gender as well. Additionally, lending and also payment and remittance services are increasingly shaped by fintech — which often exerts its influence through ownership structures — resulting in a reproduction of vulnerabilities as poorer clients are required to, often insidiously, forfeit their privacy to obtain loans. The respective experiences of FMFB and TMB in shaping and being shaped by such arrangements are described below.

Table 6.2: Selected recent banking statistics compared for FMFB and TMB

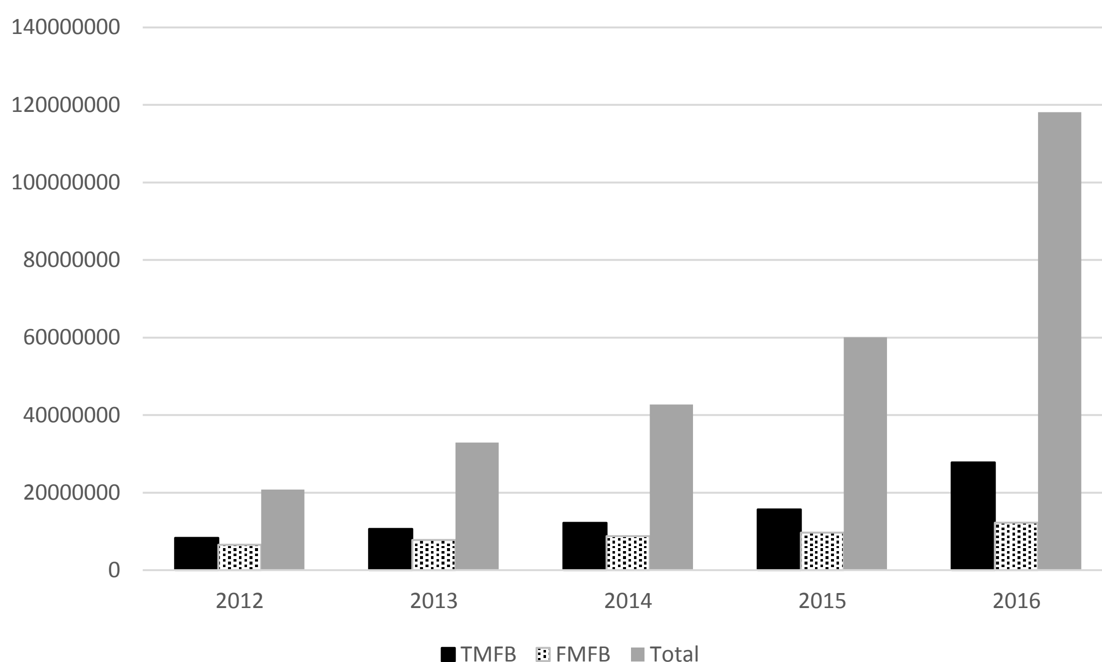
(2017)	FMFB	TMB
Total assets	25.9 billion	47.1 billlion
Loan portfolio	14.55 billion	24.7 billion
NPL	95 million	256 million
Number of borrowers	304,563	535,413
Deposits	20.9 billion	36.6 billion
Number of depositors	718,107	8,122,495
Number of branches	186	85
ROA	3.50%	8%
ROE	16.50%	1%
Non mark up income	302 million	8,486 million
Advance to deposit ratio	70%	68%

Source: Annual reports

Collateralised loans and deepening deposit bases

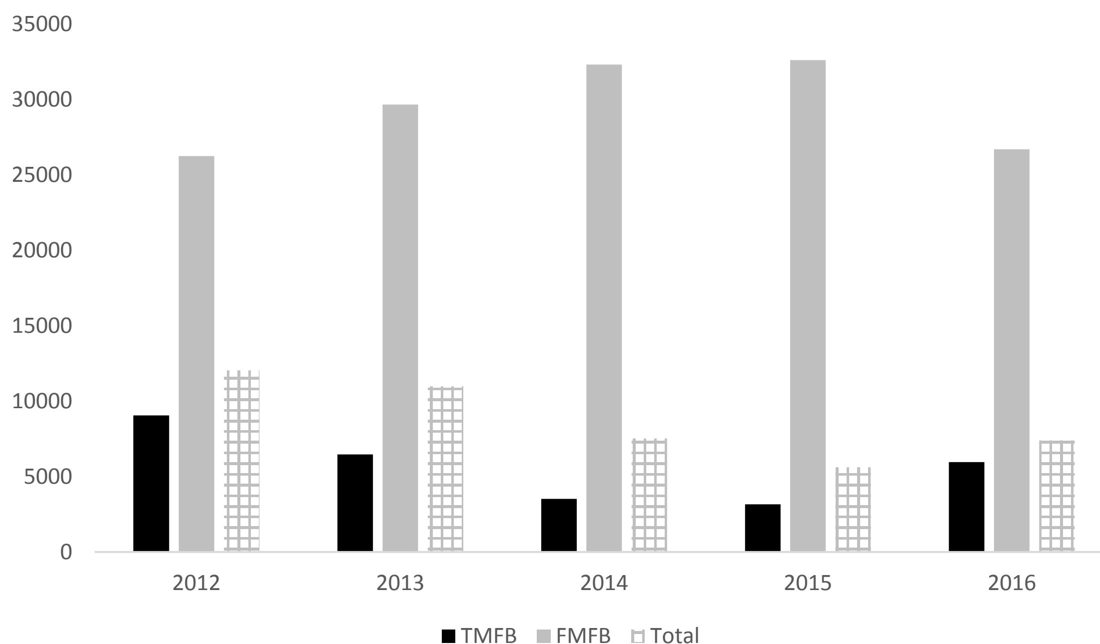
FMFB, owned by one of the largest national financial institutions, which is in turn owned by a global philanthropic foundation, has been able to take a relatively passive stance in all three areas related to financing: (1) deposit mobilisation, (2) debt issuance, and (3) seeking equity partners. In contrast, TMB's approach has been aggressive in all of these areas: this is evidenced in their (1) push for deposits by offering high rates, (2) use of capital markets for debt finance, and in (3) active pursuit of high profile partnerships with global telecom and fintech companies.

Figure 25: Deposit mobilisation



Source: PMN, Annual financial reports

Figure 26: Average size of active deposit (PKR)



Source: PMN, Annual financial reports

Surges in deposit base are a recent occurrence (Figure 25 and Figure 26). The context for these is the easing of collateral rules by the central bank. In 2012 the SBP amended the Prudential Regulations for Microfinance and allowed MFBs to accept gold jewellery as security for loans. This was an extension of new rules that permitted collateralised lending.[159] Previously, all microfinance loans were unsecured. These new rules responded to two realities; (1) that Capital Adequacy requirements (CAR) — based on Basel II — were limiting the growth of MFBs (Aslam and Azmat, 2012); and (2), in many parts of South Asia, the accumulation of gold is a traditional and preferred form of saving (Chen and Rasmussen, 2011).

The Pakistan specific context for collateralisation, mentioned earlier in Chapter 5, arose from the need to balance risk management following the delinquency crisis of 2008: there was also pressure to deepen and widen microfinance as the SBP had recently committed to increasing outreach to 3 million by the end 2010 and 10 million by 2015 (SBP, 2008). The viability of reaching targets through the group loan approach thus came under scrutiny: group or joint liability loans tend to be small enough to circumvent the issue of collateral, aside from social collateral in the form of the group guarantee (Aslam and Azmat, 2012). But when loans are larger — albeit capped in size by the regulator — immovable assets are impractical to collateralise and often valued at much more than the loan itself. The need for collateral is thus linked to the push for larger loans because group members are wary of providing guarantees for large

159 See SBP (2015)

amounts: so, small value, liquid movables are considered more often by lenders to secure performance of obligations (Aslam and Azmat, 2012).

Specific collateral requirements for loans vary across banks and are available online, including on the respective websites of TMB and FMFB. The former has a larger number of collateralised lending products including a few based on gold; the latter instead has opted to offer loans based on tangible current assets such as cash and near cash instruments, but also in some cases requires livestock or property as collateral.

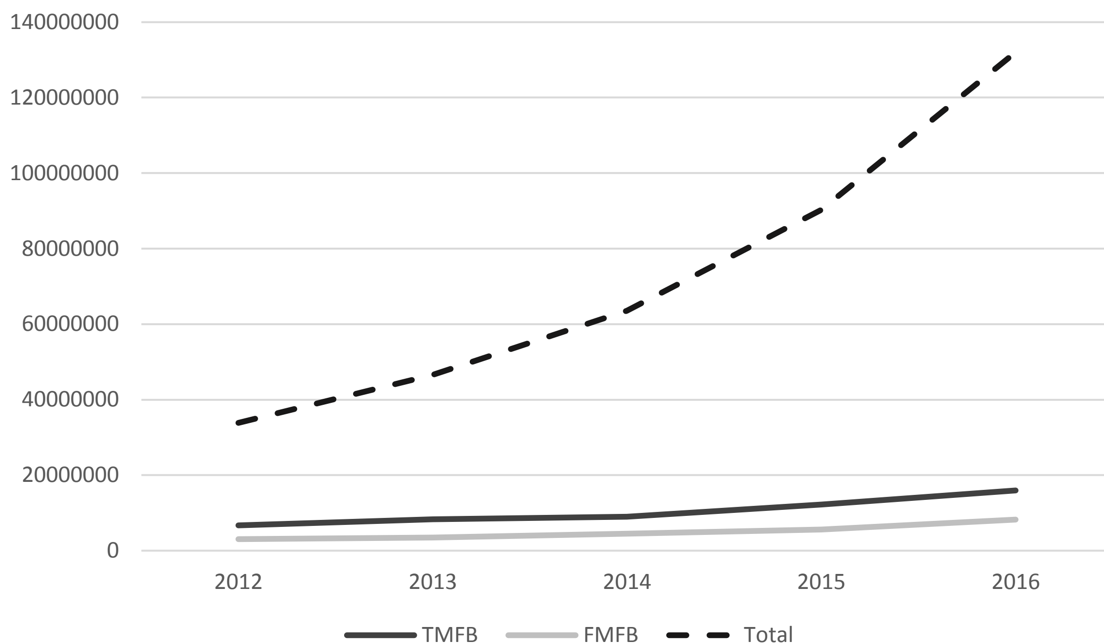
The use of collateral also relates to the issue of steep interest rates on microfinance: these are invariably higher than those offered by commercial banks and attributed to the operational costs of microlending institutions (Rosenberg et. al 2013). Gold collateralisation facilitated aggressive lending patterns: swelling gross loan portfolios and larger loan counts are shown in the figures (1) and (2). Within the year following regulatory approval, TMB, had managed to shift over 85 percent of its portfolio into gold-backed loans as new verification processes allowed for credit to be disbursed within 3 days, relative to the 21 day norm between application and disbursal for other products using standard verification processes (PMN, 2012). Gold collateral, as per prudential rules, is first evaluated by a 'shroff' or local goldsmith, who has been pre-approved by the regulator (SBP, 2015). This evaluation is much like a third party guarantee: the 'shroff' undertakes to purchase the gold at an agreed price, should the need — given defaults — arise. This process allows for quick disbursement as well as a lower lending rate: the PMN (2012) reports that gold collateralised loans tend to be 4-6 per cent cheaper than uncollateralised loans.

This surge in lending (Figure 27 and Figure 28) was backed by TMB's success in deposit mobilisation. This is reflected in individual depositor growth figures: an increase of 73 per cent to 8.57 million in 2016, from 4.96 million in the previous year, and translating into a 75 per cent increase in deposits over the same time period (Telenor, 2016: 57-60). Interestingly, the institution in the same year, 2016, reported no borrowings from banks and other financial institutions: ostensibly choosing to rely on deposits instead. In contrast, individual depositors for FMFB increased to 0.44 million in 2016 from 0.28 million in the previous year: 57 per cent growth in percentage terms but translating to a rise in deposit base of only 27 per cent. Despite the incongruity in growth here, TMB's deposit base at PKR 20.82 billion is large compared to FMFB's PKR 12.24 but the incongruity in depositor numbers indicate that the average deposit size for TMB is PKR 2429 compared to PKR 27818 for FMFB when institutional depositors are also taken into consideration: it is noteworthy also that FMFB appears reliant on institutional donors whereas the opposite is true for TMB. FMFB's relatively passive stance here may be attributed to the nature of their deposits. By avoiding costly liabilities from high yielding deposits, FMFB has avoided the need to push loan disbursement in the same manner as TMB: this is evident in a comparison of their respective deposit to GLP ratios, as seen in the figure below. Other comparative inferences that can be drawn from the financial data of the two banks are revealing as well; one is the declining trend in costs of funds; another is the rising trend in gross loan

portfolios. Both appear to be related and may be attributed to the combined effect of falling benchmark rates and a relaxation of capital at risk (CAR) and collateral rules. These are also expressed in the figures below.

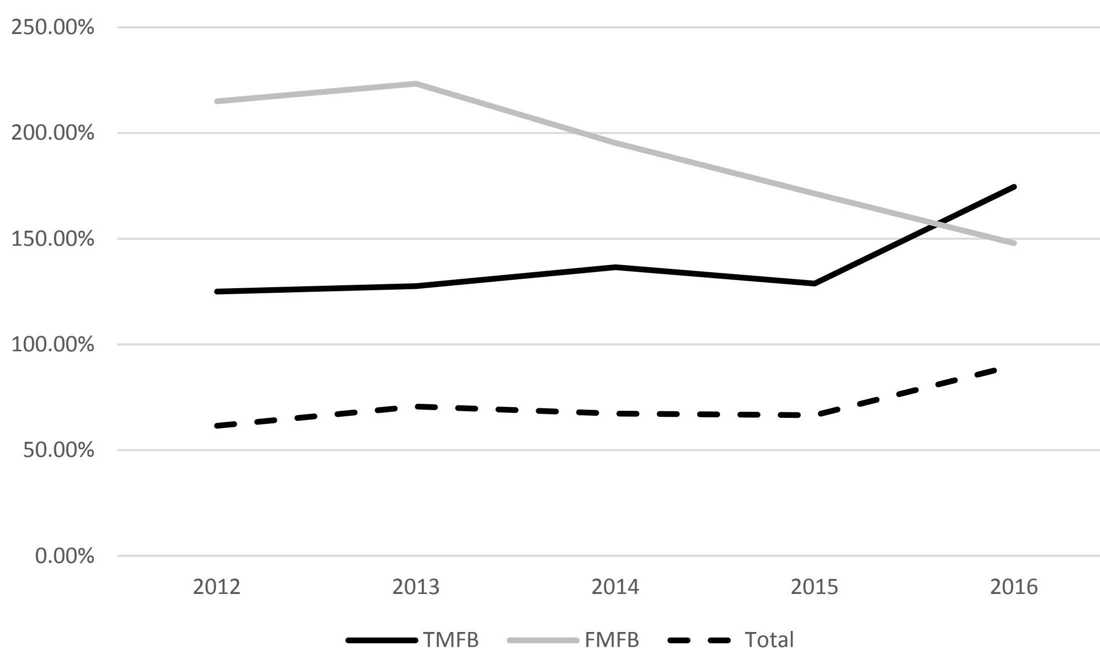
The issue of collateral is not a new one and the instance of gold backed loans demonstrates innovation from the microfinance sector to enhance credit offtake. Nenova et. al (2009: 109) note how the commercial bank fixation on collateral — particularly immovable collateral —for lending to firms has impeded SME loan for which collateral is limited and movable. Regulatory intervention to allow flexibility in what is accepted as collateral as well as enhanced information sharing through a credit bureau is thus needed to expand SME lending (Nenova et al., 2009: 100). Noteworthy is that a credit bureau can be instrumental in creating a potential collateral substitute in the form of a credit history to enable financial access for groups that may not have cash or asset collateral required but nevertheless have a good repayment record (Nenova et al., 2009: 100).

Figure 27: Gross Loan Portfolio (PKR 000)



Source: PMN, Annual financial reports

Figure 28: Deposits to GLP



Source: PMN, Annual financial reports

Financialising fintech

Fintech in Pakistan is at present almost synonymous with the payment service known as Easypaisa, which is the country's foremost digital payment and domestic money transfer service. Easypaisa was initially the proposed remedy to the burden of personnel costs which remained high despite the shift from a branch oriented approach to one that relied on community centres and sales centres with satellite touch points (Mitha, 2015). The management of Tameer was intrigued by the potential of a network of agents to open bank accounts and provide a full range of financial services using mobile technology instead of traditional branches. They explored partnerships in Pakistan while piloting a branchless banking channel with CGAP to 'test drive' various technologies including biometric ATMs and POS based lending services. [161] At the same time the Telenor, a Norway based global telecommunications company, was facing difficult competition in Pakistan and had identified mobile money as an opportunity to generate an additional income stream given weakening mobile communications revenue. Regulatory requirements held that only a bank could hold a branchless banking license to offer mobile financial services: Telenor thus sought to partner with a financial institution and was the potential for Easypaisa that drove the partial

161 Through for instance, hand-held 'point of sale' bank machines.

acquisition of Tameer Microfinance Bank in 2008: the institution eventually became Telenor Bank after the Norwegian company raised its stake to 100 per cent in 2016.[162]

Telenor's role here was thus part of this multinational company's planned incursion into mobile money and resulted in the — eventual and immensely successful — launch of Easypaisa in 2009.[163] Contemporaneous initiatives included M-Pesa in Kenya, backed by Vodafone — and supported by research from DFID — which had launched in 2007. Elsewhere, mobile money services were in a nascent stage in Afghanistan in 2009 (Heinrich, 2013), and Bangladesh in 2011 (CGAP, 2014). The appeal of mobile money had been proven earlier, in the Philippines where Smart's Smart Money launched in 2001 and Globe's GCash launched in 2004 (CGAP, 2009). The two main products offered initially by Easypaisa provided services for utility bill payments and for domestic remittances: these were sold through a network of 12,000 agents, who were usually owners of small retail businesses. With the help of extensive marketing campaigns, this OTC (over-the-counter) model proved to very effective. Easypaisa met impressive results and processed five million transactions. By the end of 2012 this had risen to 100 million transactions, the equivalent of USD 1.4 billion in less than one year. Importantly, 70 per cent of its customers were new and not Telenor Pakistan mobile subscribers (McCarty and Bjaerum, 2013)

The management's decision to postpone the launch of a purely digital service by focusing on OTC proved remarkably effective. The OTC model made it possible to serve all mobile phone subscribers, instead of only Telenor Pakistan customers, whilst complying with KYC (know-your-customer) regulatory requirements. Based on a registration process that includes a photograph and biometric fingerprinting to verify government issued identification documents, KYC requirements for financial transactions tend to intimidate many potential users. The model used by TMB may be likened to a Western Union wire transfer: the customer simply hands over cash to an agent who facilitates the transaction on the customer's behalf (Ratcliffe and Goldstein, 2013).

Despite its success, the OTC model appears to have created an issue of path dependence.[164] This is evidenced by subsequent launches of competing mobile money products including UBL's Omni, Mobilink Jazz's MobiCash, and Askari Bank and Zong's TimePey. In all of these cases both models were offered but with a clear focus on OTC, showing how mobile money strategies are primarily shaped by comprehensive KYC requirements in a telecommunications landscape without a dominant provider. OTC

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162 'Synergies between both organizations started developing around Telenor's willingness to grow in rural areas and Tameer's need for a partner who could bring both the technology and the agent network. This culminated in a formal agreement in 2008. The agreement made official both parties' intentions to jointly launch Easypaisa, an agent and mobile assisted payment service, and resulted in Telenor's entry into Tameer's equity structure.' (Mitha, 2015)

163 USD 7 million was invested in the technology platform, national marketing campaign, organisational structure, and agent training, with an additional budget ringfenced for expected losses over initial years of operations: the service began operating at break-even very quickly and boosted expectations that financial services will generate up to 10per cent of total revenue in Pakistan for the telecom giant (McCarty and Bjaerum, 2013).

164 Where despite voluntary and individually maximizing behaviour 'a minor or fleeting advantage or a seemingly inconsequential lead for some technology, product or standard can have important and irreversible influences' (Liebowitz and Margolis, 1995).

popularity is also a likely consequence of low literacy levels. The ease of use of a system where customers access services locally from agents they are acquainted with and trust, and also do not need to register with is difficult to replace (McCarty and Bjaerum, 2013).

A key implication of OTC dominance — with 87 per cent of transactions based on this model — is that most customers do not register and own personal accounts: this is an impediment to digital finance which relies on personal accounts for the use of mobile phone based services such as savings, insurance and loans (Ratcliffe and Goldstein, 2013). This is particularly irksome in Pakistan, given that each and every transaction is recorded through biometric data and photo identification. But it also represents a sizeable opportunity for new technology to bridge the gap between OTC and digital transactions. This appears to have been the motivation underlying TMB's third round of M&A, in early 2018 when China's Ant Financial — the fintech arm of e-commerce conglomerate Alibaba — purchased a 45 per cent stake in Telenor for a 'strategic partnership' (Financial Times, 2018). Ant Financial's origins are in Alipay which was established in 2004 by Alibaba and its founder, Jack Ma, as a mobile payment platform. It eventually overtook the combined transaction value of Paypal and Square and became the leading payment platform globally. Ant Financial is 'a technology company that brings inclusive financial services to the world' (Ant Financial, 2017). It is perhaps the most triumphant instance of a 'unicorn', with some valuations placing it above financial giants such as BNP Paribas, Goldman Sachs, and Credit Suisse (Quartz, 2018).[165]

Ant Financial's specialist role in utilising biometric technology to push financial inclusion is well established. Their foray into the Pakistan microfinance market appears to have been strongly motivated by the biometric potential of mobile money, particularly given the prowess of Pakistan's National Database and Registration Authority database (NADRA) in biometric verification for financial transactions (Financial Times, 2018). The tech giant is known for its authentication expertise through technologies such as fingerprint and facial recognition: these are used extensively by Ant Financial's own companies including its payment platform, Alipay, and tech developer, Megvii Technology (SBP, 2017).

These examples, and TMB's shareholder appeal — as evidenced by acquisitions — demonstrate the role of digital finance in contemporary banking.[166] Compared to TMB, FMFB comes across as passive in its approaches to use digital finance as an expansion strategy. But this is an inaccurate representation when the digital finance strategies of its parent bank, HBL, are considered. In recent media interviews, the president of HBL has described his organisation's focus on technology and innovation, including cross selling across different businesses. This could very well include making

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165 A start-up company valued in excess of USD 1 billion (Lee, 2015).
166 Digital finance may be seen as an important narrative thread of financial accesss story. The first and second threads are the narratives of participatory/ inclusive development and financial globalization respectively. The confluence of these narratives is the logic of what Gabor and Brooks (2017) call the digital financial revolution: this is based on a fintech–philanthropy–development complex. This complex which runs on the mapping, monetisation, and also expansion of digital footprints, has been described by Izabella Kaminksa as 'financial intrusion' (Financial Times, 2015).

sales to clients of FMFB, given the permissibility of cross selling products amidst lax data privacy regulation.[167]

> 'From my perspective, we have to start thinking that we're an IT company with a banking license. With 1,700 bank branches and 2,000 ATM's all over the country, HBL acquires 1 million new customers a month. With the rollout of biometric devices nationwide that number is set to double or triple' (Pakistan Today, 2018).

The involvement of microfinance banks in Pakistan in this movement is reflected in recent transformations undergone through mergers and acquisitions. More prominent examples include those MFBs that came to be owned by mobile phone operators: U Microfinance Bank and Mobilink Microfinance Bank. Less obvious examples are Finca Microfinance Bank and Khushhali Microfinance Bank: the former is partnered with a local start-up company, Finja, to offer cashless financial services, whereas the latter is majority owned by a large bank, UBL, known for its nationwide digital financial services network. The other MFBs have not yet attempted to offer digital services: at present they do not have permission in the form of Branchless Banking licenses. This fintech-philanthropy-development complex has thus obscured the distinction between funding for development and that for investment, an overlap that augments the appeal of inclusive finance.

6.5 SHADOW FINANCIAL CITIZENSHIP IN PAKISTAN

The key argument of this chapter has been that shadow financial citizenship is an outcome of the products and services offered as inclusive finance because shadow banks cannot offer financial citizenship. Figure 29, below, shows how inclusive finance, shadow banking, and fintech converge and also diverge, through a schema borrowed from Knaack and Gruinn (2017).

Inclusive finance from mainstream banks is offered through 'Asaan' accounts which are basic bank accounts.[168] This type of account is described by the regulator as a low risk bank account with simplified due diligence that all commercial banks must offer. Mobile money, such as Easypaisa, is used mainly by individuals for domestic remittances or for transferring money from one part of the country to another. The overlap here is noteworthy because it highlights the limitations of the basic bank account to offer interbank transfer services that are accessible and priced reasonably enough to compete with mobile money.

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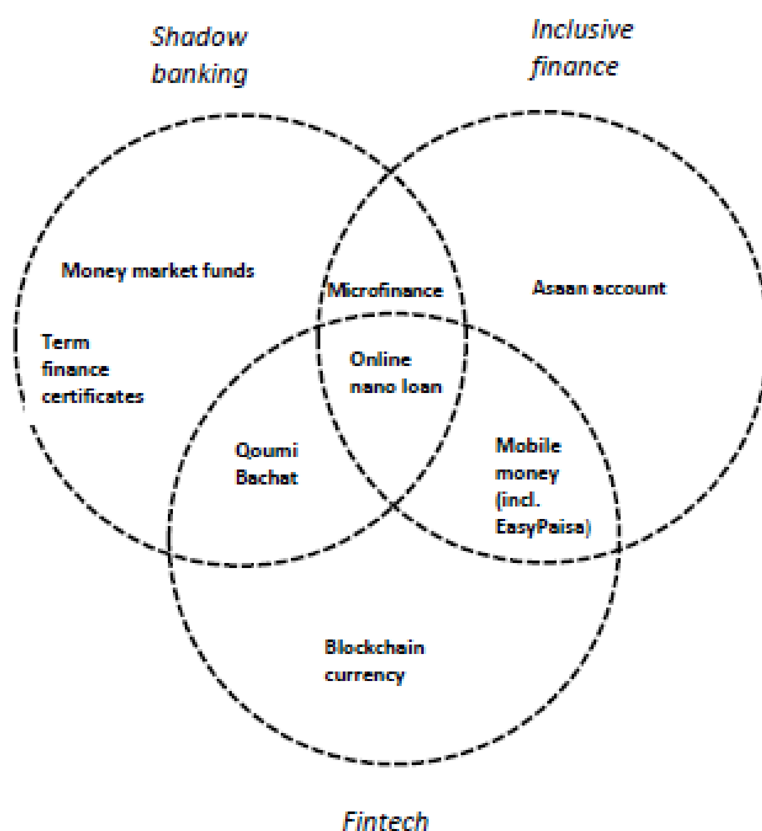
167 This was also indicated through personal communications with HBL senior executives, during fieldwork.
168 'Asaan' is the Urdu word for 'easy'.

Figure 29: Overlapping spaces of shadow banks, inclusive finance, fintech



Adapted from Knaack and Gruin (2017)

Other forms of inclusive finance which overlap with shadow banking — as they are funded through disintermediated models of banking — include microfinance also known as microloans or microcredit, and also digital loans offered specifically through microfinance banks. The latter product is relatively new in Pakistan and has been launched by Easypaisa as a 'digital nano loan' which can be approved online within five minutes: timely repayments are rewarded with larger loans in future applications.[169] This type of loan tends to be expensive: rates are not disclosed on the websites of loan providers but anecdotal evidence shows that these are equivalent to triple digits on an APR basis.[170] Such pricing is justified by practitioners for these loans because (1) they usually have a maturity period of 30 days rather than 4 – 24 months as is the case generally with microcredit, and (2) they rely on processing fees which are applied on every application (Dawn, 2018).

> 'This innovative service is aimed at the common man who has no access to formal loans or banking services. It enables easy access to working capital requirements for farmers, selfemployed individuals, street hawkers, and home-based workers. It also works as an effective tool in creating financial literacy by incentivizing positive credit behavior through access to better borrowing terms' (Telenor, 2018).

169 http://www.telenorbank.pk/easypaisa-sahara.html
170 Private communications with microfinance practitioners in Karachi (August, 2017)

Shadow banking and fintech are of course not limited to the market for inclusive finance. More traditional forms of shadow banking also exist in Pakistan which are mainly focused on debt capital, such as money market bonds and term finance certificates. Noteworthy is that these markets are dominated by public borrowing activities since government debt exceeds 40 per cent of GDP in Pakistan. Qoumi Bachat Digital is an extension of the government's National Savings Schemes which currently accounts for over one fifth of total domestic debt.[171] Blockchain is mentioned in the figure as a form of fintech that is separate from shadow banking because it does not rely on debt.

6.6 SUMMARY

This chapter explains how shadow financial citizenship emerges from bifurcated banking. Like many other poor countries where enhanced access to financial services is a policy goal, the Pakistani financial system has two parts with inclusive finance offered separately from mainstream or commercial finance. While both these parts are similar in that they (1) accept deposits, (2) provide credit, and (3) transfer payments and remittances, there are differences in the nature of the services provided by inclusive finance relative to mainstream finance.

The deposit taking activities of the two microfinance institutions in this study reflect the paramount role of deposits in the inclusive finance model which is, in Pakistan, dominated by deposit taking microfinance banks. Because deposits are needed to create loans, MFBs have come to compete with mainstream banks by offering high returns to depositors. Successful deposit mobilisation has meant that these same banks must aggressively offer loans in order to service expensive liabilities. For such lending patterns to be viable, it is necessary for MFBs to accept innovative, unconventional forms of collateral. The example of TMB shows how such strategies are shaped, with surging deposits accompanied by a growing loan portfolio, heavily collateralised by gold jewellery. In contrast, FMFB, given its background, has been relatively passive in deposit mobilisation as well as lending, particularly in its collateralised form. This is so because a deposit centred funding strategy is the preliminary approach taken by FMFB. In the sphere of payments and remittances, TMB's Easypaisa product has made a strong contribution to its overall profitability, revealing the crucial potential of fintech in inclusive finance: this is reflected in the growth strategies of FMFB's parent bank, HBL. For both MFBs, the strategic potential for future growth has driven ownership patterns.

The nature and implications of bifurcated banking are thus exemplified through the two deposit taking microfinance institutions studied here. Despite clearly different initial strategies and goals, both institutions eventually adopted similar approaches: this reveals the homogenising influence of global finance through the push to make institutions 'sustainable' through profit orientation. A key outcome of this push has

171 http://www.finance.gov.pk/survey/Chapters_15/09_Publicper cent20Debt.pdf

been the presence of shadow financial citizenship through the grey area between financial exclusion and financial citizenship. The features of this include high service charges for loans, the compulsion to provide fungible collateral, and the insidious forfeiture of digital privacy.

As shown above, the institutions offering shadow financial citizenship are adept at redesigning themselves as different yet similar to the mainstream banking sector: they are different because they offer opportunities for 'leapfrogging' and imply fast growth and innovation. At the same time, their proximity to traditional banks makes them appealing for investors and donors as part of the financial sector.

7. Evolutions in Shadow Financial Citizenship and Transformations in Financing Development

7.1 INTRODUCTION

This chapter expands the arguments made earlier about funding inclusive finance through private capital through a study of the practice known as impact investing. The key contention is that impact investing exemplifies shadow banking — by advancing its practices and utilising its networks — and is a driver for bifurcated banking by providing funding for the 'grey area' identified earlier. This claim is made by drawing linkages between inclusive finance in Pakistan and the broader trend of 'financialised development' (A. Roy, 2010).

The rise of impact investing in Pakistan, which has a penchant for inclusive finance projects, is examined here as an extension of the financial sector and development sector nexus identified in Chapter 2. Two contentions are thus made: one, that impact investors fill the void in enterprise finance created by regulatory constraints on banks, and two, that impact investors accommodate the demand for yield by shepherding global capital into poor countries. These contentions augment the finance and development literature, which critiques the financialised development associated with the Finance for Development (FfD) agenda construed by global institutions ostensibly for the Millennium Development Goals, or MDGs, of 2015 and subsequently the Sustainable Development Goals, or SDGs, of 2030.

More recently, the narrative of slogans such as *Billions to Trillions* and the World Bank's *Maximizing Finance for Development* agenda have, as discussed in Chapter 2, drawn criticism because they advance shadow banking through a 'Wall Street Consensus' (Gabor, 2019). The case of Pakistan exemplifies the traction gained by impact investing as an asset class and the related imperative to measure and evaluate outcomes. The resultant focus on base-of-pyramid initiatives, particularly inclusive finance, is a corollary of the shifts and transformations in development initiatives centred on private and philanthropic or 'patient' capital. Impact investing is a key driver of bifurcated banking because it provides funding specifically for projects — centred often, but not only on inclusive finance — which measure success through the quantity of poor individuals who use its products and services.

Earlier chapters in this thesis probe why the Pakistani banking system is bifurcated. Shadow banking is a recurrent theme in this analysis because (1) inclusive finance is a response to lending constraints faced by mainstream banks produced by

regulatory and structural factors and (2) inclusive finance is an investment opportunity for global institutional investors searching for yield. By drawing attention to how global institutional investors — in possession of private as well as public capital — fund inclusive finance in Pakistan, the current chapter builds upon the argument that inclusive finance is a form of shadow banking.

In advancing shadow banking practices, institutions, and networks, these global institutional investors are responsible for advancing disintermediated forms of banking. As such, they widen the separation between inclusive finance, which is based on disintermediated models, and mainstream finance, which is based on traditional models of intermediation. This separation underlies bifurcated banking in Pakistan.

The remainder of this chapter is structured as follows: Section 7.2 presents a concise, Pakistan specific, context for why impact investing bears relevance for contemporary development strategies in general and inclusive finance in particular, 7.3 is a discussion on the role of patient capital in development, and how this relation creates a gateway for shadow banking practices, 7.4 presents a concise overview of the shifts and transformations that have occurred over recent years to shape development initiatives by incorporating private and philanthropic capital, 7.5 describes the link between shadow banking, inclusive finance, and impact investing in Pakistan and 7.6 concludes.

7.2 FINANCING DEVELOPMENT IN PAKISTAN THROUGH SHADOW BANKING

The financialisation of development underlies crucial shifts and transformations in development initiatives that incorporate private and philanthropic or 'patient' capital. In the context of inclusive finance, the incorporation of private and philanthropic capital has gained remarkable traction because of the practice known as impact investing: based on the virtues of patient capital, this approach explicitly targets financial as well as social goals, or a 'double bottom line'.

The experience of Pakistan particularly as depicted in the grey literature of the Global Impact Investing Network or GIIN, development finance institutions, and fund managers, is used as the empirical setting to consider the trends and repercussions of impact investment as development finance.[172] Noteworthy patterns include the dominance of the energy and financial services sectors respectively, which extend BoP approaches to investment. Financial services are of particular interest because the 'impact investment-inclusive finance-nexus' provides a visible example of the expansionary imperative of global finance. The example of Pakistan shows how impact investing is drawn to inclusive finance as a development intervention for its financial logic. In other words, impact investing as a form of shadow banking absorbs inclusive

172 The Global Impact Investing Network is a nonprofit organisation dedicated to increasing the scale and effectiveness of impact investing particularly through research and building infrastructure such as measurement and evaluation tools. See https://thegiin.org/

finance. As such, it bifurcates Pakistan's banking sector by widening the scope of disintermediated approaches to finance. Additionally, the data indicates that impact investors prefer deploying capital as debt rather than equity. These tendencies are examined here and a theoretical basis for impact investing in Pakistan is then offered by invoking arguments from the literature on shadow banking.

Impact investors are effectively shadow banks because impact investing is a response to constraints imposed on mainstream banks given tight regulation, including stringent capital requirements, regulatory arbitrage: additionally it is a response to a search for yield from global institutional investors. This second tendency is particularly relevant in the Pakistan context where like other shadow banking practices, impact investing enables the push for new financial markets, products, techniques, and institutions because the demand for investables outstrips supply. The supply of investables is expanded through impact investment funds and their propensity for varying capital structures and asset classes. These rely on capital from investors such as pension funds, philanthropic foundations, banks, or public sector funders. To attract this capital these investment funds create investables in two ways: through debt and through equity.

7.3 PATIENT CAPITAL IN SHADOW BANKING

Impact investment strategies have — over the last decade or so — entrenched themselves simultaneously in the vocabulary of two global communities: development and finance. This overlap is a corollary of the Finance for Development (FfD) agenda mentioned earlier, in Chapter 2. Global institutions, particularly those under the United Nations umbrella, exuberantly support this agenda because they see it as the ostensible means to attain the targets set for the Millennium Development Goals, or MDGs, of 2015 and subsequently the Sustainable Development Goals, or SDGs, of 2030 (UNDP, 2017). More recent iterations of these approaches are reflected in the narrative of slogans such as *Billions to Trillions* and the World Bank's *Maximizing Finance for Development* agenda, which have drawn criticism for seeking to advance shadow banking.[173] This criticism is directed at development strategies that are reliant on private capital or credit, but more specifically at shadow banks which are financial institutions that are 'entities and activities fully or partially outside the regular banking system' (FSB, 2013: 5).

These concerns pertain directly to inclusive finance, particularly given the need for funds for on-lending. The practice of obtaining funds from large financial institutions and then disbursing them as credit under the pretext of inclusive finance facilitates the meeting of a double bottom line. Such lending is profitable, and given a narrative of self-help, it is also socially desirable. This is also emphasised in Target 1.4 of the SDGs:

173 These concerns are summarised in the open letter circulated here: https://criticalfinance.org/2018/10/10/

‘By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance’ (UNDP, 2017).[174]

International organisation increasingly emphasise private sector involvement in development. Their strategies are thus focused on the role of, and need for, financial capital from various sources, including public, private, and philanthropic organisations. To accommodate this variety, finance for development appears in various forms, including PPPs or public-private partnerships, blended finance, and impact investing strategies. The latter is of special interest because of its linkages with philanthropy, which has the capacity to be a source of patient capital.

Patient capital is a means to draw investors to risky but socially desirable projects. Deeg and Hardie (2016) describe it as: ‘equity or debt whose providers aim to capture benefits specific to long-term investments and who maintain their investment even in the face of adverse short-term conditions for the firm’. As such, it is a means to de-risk financial capital and to thus crowd in more investment. The need for patient capital entails the involvement of actors — including, but also from outside of the public sector — willing to accept below market returns for investments.

This aligns closely with what Bishop and Green (2006) call ‘philanthrocapitalism’, an approach to altruism which is the core of the ‘philanthropy-finance-development complex’ (Stolz and Lai, 2018; Gabor and Brooks, 2017; Mawdsley, 2015). Below market returns are an alternative to risk-based pricing because they ensue from investments that seek a double bottom line: this is the difference between risk capital and patient capital.[175] Patient capital encompasses financial gain as well as positive social and environmental outcomes, otherwise known as ‘impact’. This is so because impact investing draws on the same arguments that fuel the aspirations of individuals and institutions to be philanthrocapitalists (Bishop and Green, 2006), by committing ‘patient capital’ to initiatives where other financial capitalists fear to tread.

Both impact investors and philanthrocapitalists assume that their capital will generate some degree of financial return, but there are two key differences between impact investing and philanthrocapitalism: intent and measurement. These features instil a structural rigour on the strategies of impact investors by dictating what can and cannot be regarded as an impact investment. These constraints bear relevance for the developmental potential of impact investment as they influence how capital is deployed. This argument is made by presenting the origins and transformation of impact investing — an extension of the FfD initiative — and then noting how the emphasis on measurement prioritizes base-of-the-pyramid (BoP) markets.

174 Sustainable Development Goal 1 is ‘End poverty in all its forms everywhere‘: https://sdg-tracker.org/no-poverty
175 This characterisation is used by the Acumen Fund (2018).

7.4 PPPS, BLENDED FINANCE, AND IMPACT INVESTING: ORIGINS, AND TRANSFORMATIONS

Impact investing, as a development strategy, overlaps with slightly older tools, particularly blended finance and PPP. For all of these strategies there are multiple definitions. What links them is some form of a joint funding structure to cover finance gaps for projects that would otherwise be borne fully by either the public or private sector. What separates these strategies is perhaps more interesting: whereas PPP strategies, and to a lesser extent but also blended capital, are ostensibly designed to enable the public sector to attract private capital, impact investing strategies are designed to attract patient capital, usually from governments or philanthropists.

The World Bank (2018) definition of a PPP or public-private partnership is: 'a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance'.[176] The mainstreaming of PPPs, also known as 3P or P3, is linked to their popularity — with governments in the Global South — in the 1990s.[177] These strategies sought to replicate the experience of advanced capitalist countries — particularly of the Thatcher and Reagan regimes — where PPPs had been used extensively in the 1980s for projects of urban development (Hodge et al., 2017; Miraftab, 2004). A recent initiative is the launch of the World Bank PPP Knowledge Lab in 2015.[178] Another is the G20 Global Infrastructure Hub in 2014. [179] have been central to the formation of what Hodge et al. (2017) describe as a new identity for PPPs: with a focus on infrastructure and growth, rather on the mode of delivery.

This emphasis on infrastructure has to a certain extent, been retained in blended finance strategies, but tends to weaken when blended finance is explicitly linked to the MDGs and SDGs. Blended finance, according to the OECD (2018), refers to: 'the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets'. Some definitions specifically mention ODA or official development assistance.[180] Others are focused on grants or 'grant-equivalent finance'.[181] And some are explicit about the role of philanthropy.[182]. Blended finance strategies are thus similar to PPPs but move beyond the public and private spheres to involve development agencies, international organisations, and also philanthropists.

In its earlier forms blended finance was oriented to infrastructure projects. This is reflected in the examples of various projects lead and supported by the Aga Khan

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176 Hodge and Greve (2017) note that there are several historical examples of PPP arrangements including toll roads, land reclamation, canals, and sanitation projects in Western Europe in the 18th and 19th centuries.
177 Since the 1990s PPPs have come to seen as 'mainstream', particularly after receiving the backing of international organisations and development agencies including the UNDP and DFID.
178 https://pppknowledgelab.org/
179 https://www.gihub.org/
180 See Eurodad (2017)
181 See Mustapha et al. (2014)
182 See OECD (2017)

Foundation, a faith based organisation that operates in over 30, mostly poor, countries and generates revenues for reinvestment in further development ventures. The Aga Khan Fund for Economic Development (AKFED), through its project companies generates revenues of USD 4.1 billion with all surpluses reinvested in further development activities (AKDN, 2018b). By many accounts, AKFED through the Aga Khan Development Network, or AKDN, has played a pioneering role in promoting blended finance for development: this has been done by combining the financial capital of its own philanthropic network with resources from vast and diverse consortia of partners and stakeholders. These include international organisations such as the World Bank and the International Financial Corporation, national governments such as Canada and Switzerland, regional development banks such as the African Development Bank and the Asian Development Bank, and large financial institutions such as BNP Paribas and Blackstone. This strategy is exemplified in a 1980s speech from Prince Karim Aga Khan, as below.

> 'Bringing together the best what private initiative has to offer from various nations has many attractive aspects to developing countries. Individual financial and monetary risk is reduced, the sources from which to draw qualified manpower are multiplied and political acceptability is increased. Public, or State owned, enterprises can never be a complete substitute for private enterprise in building a nation's economy and in bridging the development gap' (Aga Khan, 1982, cited in AKDN, 2018a: 22).

There are numerous examples of large projects that have utilised the above approach. Pamir Energy which was established in 2002 through the collaboration of the Government of Tajikistan, the International Finance Corporation, and the Swiss government is an AKDN project that supplies clean energy to over a quarter of a million people in eastern Tajikistan and northern Afghanistan (European Foundation Centre, 2018). Another example of an infrastructural project, also in Afghanistan is that of Roshan, a telecom services provider, which has, since its inception in 2003, invested approximately USD 700 million in Afghanistan as the country's single largest private investor: it is also the largest taxpayer, contributing approximately five percent of the Afghan government's overall domestic revenue (Roshan, 2016: 3). The company is owned by a consortium of investors, comprising AKFED, Monaco Telecom, and the Swedish telecom provider, Telia. Another project in Afghanistan is the Government's National Solidarity Programme (NSP), of which AKDN is a facilitating partner and assists in establishing village-based Community Development Councils: this is done through an elected, accountable and transparent Council that formulates village development plans, and prioritizes village needs.

Elsewhere, there are other examples of blended finance as a development tool. These include the Bujagali Hydropower Plant, inaugurated in 2012 and built through a public-private partnership model between the AKFED, Sithe Global Power LLC, an American company majority-owned by the private equity fund, Blackstone Capital Partners IV, L.P., the International Finance Corporation, the African Development Bank,

the European Investment Bank and the Government of Uganda. The West Nile Rural Electrification Company is another AKFED lead project; a 1.5 MW plant, commissioned in September 2004, was upgraded in 2012 to boost electricity generating capacity. This was done with the support of the Government of Uganda, the German Kreditanstalt für Wiederaufbau (KfW), and the World Bank as well as others. The 3.5MW River Nyagak mini hydroelectric plant now provides a renewable source of energy to 1.4 million people.

More recently, initiatives that promote blended finance strategies have come to be associated with the SDGS for the year 2030 (OECD, 2017). The roots of this association are in the FfD or Financing for Development Agenda mentioned above. FfD as a development strategy emerged from the United Nations International Conference on Financing for Development held in Monterrey, Mexico in 2002. The ensuing Monterrey Consensus was a direct response to the concern that the MDGs required immense financial resources. Several studies place cost on the MDGs, with USD 50 billion per annum offered as a commonly cited figure (Clemens et al., 2007). The Monterrey Consensus made FDI one of the six pillars of development finance, and in the process underscored the role of private finance in an FfD or Financing for Development agenda.

In the 16 years since its inception, FfD has been subject to shifts. Initially designed for MDGs with a target date of 2015, a revised plan was presented in the July of that year at the Third International Conference on Financing for Development in Addis Ababa, to accommodate the SDGs of the 2030 Agenda for Sustainable Development. Whereas the United Nations (UN, 2002) estimated that USD 50 billion per annum would be required to meet the MDG targets, for the SDGs, the United Nations Conference on Trade and Development or UNCTAD estimates that USD 5 to USD 7 trillion is required overall and this indicates that there is an investment gap in developing countries of USD 2.5 trillion (UNCTAD, 2016). As Emma Mawdsley observes, previous financing needs for development interventions including official development assistance or ODA and also the MDGs have been dwarfed in comparison to the targets of the SDGs:

> 'A variety of MDG-related donor meetings sought to encourage the (so-called) "traditional" donors to reach their long-standing commitments to provide 0.7 % of gross national income in ODA. Few donors have ever met this target, and it seems most unlikely that the majority ever will under current definitions. As the SDGs coalesced, on the other hand, their ambition and scale evidently rendered this 0.7 % target grossly inadequate. ODA continues to be recognized as an important resource, especially for the poorest and/or most conflict-affected countries, but even if every donor met the 0.7 % target it would barely touch the trillions that have been variously estimated to be required to achieve the SDGs' (Mawdsley, 2018: 192).

Whereas the MDG focus was on poverty reduction, the SDG focus is on areas such as energy, innovation, and efficiency. Investment opportunities in these areas are framed as having trickle down effects for poverty reduction (Mawdsley, 2018). This narrative

reveals a shift: whereas the MDGs were seen as moving the emphasis from poor countries to poor people (St. Clair, 2005) and critiqued because 'to speak of poverty is to postpone speaking of development' (Sindzingre, 2004: 176), the SDGs envision a distinct role for the state. Not unlike in the past, the state is responsible for supporting the financing of development, but unlike in the past, this financing is to be arranged through the collaborative participation of public, private, and also philanthropic stakeholders. The importance of philanthropy is reflected in the literature of the joint ReDesigning Development Finance Initiative, from the World Economic Forum and OECD, which describes blended finance as the 'strategic use of development finance and philanthropic funds to mobilize private capital for development' (World Economic Forum, 2015: 3).

The attention directed to philanthropy for its potential to supplement FfD and to advance blended finance strategies has driven the institutionalisation of philanthrocapitalism. The contribution of the Rockefeller Foundation has been substantial in highlighting the nexus between finance and philanthropy which produced the concept of impact investing. The term 'impact investing' was coined in 2007 at the Foundation's Bellagio Center, 'putting a name to investments made with the intention of generating both financial return and social and/or environmental impact' (Rockefeller Foundation, 2018). A focal point for the Rockefeller Foundation is 'innovative finance', described as 'Private Capital for the Public Good' (Keohane and Madsbjerg, 2016). Innovative finance is an approach to channel private money from global financial markets by using 'philanthropic risk capital' (Rockefeller Foundation, 2018).

This approach underlies the presentation of impact investing as a new asset class that offers a double bottom line: market returns and social good (JP Morgan, 2010). In its annual Global Family Office Report, the Swiss based bank UBS observed that as family offices of high net worth individuals are taken over by younger — millennial — generations, the demand for profitable investments which also seek to address environmental and social issues has grown (UBS, 2017). Additionally, another instance of the mainstreaming of impact investment is in the endorsement by the Vatican: Pope Francis convened a landmark conference on impact investing in 2014 and this was followed by subsequent conferences in 2016 and 2018:

> '...to share and evaluate blended finance models and investible vehicles to address systemic challenges of great importance to both the Catholic Church and the global community: Climate Change, Health, Migrants and Refugees, and Youth Unemployment' (Vatican Impact Investing Conference, 2018:1).

Is there then an overlap between blended finance and impact investments? The latter are described as 'investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return' (GIIN, 2018). Given this definition, the concept of impact investment shares commonalities with blended finance strategies formulated to advance developmental

goals. The key difference that sets them apart is this: blended finance is a *strategy* whereas impact investment is an *asset class*.

The salience of this distinction is reflected in the definition of the Global Impact Investment Network, which is comprised of various international development agencies and large investment banks, and which portrays impact investing as an instrument rather than a practice. Additionally, when impact investing is presented as an asset class, the role of financial practices and instruments such as de-risking and patient capital, exemplify contemporary manifestations of development and finance. Moreover, the position of impact investment as an asset class also relates to the need for evaluation: in this case based on the metrics of intent and measurement.

Impact investing as a new asset class

The positioning of impact investing as an asset class connects the practices of philanthrocapitalism and shadow banking. Impact investing has led to the production of financial instruments that are offered by asset managers to attract capital from philanthropists: impact investments thus link shadow bankers to philanthrocapitalists.[183]

The Financial Times defines an asset class as a broad group of securities or investments that tend to react similarly in different market conditions: the three basic asset classes are equity securities (stocks), fixed-income securities (bonds), and cash equivalents (money market vehicles) but the consideration is often expanded to include real estate, commodities and derivatives (Financial Times, 2017). [184]

The notion that impact investments are a separate and new asset class has much to do with risk and return.[185] Whereas the other asset classes mentioned above are evaluated in terms of how much they return relative to the risk they entail', impact investments look beyond return in a purely financial sense, and seek to achieve non-financial goals even when this compromises financial profitability. The attainment of these goals is made possible by patient capital and measurement techniques geared to evaluating social and environmental outcomes. While the objectives of such investments are diverse, some outcomes are more conducive to measurement than others. Table 7.1 presents illustrative examples of measurable outcomes, showing how projects that have a focus on numbers of individuals — such as financial services, education, or energy — are more conducive to being measured and reported.

183 Here the description of shadow banking by Pozsar et al. (2010) of shadow banking as consisting of financial intermediaries that conduct maturity, credit, and liquidity transformation without explicit access to central bank liquidity or public sector credit guarantees, is relevant.
184 Other alternative classes may be found under the headers of private equity, energy, infrastructure, real estate and credit.
185 This concept, of a risk-return spectrum or trade-off, is central to Modern Portfolio Theory and is attributed to the American economist Harry Markowitz who was awarded a Nobel Prize in Economics in 1990.

Table 7.1: Illustrative Examples of Measurable Social or Environmental Outcomes

Agriculture	**Increase in productivity or crop yield as a result of improved technology or training**
Education	Participation rates of girls in secondary education in sub-Saharan Africa
Energy	Number of individuals at the base of the pyramid who gain access to electricity
Environment	Tons of CO2, equivalent offset as a result of organisation's product or service
Financial Services	Number of micro-insurance products sold to people with AIDS and infected with HIV
Health	Readmission rate of diabetes patients using innovative product for monitoring health
Housing	Reduction in the rate of homelessness among major US cities

Source: World Economic Forum (2013: 7)

Table 7.2: Key tools for measuring impact

Tool	Description	Institutional background
IRIS (Impact Reporting and Investment Standards)	Taxonomy or set of terms with standardized definitions that governs the way companies, investors, and others define their social and environmental performance.	Sponsored by The Rockefeller Foundation, Acumen and the B Lab to create common metrics for reporting the performance of impact capital. Since 2009, IRIS has been housed at the Global Impact Investing Network. It incorporates sector-specific best practices and reports major trends across the impact investing industry.
B Analytics	Customizable platform that various players in the impact space use for measuring, benchmarking and reporting on impact.	Acumen developed PULSE in 2006 as a software that enables impact investors to collect, manage and report on the impact of their investees: PULSE was incorporated into B Analytics in 2013 turning it into a fully integrated data and technology platform for investors to measure their impact of their portfolios.
GIIRS (Global Impact Investment Ratings System)	Impact ratings tool and analytics platform that assesses companies and funds on the basis of their social and environmental performance. Based on IRIS definitions; generates data that feed industry benchmark reports.	Developed by B Lab and launched in 2011 to manage, benchmark and assess the social and environmental impact of developed and emerging market companies, portfolios, and funds. Uses a ratings and analytics approach based on a broad universe of impact data. Data is self-reported by companies and reviewed by a third-party verification service provider, Deloitte before a company can receive a rating.

Sources: Compiled by author, based on Acumen (2018); Brandenburg (2012).

These social and environmental outcomes are the subject of a range of measurement techniques. Commitments to measure impact, along with expectations of returns, and the intent to have a positive social impact are the three features that set an impact investment apart from forms of investment (UNDP, 2017). This focus on measurement subjects this developmental approach to a level of standardisation that is

unprecedented in global development, albeit not in finance. The three key tools for measuring impact are IRIS, PULSE, and GIIRS. Table 7.2 shows how these are likened to tools used by commercial investors, such as the Generally Accepted Accounting Principles (Financial Reporting Council, 2013) and credit rating tools such as Moody's.

These tools are employed across various geographies including the Global South as well as advanced capitalist countries. However, in the context of development IRIS is of particular interest because of its capacity to frame investment strategies. In doing so it facilitates a form of 'social closure' (Palan, 1999), which Heloise Weber describes this as a form of governance that 'pushes questions of social and political struggle away from the realm of the public sphere' (2004: 61). Particularly worrying is the predilection of IRIS for the narrative of BoP or base-of-pyramid initiatives which are the subject of C.K Prahalad's immensely successful 2004 book: 'The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits'.

BoP strategies for reducing poverty rest on the assumption that poor people, who make up a substantial chunk of the world's population, offer immense potential as customers of products and services that can meet their specific needs (Prahalad, 2005). Microfinance and mobile banking are examples of such products and services, as are singularly packaged toiletries and alcohol: such strategies have been criticised however, for exploiting 'poor people's vulnerabilities, such as their lack of education and their desire for cheap relief from chronic distress' and also for under-emphasising the state's role and responsibility in poverty reduction (Karnani, 2009).

Such critiques problematise the impact investing industry's hefty emphasis on financial services, as shown in Table 7.3. In particular, the BoP bent of IRIS is strongly reflected in the manner in which outcomes are measured. Very often, the unit of analysis is either individuals or products consumed. This is reflected in the heavy presence of impact enterprises operating in the financial services sector: these measure impact, for instance, in terms of number of micro-insurance products sold or number of persons or number of women who accessed financial services. Data gathered by the Global Investment Impact Network (GIIN) for 2013 shows that 73 per cent of impact enterprises, 2,707 in number, were in the financial services: data for 2015 shows a decrease in percentage and but a rise in absolute terms with financial services organisations making up a percentage of 63 per cent of the total despite growing to 2,949 in total (see Table 7.3). This can be ascribed to the rise in the number of organisations described as 'other' or 'technical assistance'. The latter might indicate a sharp increase in the number of consulting or advisory organisations operating in the impact investment sphere: in 2013 there were only 4 reporting organisations worldwide that were classified as technical assistance, whereas in 2015, there were 158, of these, 139 were based in North America. While data for 2018 does not contain the number of organisations, it does show that financial services including microfinance accounted for 28 per cent of assets under management by the global impact investing industry (GIIN, 2018).

This overlap between BoP and financial services is the essential basis for lapses in financial citizenship because it legitimises less than complete access to mainstream finance and causes the system to be bifurcated. Mawdsley (2018a) notes that mainstream development models seek to deepen and expand financial markets and logics and that this is exemplified thus: in the shift from foreign aid to development finance, and also in the nature of the macro-micro linkages between financial circuits in interventions such as microfinance which extend the reach of financial technology and capital.[186]

Table 7.3: Number of impact investment enterprises by region and sector[187]

	East Asia and Pacific	Sub Saharan Africa	South Asia	Europe and Central Asia	Latin America and the Caribbean	North America	Middle East and North Africa	Total
Agriculture	18	141	14	17	293	34	3	520
Artisanal	4	..	3	4	14	8	0	33
Culture	0	0	0	..	15	11	..	26
Education	..	0	..	..	5	34	0	39
Energy	48	32	14	3	17	9	0	123
Environment	..	0	0	..	9	48	0	57
Financial Services	361	598	406	443	518	542	81	2949
Health	3	10	8	4	21	27	..	73
Housing Development	0	..	5	..	5	31	0	41
ICT	11	46	16	8	50	64	4	199
Infrastructure/ Facilities	..	0	..	..	7	0	0	7
Other	12	12	30	14	104	51	9	232
Supply Chain	4	..	3	..	12	78	0	97
Technical Assistance	..	0	..	4	15	139	0	158

186 The ascendancy of financial logic has also been the subject of concern in an emergent literature about the encroachment of the financial sector into development. For instance, Bayliss and Van Waeyenberge (2018: 578) point to a recent revival in PPPs to exemplify this encroachment and observe that past efforts such as those in 1990s — involving the World Bank and also regional development banks — to enlist the private sector in development initiatives were driven by a narrative of efficiency gains through privatisation; but, current approaches present PPPs as an opportunity to utilize financial capital given 'a glut in global savings'.
187 Dots denote non-zero values that have been withheld due to the IRIS anonymity policy. The total column does not include these non-zero values.

Tourism	..	0	0	4	4	9	0	13
Water	3	..	..	0	..	4		7
Total	472	844	505	510	1091	1089	100	4611

Source: GIIN (2015, p. 2)

How to use shadow banking and financial innovation for development

Recent survey data from GIIN (2018) indicates that private debt, often in the form of fixed income is, responsible for 34 per cent of the assets under management in the impact investing industry; this is followed by real assets — for instance infrastructure, real estate, and commodities — at 22 per cent; and private equity — through which investment funds acquire shareholding and ownership stakes in companies — at 19 per cent. These investables are incorporated into the strategies and portfolios of the some of the largest financial institutions. For instance, the 2015 acquisition of Imprint Capital Advisors, an 18 person San Francisco based impact investment fund, by Goldman Sachs was an indication, for the Wall Street financial community, that client demand for impact investments is substantial (Bloomberg, 2015).

Another instance of Wall Street engagement with impact investing is to be found in the Global Impact fund launched in 2018 and managed by KKR, the New York based private equity firm which manages over USD 190 billion.[188] For global financial institutions, acquiring or establishing a fund dedicated to impact investing is often a means to overcome size constraints: poor countries have shallow markets so investment opportunities, even when lucrative, tend to be too small to attract financial capital in the large tranches that are customary for global fund managers. The FfD agenda has to an extent overcome this problem and connected small impact investment funds with large global financial institutions through initiatives such as the PRI or United Nations Principles on Responsible Investment. By asking financial institutions to become signatories, the PRI generates explicit commitments to report on responsible investment activities annually; the current list of signatories currently exceeds two thousand (PRI, 2018).

In addition to global financial institutions, impact investment funds receive capital from development finance institutions. For instance, the United Kingdom's DFID, through its investment company the CDC or Commonwealth Development Corporation, has been deploying capital in impact investment funds since 2012: this is done directly, such as through establishment of a CDC managed Impact Fund, and also indirectly, as is the case with investments made by the Impact Fund into other funds focused on Africa, and Asia (The Impact Programme, 2018). Another instance which

188 http://www.kkr.com/businesses/global-impact

reflects a somewhat different arrangement is the Microfinance Initiative for Asia (MIFA) Debt Fund. This was established in 2012 by Germany's Federal Ministry for Economic Cooperation and Development (BMZ), Germany's development bank (KfW), and the International Finance Corporation (IFC), and is managed by a privately owned, Swiss based, impact investment firm (OECD, 2018).

There are thus investments made *in* impact investment funds, such as those by global financial institutions and by development finance institutions; and there are investments made *by* impact investment funds, such as those in BoP initiatives for financial services. The onus of meeting the requirements of metrics such as IRIS fall on the latter whereas the deployment of capital, either in the form or debt or equity, is in the hands of the former. The next section discusses how this arrangement has shaped development and finance in Pakistan.

7.5 IMPACT INVESTING AS SHADOW BANKING IN PAKISTAN

The relationship between impact investing and shadow banking in Pakistan is reflected in two trends that have occurred in the country. One of these is the growing interconnectivity between microfinance and global capital: this is discussed below in the context of how microfinance lenders have been enabled — domestically and also internationally — in seeking wholesale funding, first from the World Bank, and then through other investors such as British and German development finance institutions. This is related to the second trend of how development finance institutions, with a preference for credit based investment or debt instruments, dominate the impact investing landscape in terms of capital deployed. These trends may be seen in the light of the two explanations of shadow banking presented above: supply side and demand side.

Shadow banks, development finance, and inclusive finance

Impact investing though microfinance in Pakistan has a context in the wider financial landscape of the country: this is comprised of commercial banks, development finance institutions, and microfinance banks, all of which are regulated by the State Bank of Pakistan or SBP.[189] As mentioned earlier, in Chapter 4, this arrangement has arisen following a programme of financial liberalisation, privatisation, and deregulation which commenced in the 1990s, and the first for-profit, commercial, microfinance institution, Khushhali Bank, came into existence in August 2000.

189 In Pakistan, DFI refers to a bilateral institution established to promote investment into Pakistan and to enhance trade flows between Pakistan and the sponsoring country. Another category of financial institution regulated by the central bank or SBP is that of specialized banks which are permitted to lend to specific types of borrowers such as agriculturalists but not permitted to carry out other banking activities such as deposit taking. Other financial institutions such as leasing companies, mutual funds, and microfinance providers which are non deposit taking institutions are regulated by the Securities and Exchange Commission of Pakistan (SECP).

Official support for microfinance was however, expressed much earlier in the country's PRSP or Poverty Reduction Strategy Papers. These documents are a part of the IMF's late 1990s strategy to target poverty reduction through more participatory approaches which required countries to prepare regular reports — updated every three years or so — in collaboration with various stakeholders and partners, including the World Bank and IMF (IMF, 2004). The Government of Pakistan released an initial or 'I-PRSP' in late 2000 and a full PRSP in 2003 (IMF, 2004). Of especial relevance in the strategies articulated thus is the role of the World Bank sponsored Pakistan Poverty Alleviation Fund. Chapter 4 discusses how this was established in the year 2000 as a special purpose vehicle designed to channel funding to broad based programs in community physical infrastructure and capacity building interventions, as well as microfinance: as such, it came to function as the country's apex fund.[190]

Eventually, as microfinance and financial inclusion became increasingly embedded in the strategies of the central bank of the Ministry of Finance (NFIS, 2015), the microfinance lending portfolio of the PPAF was shifted to a newly established private sector investment company: the Pakistan Microfinance Investment Company or PMIC. As mentioned earlier, the establishment of the PMIC opened a sizeable channel connecting the domestic microfinance industry to global fund managers. This is so because of the ownership structure of this institution: 49 per cent by the PPAF, 38 per cent by Karandaaz, and 13 per cent by Germany's state owned KfW. The role of these shareholders is to connect microfinance lenders in Pakistan with global capital markets as well as international donors. The PPAF, for instance is funded by multiple donors including the Government of Pakistan, the World Bank, DFID, and KfW. Microfinance lenders had in the past been partially reliant on World Bank disbursements to the PPAF.[191] But they can now seek funds — in the form of wholesale structured credit and equity-linked direct capital investments —from the PMIC which had additional backing from a major development agency, and also from DFID as well the Bill and Melinda Gates Foundation (Karandaaz, 2018).

The company structure of Karandaaz is a revealing example of an impact investing institution that is described both as a nonprofit company and a special purpose vehicle (GOV.UK, 2014) focused on promoting access to finance for small and medium enterprises and financial inclusion (Karandaaz, 2018).[192] This organisation was set up by DFID 'to strengthen the microfinance industry, entrepreneurship and small business development in Pakistan by working with existing institutions and through innovative financial products' (GOV.UK, 2014: 3) and is legally equipped as a special purpose vehicle to participate in various financial instruments: equity, quasi-equity,

190 CGAP (2002) describes an apex fund as 'a second-tier or wholesale organisation that channels funding (grants, loans, guarantees) to multiple microfinance institution (MFIs) in single country or region'. See Chapter 4 for more details.

191 Some lenders could use the funds of depositors for on-lending but this option was not widely available because of (1) low numbers of depositors/ savers and (2) licensing restrictions on which institutions were permitted to accept client deposits.

192 Companies in Pakistan that wish to be registered as nonprofit or non governmental oraganisatiaons may do so under Section 42 of the 1984 Companies Ordinance: this is the status under which Karandaaz operates.

debt, guarantees and other instruments for providing capital to small, medium, and microfinance enterprises.[193]

Microfinance lenders had in the past been partially reliant on World Bank disbursements to the PPAF.[194] But they could now seek funds — in the form of wholesale structured credit and equity-linked direct capital investments —from the PMIC which had additional backing from a major development agency, and also from an impact investing fund sponsored by DFID as well the Bill and Melinda Gates Foundation (Karandaaz, 2018).

The importance of development finance institutions such as KfW and DFID is mentioned in the reports of the Global Impact Investing Network (GIIN), which is the key source of data on such initiatives particularly in South Asia. Within such reports Pakistan is described as one of the largest impact investment landscapes in the region, with close to a total of USD 2 billion deployed: most of this is by institutional investors — mainly DFIs — but there is also considerable investment from high net worth individuals (HNWIs) (GIIN, 2014). This includes impact investors as well as 'impact related investors': the latter are a separate category because despite being involved in activities that are much like impact investing, there is an absence of an explicit impact intention. A view from many fund managers that impact is achieved by default through their activities. This might be in the form of increased access to capital where there was less before, or impact through investment in sectors like agriculture, which will affect farmer incomes, even without this being intentional ex ante (GIIN, 2014: 12). There is an understanding that such institutions are poised to act as intermediaries for the deployment of impact capital and as such have either expressed interest in or are in the process of developing a metric based approach to measuring and reporting impact (GIIN, 2014). Additionally, there are several foundations as well as family offices of HNWIs, which are not impact investors as they tend to have either purely philanthropic or commercial objectives but are nevertheless relevant in the broader landscape as they have the potential to offer a large pool of domestic capital (GIIN, 2014).

These observations capture the presence of a large number of social enterprises in Pakistan that resist the classification of impact enterprises, primarily because they pre-date the rise of FfD and the formal conceptualisation of impact investing.[195] GIIN (2014) analysis indicates that such activity accounts for a small share of the overall impact investment landscape: impact-related investors deployed capital of approximately USD 481 million relative to the nearly USD 2 billion deployed by impact

193 The SPV structure typically used for development programs is based on creating "not–for–profit" legal entities, into which development programs can place often large amounts of money to implement projects/ objectives (KPMG,2017)

194 Some lenders could use the funds of depositors for on-lending but this option was not widely available because of (1) low numbers of depositors/ savers and (2) licensing restrictions on which institutions were permitted to accept client deposits.

195 A number of social enterprises in Pakistan are categorized as NGOs despite operating with commercial models. One instance is the Pakistani branch of Hamdard, which became an Islamic trust or 'waqf' in 1953 and now runs a wide range of organisations and businesses, including a university and several laboratories that produce and distribute a wide range of pharmaceuticals at highly affordable prices: another instance is the organisation known as The Citizen's Foundation, which is a low-cost education provider that has been running schools in various poor neighborhoods across Pakistan since the mid-1990s (Ali and Darko, 2015).

investors. The former category consists of an unconfirmed number of angel investors: some of these are tied to incubators and accelerators whereas others operate more informally. The latter category refers to 18 impact investors identified by GIIN (2014): these are constituted by 11 DFIs as well as nine funds with a venture capital or private equity strategy that incorporates social impact.

This mixed structure reflects gradual changes that have occurred since the late 1990s, when Ashoka, a USA based organisation that 'identifies and supports the world's leading social entrepreneurs, learns from the patterns in their innovations, and mobilises a global community to embrace these new frameworks and build an "everyone a changemaker" world'recruited its first fellows in Pakistan in 1997.[197] This was followed by the arrival of the Acumen Fund in 2002.[198] And subsequently, by the Karachi based SEED (Social, Entrepreneurship and Equity Development) fund established in 2009 to offer investment, incubation and entrepreneurial services for 'societal and economic change'.[199] These early participants played a meaningful role in highlighting the developmental significance of 'patient' or philanthropic capital (Acumen, 2018). They are also seen as key players in the social enterprise industry (Ali and Darko, 2015). This reputation belies their relative contribution in terms of monetary value: to date, the Acumen Fund has invested USD 16 million in Pakistan since 2002 (Acumen, 2018), whereas SEED has invested just under USD 0.65 million since 2009 (Seed Ventures, 2018). This may be compared to the USD 157 million that the CDC — the development finance arm of DFID — has invested since it first entered the Pakistan marker in 2015 (CDC Group, 2015).

The CDC's approach here typifies that of DFIs in terms of sectoral focus; of the USD 157 million, USD 122 million was invested in financial services and USD 32 million d in energy (CDC, 2015). It is notable that the CDC investment in financial services consisted of a 5 per cent direct equity stake in HBL, which is Pakistan's largest commercial bank and controlled by the Aga Khan Fund for Economic Development or AKFED which holds a 51 per cent stake in the institution.[200] The AKFED, through HBL, also owns FMFB or First Micro Finance Bank, one of the largest and oldest microfinance banks in Pakistan which is discussed methodically in Chapter 6. Through this subsidiary organisation, the CDC's share in HBL allows it to 'help people on low incomes access potentially life-changing financial services such as micro-credit to start or grow a small business' (CDC, 2015: 4).

Like the CDC, Proparco, the private sector financing arm of Agence Française de Développement has invested USD 20 millionin wind energy.[201] Another USD 21 million has been invested for a gas fired power plant.[202] USD 5 million has also been invested

197 https://www.ashoka.org/en-gb/about-ashoka-0
198 Acumen Fund (2018)
199 http://seedventures.org/about-us/vision-mission/
200 This is the same organisation mentioned earlier in this article for its work in Africa, Central Asia,and Afghanistan.
201 http://www.afd.fr/en/pakistan-winds-hope
202 https://www.proparco.fr/en/engro

by Proparco in financial services.[203] Other DFIs involved in energy and finance in Pakistan are the Norwegian Norfund, which has a Pakistan allocation of 3 per cent of a USD 42 million investment fund to concentrate on micro-financing institutions (Norfund, 2018). And as mentioned earlier, KfW, the German development bank has provided finance for various sectors in Pakistan including energy and health and also owns 13 per cent of the Pakistan Microfinance Investment Company, the apex fund for microfinance in the country. [204]

This interest in financial services, primarily microfinance, is captured in GIIN (2014) data which indicates that financial services received USD 213 million of the capital deployed by both DFIs and non DFIs whereas the energy sector received approximately USD 624 million. The dominance of energy here is directly related to the acute power shortages that Pakistan has faced, particularly over the last decade (Haque, 2017), and also to the proclivity of this sector to absorb 'large ticket size investments that align with DFI mandates' (GIIN, 2014: 19). This is partially so because Pakistan's energy sector has since the reforms of the 1990s been geared towards attracting private investment. This has been done by ensuring that the independent producers of electrical power receive a fixed return (IRR) on their investment and are also reimbursed for all direct 'pass through' costs/expenses incurred in power generation (Shaikh et al., 2015).

Inclusive finance in Pakistan through private equity and private debt

Such arrangements underlie the preference of impact investors for debt over equity: most impact capital, approximately USD 1.3 billion of nearly USD 2 billion, has been deployed in Pakistan through debt (see Table 7.4). This is noteworthy because impact investing tends to be associated with private equity and venture capital approaches: these imply that the investor acquires a stake in the enterprise. However, recent data on global trends in impact investing shows that private debt is the biggest asset class now for impact investments, and that a large chunk of investments in developing and emerging markets are via PDIF or private debt impact funds (Forbes, 2018).

Table 7.4: Impact investing amounts deployed in Pakistan to date

USD Million	DFI	Non DFI	Total
Equity	153	26	179
Debt	1189	127	1316
Total[205]	1830	162	

Source: GIIN (2014)

The focus on debt in Pakistan is largely driven by DFIs with relatively low risk appetites. Debt instruments require a lower level of due diligence relative to equity investments,

203 https://www.proparco.fr/en/proparco-finances-microfinance-institution-pakistan
204 http://pmic.pk/wp-content/uploads/2017/10/PACRA-PMIC-PR-Oct17.pdf
205 Includes other instruments, mainly guarantees.

and also demand less post-investment management. Even though non-DFI impact investors tend to invest a greater percentage of capital in equity than DFIs — 16 per cent versus 7.3 per cent for DFIs — the partiality to debt rather than equity still prevails (GIIN, 2014). Though not clear from the GIIN (2014) study, there appears to be an overlap between the activities of DFIs and investment funds. For instance the Norwegian Investment Fund for Developing Countries invests in microfinance through its NMI Global Fund which in turn invests in a number of investment funds focused on microfinance: earlier data shows that NMI Global Fund has a 3 per cent allocation for Pakistan (Norfund, 2018). Similarly, the DFID Impact Fund invests in Pakistan through the Singapore based Insitor Impact Asia Fund, which uses DFID capital for stakes in early and growth stage companies across South Asia. Another instance is USAID's Pakistan Private Investment Initiative is comprised of three professionally managed investment funds: the Abraaj Pakistan Fund, the Pakistan Catalyst Fund, and the Boltoro Growth Fund (USAID, 2018).

Given the case of Pakistan, there are two arguments for applying a shadow banking lens to impact investing. One of these operates on the 'crowding out' assumption of bank finance and, more specifically, on the low ratio of private credit to GDP. The central bank notes for instance that the total assets and deposits of the country's banking sector have doubled since 2008, but private sector credit to GDP has declined from 22 per cent in 2009 to just 14.7 per cent in June 2014. The decline in credit provided to SMEs has been particularly pronounced, falling from 16 per cent of bank lending in 2008 to 7 per cent in 2014 (SBP, 2015). Fiscal patterns come across as the underlying cause of why commercial banks in Pakistan have been so lax in widening their customer base: the low tax base, at less than 11 per cent of GDP, compels the government to rely on borrowing for deficit funding (Ministry of Finance, 2017). Private businesses account for 40 per cent of bank credit, and only 0.4 per cent of all borrowers are responsible for 65 per cent of all bank loans (SBP, 2015).

And, as discussed in Chapter 5, the absence of effective measures to widen and also to deepen the tax base, make it unlikely that commercial banks, which are currently earning heavy spreads by investing in risk free treasury bills, will shift their focus away from the government and large corporate to the lower income segments of the non corporate private sector. Persistent government borrowing from commercial banks has crippled the banking sector by inundating it with a supply of zero risk weighted assets as government paper (Choudhary et al, 2016). These are a strong disincentive for commercial banks to actively seek projects to expand their loan portfolios. The borrowing patterns of the Pakistani state are insensitive to the cost of borrowing when there is a need to finance the budget deficit, given the absence of a sufficiently deep local currency bond market (Choudhary et al., 2016). Additionally, it is important to consider the role of stringent capital requirements — such as those imposed by the Basel rules — which deter banks from private sector lending as default risk comes across

as high for various reasons including limited collateral options and irregular cash flows.[206]

The role of impact investors in meeting the credit needs of enterprises excluded from the traditional banking sector because commercial banks will not lend to them is an empirical expression of shadow banking done to overcome regulatory constraints. Moreover, by enlisting philanthrocapitalists in the global FfD initiative through a valorisation of 'patient capital', investment funds seeking impact have prompted an expansion in the production of debt instruments, and responded to a demand from a global community of investors, including private asset managers and public donors, for asset streams or yield. The yield seeking aspect pertains mainly to the deployment of impact capital in the form of debt: as mentioned earlier, in Pakistan this is the dominant form of impact investment and preferred particularly by DFIs. [207] Using an OTD approach, fund managers — often subsidiaries of DFIs — are able to originate equity investments to attract capital from IFIs, DFIs, and other investment funds, as demonstrated earlier in the examples of DFID, USAID, and Norfund.

7.6 SUMMARY

The impact investing fixation with inclusive finance — which is itself an extension of the financial sector and the subject of several critiques — draws attention to the role of shadow banking in development. Financialised development of this nature sees impact investors, on one hand, fill a void in enterprise finance which has been created by regulatory constraints, and on the other hand accommodating a buoyant demand for financial yield by shepherding the entry of global capital into developing markets.

Impact investing strategies in Pakistan reflect shifts in development approaches: these arose as global financial capital came to occupy a principal function in philanthrocapitalism. Initiatives such as the FfD agenda and the adoption of impact investing strategies by private as well as non-private institutions, including international organisations such as the World Bank and the UNDP, have been central to such shifts: they also reflect an influential viewpoint: that development is essentially a problem of finance. This viewpoint is invoked regularly in the context of the SDGs, and has in the past, informed the pursuit of the MDGs.

Recent examples from impact investing in Pakistan show that the core features of impact investing, measurement and reporting facilitate a BoP focus which limits

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207 This is an empirical case of shifts in banking models. Chapter 3 discusses such shifts— from an originate-to-hold-model (OTH) to an originate-to-distribute-model — and describes the dramatic outcome of new financial technologies and regulations that pushed banks to shed their traditional role of intermediation since they were no longer constrained by balance sheets. Under OTH, banks accept deposits to grant loans and operate on the spread generated. Under OTD, banks 'slice and dice' the loans they grant and then sell the risks associated with these loans to other financial market players. This process is known as 'securitisation' (Kessler and Wilhelm, 2013; Engelen et al., 2010; Aalbers, 2009; French and Leyshon, 2004) and permits banks to eschew the incentives to control and account for the variety and quality of risks they themselves originate (Nesvetailova, 2017).

social impact and leaves such strategies open to the development critiques of 'self help' and 'romanticising the poor'. This BoP focus in financial services is at the core of shadow financial citizenship because (1) it is consistent with the financial logic of contemporary development which seeks to strengthen links between private, often global, capital and development strategies and often enlists shadow banks in this process (2) it bifurcates finance by widening the grey area between complete access to mainstream finance and exclusion from formal finance.

8. How Inclusive is Inclusive Finance and Why does it Bifurcate Banking?

8.1 INTRODUCTION

As shown in the last four chapters, Pakistan has a bifurcated banking system. This is characterised by uneven access to financial services across two segments of banking: inclusive finance and mainstream finance. While those who use inclusive finance are considered financially included (Global Findex, 2017) the financial services they are able to access are different from those available from mainstream banks.

The existing scholarship frames bifurcated banking in poor countries as caused by a split between formal and informal financial services. Related to this is the conceptualisation of a 'missing middle', which acknowledges the gap between financial access for very large firms, and financial access for very small firms. In advanced capitalist countries, a bifurcated system is revealed in the disparity between those who attain 'financial citizenship' and those who are described through terms such as 'adverse incorporation', 'exploitative greenlining', and 'precarious inclusion'. These themes prevail with inclusive finance.

The colonial history discussed earlier shows that a separation between formal and informal existed well before inclusive finance was used as a poverty reduction strategy. But by offering financial services to those in informal employment, without giving them full access to formal finance, inclusive finance strategies reinforce — rather than overcome — the separation between formal and informal.

This is reflected in the inequities in eligibilities and requirements described earier. Innovative collateralisation practices, such as the use of gold jewelry, are one particularly salient example of the techniques used by the inclusive finance industry to incorporate the informal sphere into one part of this bifurcated banking system. Other examples include relaxed KYC requirements, such as those that allow customers with limited documentation to open accounts, but these also place strict controls on how those accounts may be used in terms of transaction amounts, frequency, and range of services. Also, because credit offered as inclusive finance is subject to loan caps, those who can use only inclusive finance are restricted in how much they can borrow.

This is related to the observation that inclusive finance creates inequities in rates and pricing. Inequities in interest rates add to the difficulties — which include stiff competition and limited scalabilty — that microentreprenuers face in growing their businesses. Loans made purely for day to day or 'consumption smoothing' purposes are particularly expensive; they also rely heavily on data capture in the form of digital

footprints, which carry information related to location, phone usage, and existing loan history. Inequities in pricing are also revealed in mobile money and payment services; these are largely used as a substitute for interbank transfers which are unavailable to those using 'low KYC requirement' bank accounts. Because of the emphasis in Pakistan on biometric verification, these too are an opportunity for the inclusive finance industry to extract data which is also eventually used for credit scoring.

These practices of data extraction are another feature of bifurcated banking and they substantiate inequities in privacy and surveillance. These inequities are at the core of an emergent trend in finance, in which data is harvested to be used for credit scoring. Such practices expand the reach of global financial capital by allowing for new products to be created and offered to support debt led consumption. This is the case for financial services such as 'nano loans' which rely on digitised evaluation techniques to offer what is in effect, instant credit. In exchange, borrowers are required to renounce any claims to privacy insofar as their mobile phones are concerned. Such lending practices are in contrast with personal loans or credit cards for those who are able to avail credit issued from mainstream banks.

The inequities highlighted here are facets of the shadow financial citizenship framework which is used in this thesis to conceptualise bifurcated banking in Pakistan. But to what extent can these findings be generalised? This question is addressed by revisiting the financialisation perspective invoked earlier.

Inclusive finance as a driver of bifurcated banking reveals both general and particular features of financialisation in poor countries. Indeed, a core argument of this chapter — that there are features of financialisation specific to poor countries — is made by locating inclusive finance in the vibrant discussion on financialisation in developing economies (e.g, Bonizzi et al., 2019), and also what Akyüz (2017) describes as 'playing with fire' in commenting on the deeper integration of emerging and developing economies into the global financial system. This latter discussion is an extension of one initiated earlier in this study, in Chapter 2, which questioned the practices of financial deepening and builds on the scholarship of 'subordinate financialisation' (Bonizzi et al, 2019, Powell, 2013).

These structures may be associated with the liberalisation of global finance and emanate from changes imposed thus on state policy, including through the macroeconomics of debt and austerity. Bifurcated systems are a corollary of the phenomenon of subordinate financialisation which is for Pakistan, reflected through reserve accumulation, responses to currency hierarchies, and a misplaced emphasis on credit constraints from the demand for and supply of loanable funds. The incapacity of mainstream banks to facilitate money creation and to support economic activity is thus a feature of how financialisation operates in poor countries in general and Pakistan in specific. For this reason, alternative approaches to banking, involving the state, such as through the post office and the central bank, and particularly through the utilisation of technology, are considered as a means to widen financial citizenship

The remainder of this chapter proceeds as follows: Section 8.2 draws on Susanne Soederberg's concept of debtfare to examine the role of the state in making financial systems predatory, rather than inclusive: this is centred on the monetary facets of state fragility. Section 8.3 builds on this by drawing attention to constraints faced by the state and monetary authorities in poor countries which arise from the structure of the global macroeconomy. Section 8.4 identifies potential strategies to bring financial inclusion closer to financial citizenship. Section 8.5 concludes.

8.2 THE PAKISTANI 'DEBTFARE STATE'

The structural inequalities which lie at the core of bifurcated systems, are both the cause and consequence of policies centred on financial inclusion and democratisation of credit. Here, the related concepts of the debtfare state and the poverty industry are especially useful as they capture the role of the state as well as the financial system in upholding bifurcated banking.

The notion of 'debtfare states' is among Susanne Soederberg's contributions to the literature on financial inclusion and the 'democratisation of credit'. Both terms refer to similar concepts, but the former tends to be invoked for poor countries and the latter for rich countries. For Soederberg (2014), the debtfare state is a particular form of neoliberal governance which upholds a 'poverty industry' running on the exorbitant fees and charges from products such as payday and student loans, and credit cards: the clients of the poverty industry are synonymous with the Marxian sub-category of the 'surplus population'.

Soederberg (2014) observes that the poverty industry exists not only because of the need for financial services for the unemployed and underemployed, but because this need is persistent and recurring. Repayment obligations deepen the imperative for indebted workers to work in low paid jobs, and these compulsions underlie the reproduction of the surplus population.

> 'The debtfare state, alongside other components of the neoliberal state form (e.g. workfare, competition states, and prisonfare), has partly assisted in the rearticulation and re-creation of the outside–inside (or, informality – formality) dualism in Mexico, and, more generally, in the making and remaking of neoliberal forms of domination, albeit in an uneven and paradoxical manner' (Soederberg, 2012: 562).

Debtfare states, as Soederberg (2015; 2012) shows through the examples of the United States and Mexico, feature in advanced capitalist as well as Global South countries. In doing so, they offer a framework to draw parallels between segregated banking and inclusive finance. These linkages have been identified by Soederberg (2015) in her depiction of the poverty industry as a contemporary feature of American as well as Mexican capitalism. This analysis may be extended to draw further country comparisons, including with Pakistan.

For instance, the Mexican debtfare state is described as formulated on two — macro and micro — scales. One of these is that of the politics of austerity and the other is the colonisation of informal spaces through debt. The politics of austerity seek to 'normalize and discipline social relations, particularly labour, to the exigencies of capital under the auspices of growth' (Soederberg, 2012: 565), and the colonisation of informal spaces 'assists in legitimizing the penetration of formal banking institutions into spaces of informality, where the relative surplus population resides' (Soederberg, 2012: 567).

The macroeconomics of debt and austerity in Pakistan (Kemal et al., 2017; Shabbir and Yasin, 2015) are like those of Mexico and largely typical of Global South countries where 'the disconnect between the promises of the pro-growth orthodoxy (and the "Washington Consensus" of the World Bank and the IMF, more generally) and the outcomes of neoliberal reform' has been experienced (Soederberg, 2012: 566). These outcomes, characterised by low growth as well as fragile export and capital markets, troublesome current account and public budget deficits, and high socio-economic inequality, arise from a state policy fixated with achieving economic growth through expanding the private sector (Soederberg, 2012).[208]

For Pakistan, a habitual implication of this approach has been tight monetary policy to control inflation.[209] This tends to be accompanied by a strong emphasis on building foreign exchange reserves, to ward off financial vulnerability. Such strategies complicate the management of both domestic investment and domestic debt as weakened tax revenues expose the economy to the inflationary pressures that arise from deficit financing (Akram, 2011). The issue of deficit financing — when the government seeks to borrow from either the public or private sector, and often both, to plug the gap between revenues and expenditures — is a chronic problem for policymakers in Pakistan.[210] It is not only inflationary but also crowds out private sector investment. Small borrowers in particular are overlooked by banks which prefer to lend to corporate or government organisations.[211]

The other scale on which the debtfare state is formulated pertains to intrusions made by debt capital into an informal economy which is recast, on occasion, through terms such as 'the unbanked' or 'the bottom of the pyramid'. These strategies are integral to the 'neoliberal developmental model'. The commercialisation of microfinance and the rise of retail banking highlight how state backed initiatives 'seek to integrate the poor into the secondary forms of exploitation involved in making money from money' (Soederberg, 2012: 569)

For Pakistan, the clearest explication of state backing for commercial microfinance, and related inclusive finance products and services, is to be found in the

208 Particularly compared to the period between the 1960s and 1980s (Cypher and Wise, 2010 cited in Soederberg, 2012).
209 The enlistment of the central bank or State Bank of Pakistan in the processes of the Washington Consensus is discussed in Chapter 4
210 Fiscal deficits may be financed through various combinations of domestic and external sources. Domestic sources have two subcomponents: printing new money (government borrowings from the central bank) or issuance of interest bearing debt to both bank and non-bank institutions. Externally, governments borrow money from international financial markets (Agha and Khan, 2006).
211 The government's role as a 'dominant borrower' is discussed in Chapter 4 and Chapter 5.

National Financial Inclusion Strategy document published by the central bank (SBP, 2015).[212] Within this, financial inclusion in the form of access to credit as well as payment and remittance systems is presented as vital for national growth, and also for overcoming poverty and inequality. But the problem that Soederberg (2012) draws attention to for Mexico is also applicable for Pakistan: how are the poor to build up financial assets given the configuration of the poverty industry? An alternative form of this conundrum — on how to escape the poverty industry — is presented through the question of graduation which Shankar (2016) observes in the need for microfinance clients to systematically transition from microfinance to commercial finance. But this need remains unfulfilled and manifests itself as an issue of the missing middle, in which there is 'a lack of financing options for enterprises whose needs fall in between the typical loan sizes offered by MFIs and commercial banks' (Shankar, 2016: 3).[213]

8.3 FRAGILITY FROM FINANCIAL GLOBALISATION

These patterns of segregation, inclusion, and predation draw attention to how financial globalisation affects the Global South. Recent scholarship on this issue builds on earlier debates about the risks of financial globalisation and liberalisation: these past debates have generated a vast literature — including engagement with Latin American Structuralist studies on the hegemonic role of the US dollar and its financial and monetary implications — and this is summed up in Akyüz (2017).

As noted by Alami (2018), more recent approaches on the subordinate position of poor countries in the global financial system (Bonizzi et al., 2019; Kaltenbrunner and Painceira, 2018; Bonizzi, 2017; 2014) perceive it as a feature of financial as well as monetary structures. Such an approach relies on highlighting how financialisation is transmitted through interconnected channels and mechanisms: primarily reserve accumulation, currency hierarchies, and a misplaced emphasis on credit constraints from the demand for and supply of loanable funds.

The practice of heavy foreign exchange reserve accumulation is often attributed to the experiences of developing and emerging economies following the 1990s financial crisis in East Asia, and also the 1995 Mexican Peso crisis and 2001 Turkish banking crisis (Marois and Munoz-Martinez, 2016). For instance, China saw its reserves grow from USD 107 billion at the end of 1996 to USD 1,068 billion at the end of 2006; and, the combined value of the foreign exchange reserves of China, Japan, and Korea in 2006 exceeded USD 2,000 billion (Aizenman and Lee, 2008).[214]

For some researchers (e.g, Dooley et al., 2005) these patterns underpin the adoption of mercantilist strategies by emerging economies: hoarding international reserves advances a development strategy that is based on growth through under-valued real exchange rates. Additionally, strong reserves offer potential 'collateral' to attract

212 See Chapter 4 for more on this policy document
213 See Chapter 4 for a more detailed discussion on 'the missing middle'
214 Reserve accumulation patterns for selected countries are in Appendix F.

foreign direct investment, and as such, reserve accumulation is seen as instrumental to a an outward oriented growth strategy (Aizenman and Lee, 2008). The alternative explanation for reserve accumulation or hoarding is that of 'self-insurance/precautionary demand' (Aizenman and Lee, 2008: 593, Ben-Bassat and Gottlieb, 1992): large reserves reduce the probability and magnitude of output drop in case of capital flight.

Regardless of motivation, the trend of heavy reserve accumulation is a key mechanism through which the international financial system advances domestic financialisation (Bonizzi, 2014). For some countries, reserve growth strategies have enabled central banks to create domestic liquidity through bond issuance linked to sterilisation activities. This augmented liquidity has been used by domestic banks for balance sheet expansion, including through risky and speculative purchases (Gabor 2010; Painceira, 2010). This has been the case in Brazil, Korea, and some East European economies where inflows from exports and foreign direct investment exerted upward pressure on the domestic currency; however for many other countries, reserve management has been concerned less with countering currency appreciation, and more with managing external debt and liabilities, and consequently, currency depreciation.[215]

Pakistan falls into this latter category because of the unenviable reality of an external debt to GDP ratio of 30.4 per cent (World Bank, 2018) combined with an acute case of 'original sin'.[216] As noted by Husain (2017) as much as 24 per cent of government revenue is used for interest rate charges and to repay foreign loans. Not only is this a strain on the public budget, it is also troublesome for the overall economy because of volatility from retail price inflation, especially when currency depreciation causes spikes in domestic commodity rates: particularly fuel, edible oil, and wheat (SBP, 2018). Retail price inflation is measured through the CPI or consumer price index: 37.5 per cent of its weighting is for food and related items and items that are sensitive to global oil prices — including electricity, gas, and transport — are responsible for another 37 per cent of so of CPI weighting (SBP, 2018).

Inflation, which refers to decreases in the purchasing power of money may be taken to represent monetary volatility. For Antonia Settle (2016: 107) this is a feature of financialisation in developing and low-income countries: or 'a problem of uncertainty arising from the liberalisation of money and markets under global conditions of financialization and articulated empirically in price volatility'. Settle (2016: 108) argues that in countries where the population of the 'unbanked' is large, households and individuals engage with financialisation in ways that are detached from 'the conventions of official banking and state money'. This is exemplified through field work in Pakistan in which individual economic strategies are found to be aligned with the beginning of a period of sustained rupee decline that followed 1990s policies of opening up the rupee to foreign markets (Settle, 2016). These economic management strategies entail the

215 See Moreno (2011) for how in many such economies, such an approach can hinder the conduct of monetary policy.
216 'Original sin' is a term attributed to Eichengreen and Hausmann (1999) to describe the inability of developing and emerging countries to borrow in their domestic currency.

greater use of 'real assets' such as cattle, vacant land, and second-hand motor vehicles, diversification away from cash, and the use of dollars as a hedge, including for overnight holdings.

> 'Financialization here plays itself out not within the institutional norms of advanced economies' financial sectors but in the specific institutional context of a low-income economy. Hence, informality is dominant and state money is not trusted, formal financial markets are largely inaccessible and 'real' markets provide liquid markets for alternative stores of value. The fact that these practices respond to new instability norms generated by financialized globalization reflects that these practices are not some kind of absence of financialized globalization or receding engagement with complex finance; not a return to pre-capitalist 'survival practices' but an expression of global financial integration and an alternative, locally constituted version of financialized globalization' (Settle, 2016: 117).

To a large extent, the phenomenon described above is reflective of the currency hierarchies, which Bortz and Kaltenbrunner (2018: 382) see as manifest in the 'subordinated position of DEE currencies'. [217] This approach builds on a Post-Keynesian perspective which distinguishes between 'soft' and 'hard' currencies, given differing abilities to credibly maintain value because of variations in liquidity premia. This subordinated position is described in the emergent literature on subordinated financialisation, which examines the role of the international economy in domestic financialisation. The international currency hierarchy compels DEEs to keep domestic interest rates high to uphold the value of their currencies: but higher interest rates push excessive borrowing in cheaper international markets. This pattern creates external indebtedness, debt-servicing costs, and vulnerability to shocks in external financial markets: a possible solution involves capital controls and specialized financial institutions, such as development banks, to fill the domestic financing gap (Bortz and Kaltenbrunner, 2016).

The problem of domestic financing gaps may be studied through recent analyses by Antonia Settle (2016) of the constrained nature of bank deposit mobilisation in Pakistan, particularly since the reforms of the 1990s. For the central bank, this weakness in the deposit base shows a preference for consumption over saving: the underlying assumption is that whatever is not saved is consumed (SBP, 2016). But as Settle (2016: 358) asserts, this view reflects a misunderstanding of how individuals and households respond to a feeble currency: a more accurate reading on of a low deposit base attributes it to the risks associated with holding money as cash or bank deposits which erode the 'privileged position of national currency as money'. In the words of Pakistan's central bank:

> 'Fundamentally speaking, Pakistan seems to be stuck in a low-saving low-investment trap, which has seriously hampered its growth potential: a low savings rate reduces the volume of investible funds; low investments make growth spurts unsustainable; and low growth generates fewer domestic savings' (SBP, 2016: 3).

217 'DEEs' refers to developing and emerging economies.

To overcome this, the SBP has sought to enhance competitive pricing and product innovation, for instance in the form of a National Financial Inclusion Strategy (SBP, 2015). Settle's (2018) critique of this approach highlights the SBP's lack of engagement with alternative monetary forms which are a response to, and also a symptom of, financialisation.

In seeking to enhance saving in order to overcome low-investment, central bankers take a distinctly mainstream view in which the quantity of loans disbursed in a period is limited by the amount of saving in the same period: so eschewing consumption — and also other spending — is necessary to make more credit available for investors. This is the core assumption of loanable funds theory, which sees interest rates as determined by the demand for investments and supply of savings: this underpins the needs for deposits in an intermediated banking system. This perspective thus tends to underplay the structural and/or institutional features that shape the financial system (Van Waeyenberge and Bargawi, 2015).

The alternative to a loanable funds approach reverses the causal relation between loans and deposits and links investment to money that is endogenously created. Whereas the loanable funds model requires banks to hold deposits to make loans, the endogenous money — or finance through money creation — approach notes that it is deposits that are created through loans (Jakab and Kumhoff, 2015).

For instance, Vineet Kohli shows in a study of Indian monetary policy that attempts by policymakers to enhance the availability of credit 'fail to materialise when money supply is endogenously determined by the level of economic activity' (Kohli, 2016: 87). Given an endogenous money supply, attempts to deregulate and liberalise the financial system, through measures such as cuts in the statutory liquidity ratio (SLR) and cash reserve ratio (CRR), are found to have the unintended consequence of increasing commercial bank holdings in government securities. This occurs because the freeing up of reserves boosts demand for government securities, and the central bank is likely to accommodate this demand by selling these government securities, rather than placing downward pressure on interest rate yields. A key implication of this outcome is that credit off-take is constrained not because reserve requirements are onerous, but because there is a lack of demand for loans from creditworthy borrowers (Kohli, 2017).[219] This portrayal is consistent with earlier discussions about the government as a 'dominant borrower' in Pakistan.[220] This is typically seen in the light of monetary financing of budgetary deficits and presented as a crowding out argument. Even given this arrangement — because policy measures are not equipped to address credit demand — inclusive finance is a form of financial innovation and a response to the reluctance of commercial banks to lend to small borrowers.

An endogenous money approach thus draws attention to the structural and institutional features that impede the two functions of banking identified earlier: (1)

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219 Larger borrowers are more likely than small borrowers to be perceived as creditworthy: this point relates to the earlier discussion on black banking and is empirically shown in various studies (e.g, Chen et al, 2017: Kohli, 2015)
220 See Chapter 4

money creation for the functioning of the economy, and (2) lending to productive enterprises to support economic activity. While a thorough discussion of these impediments is outside the scope of this dissertation, Karwowski's (2017) observations on investment patterns in a financialised South African economy are relevant here: notwithstanding the argument that banks create deposits through credit extension, financial institutions may be seen in the context of time and space, or national setting. As noted by Victoria Chick and Sheila Dow in their exposition of the stages of banking, banks may create money through lending when loan creation does not depend on deposits: this occurs when the central bank assumes full responsibility for financial stability (Chick and Dow, 1988).[221] For developing or emerging capitalist economies, including India, Pakistan, and South Africa, this is not the case as central banks may only partially accommodate monetary expansion because of the inflationary and currency depreciation risks associated with a policy of low interest rates.

The endogeneity of money thus draws attention to asymmetries in money creation.[222] Developing country central banks typically face structural impediments to credit growth. These are binding to varying extents depending on the domestic relationship between credit expansion and the exchange rate set by the demand and supply of foreign currency: imports and investment motives including speculation determine demand, and supply is determined primarily by exports and also remittances.[223]

> 'The process of domestic credit-financed investment expansion influences both factors: First, as the increased investment also increases domestic incomes, import demand will be stimulated depending on the degree to which capital goods and consumer goods are imported. A country with very little domestic manufacturing industry to start with might actually see a rather large increase in imports stemming from increased investment demand, while a well-diversified economy might see only a small increase in imports. Second, with an increase in aggregate incomes and aggregate savings, households might increase their demand for foreign assets and hence again the demand for foreign currency, again putting downward pressure on the exchange rate' (Dullien, 2009: 17).

In contrast to poor countries, rich or advanced capitalist countries are adept at money creation: (1) banks may create deposits of new money through lending, and in doing so are constrained mostly by profitability and solvency considerations (Jakab and Kumhoff, 2015); and (2) central banks may secondarily create money by purchasing assets — including through quantitative easing measures — mainly from nonbank financial companies (McLeay et al., 2014). As a result of these asymmetries, poor countries — and the institutions within them — are prone to becoming indebted as recipients of credit created in rich countries:

221 Chick and Dow (1988) observe: 'in the fourth stage, a central monetary authority accepts the function of lender of last resort. The stock of bank reserves is now responsive to demand from the banks. Banks collectively expanding credit can now do so without risk of being caught short of reserves.

222 Or more specifically, privately created money; this is the description used by Soederberg (2014) for 'credit'.

223 More details on the determinants of foreign currency demand and supply are available in https://unctad.org/en/Docs/osgdp20091_en.pdf

> 'Since the 1990s, a dominant strategy employed by capitalists to absorb the tensions of over-accumulation has been the creation and extension of credit money to low-income workers in exchange for high rates of interest as well as commissions and fees' (Soederberg, 2014: 27).

The absorption of inclusive finance by shadow banking networks is an outcome of these asymmetries. Bifurcated banking emerges as a result and thus may be overcome only through a drastic overhaul of the financial system: this could address the structures outlined above or take a more targeted approach as presented in the next section.

8.4 OVERCOMING SHADOW FINANCIAL CITIZENSHIP

These constraints characterise the subordinated form of financialisation that drives shadow banking in the form of inclusive finance. Commercial or mainstream banks are systematically prevented from meeting the lending needs of those who are not either large or public borrowers. There is thus a need for alternative approaches to meet the banking needs of large segments of society. These needs may be summarised thus: safe access to deposit facilities, reasonably priced loans, and efficient and affordable means of transferring payments. Possible alternatives to mainstream banking that meet these needs include (1) post office banking, and (2) central bank accounts for the general public. This list of two is not exhaustive, but the examples of post office and central bank led approaches highlight how many impediments to financial citizenship may be overcome through government involvement combined with technology.

Post office banking

The origins of post office banking are British: first used in 1861, it spread from Great Britain to the Empire and commenced in Canada in 1868, New South Wales in 1871, and in New Zealand in 1876: by the turn of the century almost every Western country had adopted nationwide post office banking (Baradaran, 2015).[224] The goal of post office banking was financial inclusion. In Great Britain these banks initially offered a deposit rate of 2 per cent which was less than what mainstream banks offered. In the United States, post office banks were endorsed by President Ulysses S. Grant in 1873: earlier proposals for these banks to offer deposit rates of 4 per cent to attract savings had been rejected because of pressure from mainstream banks (Baradaran, 2015).

American post office banking was largely successful until deposit insurance quelled instability in banks in the 1950s. The appeal of post office banks before this is attributed to their role as a safe haven for deposits, particularly in the 1930s, and also to their role in mobilising funding through treasury bonds in the form of Defense Savings Stamps, for the war during the 1940s (Baradaran, 2015). The formal demise of post office

224 Germany was the exception which chose not to adopt this approach because of an already existing system of savings banks and credit unions (Baradaran, 2015).

banking was in 1970 when the United States Postal Service ceased to be a cabinet department and became an independent agency which was now required to fund itself (Baradaran, 2015).

The recent push for a revival of post office banking in the United States comes from a white paper report published in 2014 by the Office of the Inspector General (OIG) of the United States Postal Service (USPS).[225] More recently, in April 2018, Senator Kirsten Gillibrand sponsored legislation to 'provide that the United States Postal Service may provide certain basic financial services, and for other purposes'.[226] Support for post office banking assumes that a public bank with a wide geographical presence can offer a broad range of services at a lower cost. Not only would such an institution avail of economies of scale and scope from existing infrastructure, it would also be able to offer products at or close to cost because of the absence of profit-maximising shareholders (Baradaran, 2015).

A supplementary point made by Baradaran (2015) as well as the CGAP (2014) is that placing the USPS in a banking role would stem the financial decline of a historic institution which has suffered from the rise of digital communications. Given the experience of post office banking in the United Kingdom, this is not a secondary issue. Examining the initiative to offer universal banking through the post office, Midgely (2005: 283) finds that post office banking 'became tied to finding new business to maintain the viability of the Post Office network'.

Here it is worth noting that the system of post office banking in the United Kingdom is different from what was used, and now proposed again, in the United States. The former system is centred on the POCA or Post Office Card Account which provides a facility for the withdrawal of benefit, pension and tax credit payments: this is not equipped for deposits but it is possible for customers with deposits at some other banks to carry out transactions through the post office. An auxiliary issue then is the disinclination of mainstream banks to cooperate with financial inclusion initiatives involving competitors: this has been expressed in their reticence to sign up for network banking agreements (Midgely, 2005). Until recently, only a small number of banks offered their customers access through the post office, but with recent agreements, it is expected that customers of most major banks would be able to manage their accounts through the Post Office (Financial Times, 2017). Given the experience of the United Kingdom, it is likely that for post office banking to be successful, assistance from the state to ensure linkages with the mainstream system is essential.

Central bank deposit accounts

Another strategy that would extend financial citizenship proposes accounts for the general public at the central bank. Ricks et al. (2018) refer to this form of account, which

225 https://www.uspsoig.gov/sites/default/files/document-library-files/2014/rarc-wp-14-007.pdf
226 https://www.congress.gov/bill/115th-congress/senate-bill/2755/text

would be used for deposits and payments, as 'FedAccounts'. A related proposition, discussed by the Bank for International Settlements is that of central bank digital currencies or CBDCs (BIS, 2018). These proposals have a common starting point in the acknowledgement that central banks *already* provide digital money in the form of reserves or settlement account balances that are held by commercial banks and certain other financial institutions at the central bank.

> 'Among the perks of being a bank is the privilege of holding an account with the central bank. Unavailable to individuals and nonbank businesses, central bank accounts pay higher interest than ordinary bank accounts. Payments between these accounts clear instantly; banks needn't wait days or even minutes for incoming payments to post. On top of that, central bank accounts consist of base money, meaning they are fully sovereign and nondefaultable no matter how large the balance' (Ricks et al., 2018: 1).

The proposed FedAccount would be an extension of the privileges currently offered to financial institutions and have all the functionality of an ordinary bank account but without overdraft coverage. Essentially, such a FedAccount would do for non-physical money what the government already does for physical money to make it function like an 'open-access resource' (Ricks et al., 2018).

Linking the proposals would see the FedAccount allowing for transactions using a CBDC: the salient features of such transactions include the ease of cash transfers, which could be done either peer-to-peer or via an intermediary, and the feasibility of interest payments — or even deductions in case of a negative interest rate — on deposits (BIS, 2018). For Ricks et al. (2018), particularly compelling is the viability of real time payment transfers that can be carried out free of cost, and instantly: they also note that interest payments on CBDC deposits would have the same internal rate of return that the central bank pays to commercial banks on deposits.

This FedAccount-CBDC approach does not involve lending and as such does not offer a full solution to the problem of predatory lending: however, as discussed earlier a key feature of shadow financial citizenship relates to the nature of fintech that is used for payments and remittances. A real time, free or even low cost, payments system would overcome the problem of exploitative fees as well as that of financial intrusion which occurs when data is harvested for value extraction.

One facet of CBDC which might restrict its tractability in poor countries, particularly where the informal economy is large, is its emphasis on digital transactions. Ricks et al. (2018) suggest various ways to address this issue — which arises from the reliance of large swathes of the population in rich as well as poor countries on cash — and emphasise the need for coordination with existing infrastructures, including of the post office, third party banks, credit unions, and ATM networks.

The CBDC approach is radical in that it effectively entails a shift from fractional reserve banking to a central bank administered narrow-banking system. Writing in 'The Guardian', Nouriel Roubini points out that if private banks were to shift their deposits into CBDCs, then traditional banks would become loanable funds intermediaries.

Additionally, the implementation of a central bank system of digital money would obviate the role currently played by cryptocurrencies because 'CBDCs would likely replace all private digital payment systems, regardless of whether they are connected to traditional bank accounts or cryptocurrencies' (Roubini cited in The Guardian, 2018).

8.5 SUMMARY

This chapter makes the contention that inclusive finance, particularly as reflected through the case study of Pakistan, contains generalisable features which reveal its connections with broader, structural patterns of financialisation. More specifically: inclusive finance as a form of shadow banking exemplifies subordinate financialisation and Pakistan's subordinate position in the global financial system is responsible for a bifurcated banking sector. To expand upon this connection, the notion of debtfare is applied to Pakistan. Through this it is argued that the macroeconomics of debt and austerity, and also the intrusions made by debt capital into an informal economy, make the Pakistani state prone to applying a mode of governance which facilitates a 'poverty industry'. Inclusive finance is a component of this poverty industry, which may be considered through a lens of subordinate financialisation. Such an approach acknowledges that financialisation is encountered differently by poor or emerging capitalist countries relative to their advanced capitalist counterparts. More specifically, asymmetrical constraints on policies relating to reserve accumulation, credit creation, and currency management are responsible for shaping domestic financial structures in poor countries, and thus producing shadow financial citizenship. This is not to say that shadow financial citizenship cannot be overcome. The examples of post office banking and central bank currencies and accounts demonstrate that a substantial overhaul of the financial system is needed in order to expand financial citizenship and thus overcome shadow financial citizenship.

CONCLUSION

In the preceding chapters of this thesis, I have examined bifurcated banking as a general and also specific phenomenon associated with inclusive finance; particularly as it overlaps with shadow banking. Bifurcated banking is an issue of financial citizenship; it occurs because financial systems have an inside as well as an outside. As such, I resist the view that bifurcated systems exist because poor people have a specific requirement for inclusive finance. I advance the alternative view that inclusive finance is offered to poor people because of shifting models of banking. A central argument of my thesis, this draws on the original literature on financial citizenship to attribute the persistence of the unbanked and underbanked to shifting models of banking. The incorporation of shadow banks and shadow banking practices into my analysis allows for an augmented version of financial citizenship, which I introduce in this thesis as shadow financial citizenship.

The absorption of inclusive finance by shadow banking is expressed in the concept of shadow financial citizenship. Inclusive finance as shadow banking has been previously mentioned — briefly and tangentially — in studies about transformations in development practices. I extricate these mentions from two sets of scholarship: (1) on the proliferating commercialisation of the 1970s microcredit model, and (2) of the Finance for Development agenda derived from the funding requirements of MDGs and SDGs. Particularly, in the context of the latter, incursions made by shadow banking networks into global development strategy, are a core proceeding of the 'Wall Street Consensus' as an approach distinct from previous ones, including the Washington Consensus.

My use of Pakistan as a case study to examine the linkages between shadow banking and inclusive finance reveals how this nexus is a corollary of, what is often described as, a 'sustainable' model of inclusive finance: independent from subsidies and charity. But in an intriguing twist, the inclusive finance industry has come to be a favoured destination for philanthrocapitalist initiatives such as impact investing, and strategies which emphasise patient capital, such as blended finance. Moreover, the fixation of inclusive finance with data — as credit scoring technologies become intrinsic to financial innovation — is shown to be a key aspect of the 'value proposition' of this industry.

Institutional investment in the Pakistani inclusive finance also reflects a policy stance, tacit as well as stated, which sees products and services centred on microcredit, branchless banking, mobile money etc. as a core tool to complete the financial spectrum. Mainstream banking is geared to lend to the Pakistani government and to large corporates, and the implications of this are reflected in studies on the 'missing

middle' and data on private credit offtake. To equip inclusive finance to plug these systemic gaps, the central bank has actively shaped this industry as an alternative — and hence conspicuously different — to mainstream or commercial banking. Bifurcated banking is an attribute of this differentiation, which I problematise here through a shadow financial citizenship framework. This framework reveals that there is a distinct set of inequities faced by those who are expected to use inclusive finance.

These inequities may be summarised as (1) inequities in rates, exemplified through relatively expensive credit and charges for payments and related transactions; (2) inequities in requirements, exemplified through KYC and other documentary requirements as well the collateralisation of everyday life such as through gold jewellery and livestock; and (3) inequities in surveillance, exemplified by alternative credit scoring techniques which rely on personal data. These inequities, which are anchored in the dependence of inclusive finance on disintermediated models of funding, seek to create new asset streams and extract value by expanding the frontiers of the global financial system.

Contributions

The conceptual framework that I assemble in this thesis and my empirical analyses from the case section contribute to the disciplines of international political economy, and also development studies. The analytical tools which I use to study bifurcated banking, and by extension, inclusive finance and shadow banking, advance the academic literature in three key areas. These are (1) the political economy of financial citizenship, (2) financialisation in the Global South, and (3) the political economy of subordinate financialisation.

Earlier scholarship on financial citizenship uses the concept to demonstrate the exclusionary tendencies of new models of banking. This literature expresses concerns about the withdrawal of financial infrastructure, emphasising its role in urban and community economic decline in Britain and the United States (e.g. Dymski, 2005; Dymski and Veitch, 1992; Leyshon and Thrift, 1995). More recent scholarship utilises the term primarily to discuss 'financial subject formation' (e.g. Lai and Tan, 2015; Kear, 2013): in this set of literature, there is some scepticism directed at financial citizenship for tacitly — albeit unintentionally — endorsing financial forms of governance. In this thesis, I resist engagement with the misgivings associated with financial governance. By focusing on the 'outside' relative to the 'inside' of the financial system and probing the role of shadow banking in this arrangement, financial citizenship — as a necessary concept — is defended and reinvigorated in the form of shadow financial citizenship. Furthermore, this augmented concept allows for a more thorough consideration of the shifting boundaries of the financial system by noting how these shifts reproduce inequalities.

As mentioned earlier, my thesis identifies primarily with what has been described as a contemporary view of financialisation: the contribution made here

expands the literature on the financial logic and technologies associated with a specific setting. The contemporary view is relevant here because it emphasises the processes and practices associated with the rising influence of financial logic and tools on firms, households and individuals. This contemporary view may be contrasted with the 'epochal' view, which concerns itself with the wider transformation of the economy and society that is pushed by the dominance of the financial system. A concise but thorough survey of these views on financialisation, as well as the underlying perspectives and schools of thought, is available in French et al. (2011). Based on this, the authors make the argument that there is — among other, related issues — a need for the scholarship 'to recognize how many of the processes associated with financialization are geographically uneven' (French et al., 2011: 814). My thesis speaks to that need by (1) probing the unevenness of how financialisation is exerted, and (2) by explicitly attributing such processes to the structure of the international financial system.

The international element of inclusive finance is a core theme of this thesis. In particular, the case study underscores how financial integration can reproduce inequalities. The subordinate financialisation literature is crucial for articulating how for poor countries, not only is the encounter with financialisation from a subordinate position; financialisation *further undermines* their subordinate position in global structures (Bonizzi et al. 2019). To advance these contentions, I provide empirical evidence to demonstrate the linkages between the focal points of this thesis — shadow banking, bifurcated banking, and inclusive finance — and global financial structures which impose fragilities through currency hierarchies and volatile capital flows.

Limitations and avenues for further research

The contributions of this thesis should be considered in the light of some limitations. Of particular relevance are the shortcomings associated with the single case study methodology: I highlight these in the introductory chapter. These shortcomings may be overcome by exploring the phenomenon of bifurcated banking and the conceptual framework of shadow financial citizenship in other settings where inclusive finance is prominent. Other avenues for further research offered here further highlight the limitations of the present study. Given its cross-disciplinary nature, these may pertain, for instance, to international political economy, development, and human geography. A brief set of suggestions is given below:

The operationalisation of shadow financial citizenship is one possible avenue for further research. The idea that financial citizenship as a concept has 'operability' is not a novel one and has policy relevance from the standpoint of individual financial responsibility and security.[227] Building on this, there is scope for defining a measure or set of measures that capture how the reality of financial inclusion and financial

227 See for instance Lindsey Appleyard and Shaun French's project on financial citizenship and credit unions: 'https://www.coventry.ac.uk/research/research-directories/current-projects/2016/financial-citizenship-building-financial-security-capability-and-inclusion-in-communities/

exclusion is such that binary conceptualisations are ineffective. An approach of this nature has direct applicability to global development practice, particularly for instance, when it is centred on the SDGs:

> 'Financial inclusion is positioned prominently as an enabler of other developmental goals in the 2030 Sustainable Development Goals, where it is featured as a target in eight of the seventeen goals. These include SDG1, on eradicating poverty; SDG 2 on ending hunger, achieving food security and promoting sustainable agriculture; SDG 3 on profiting health and well-being; SDG 5 on achieving gender equality and economic empowerment of women; SDG 8 on promoting economic growth and jobs; SDG 9 on supporting industry, innovation, and infrastructure; and SDG 10 on reducing inequality. Additionally, in SDG 17 on strengthening the means of implementation there is an implicit role for greater financial inclusion through greater savings mobilization for investment and consumption that can spur growth' (UNCDF, 2019: 1).

A measurable version of shadow financial citizenship might assume the form of a multidimensional indicator structured as a composite variable. As such it would enable quantitative analyses on the relationship between development goals and the *extent* and *nature* of financial inclusion.

Another theme which has been mentioned — but not exhausted — in the present study is that of Pakistan as a financialising economy. The example of the inclusive finance industry here demonstrates how financial logic has suffused government led poverty reduction initiatives. This analysis may be supplemented with others that scrutinise processes and practices that are indicative of financialisation; additionally there is an absence of studies on Pakistan that evaluate financialisation as expressed in the growth patterns of the FIRE — finance, insurance and real estate — sector, and/ or the financial activities of nonbank companies.

An additional topic that might build on the present study is that of credit creation in poor countries. I have shown in this thesis that asymmetries in the capacities of national central banks and domestic financial institutions to produce money in the form of credit, place poor countries at a disadvantage. This weakness is expressed as constraints poor countries must contend with — relative to their advanced capitalist counterparts — in implementing monetary policy. These asymmetries are empirically revealed in the responses of central banks to the global financial crisis of 2007-9; this is supplemented by analytical proof from an emergent set of literature, including from the Bank of England (Jakab and Kumhoff, 2015). But there has been only limited discussion on how such strategies — in theory as well as practice — carry implications for the Global South. This deficiency in the scholarship may be summarised as two questions: (1) What can Global South countries do to gain more autonomy over monetary policy? (2) How is the Global South affected by private and public money creation in the Global North?

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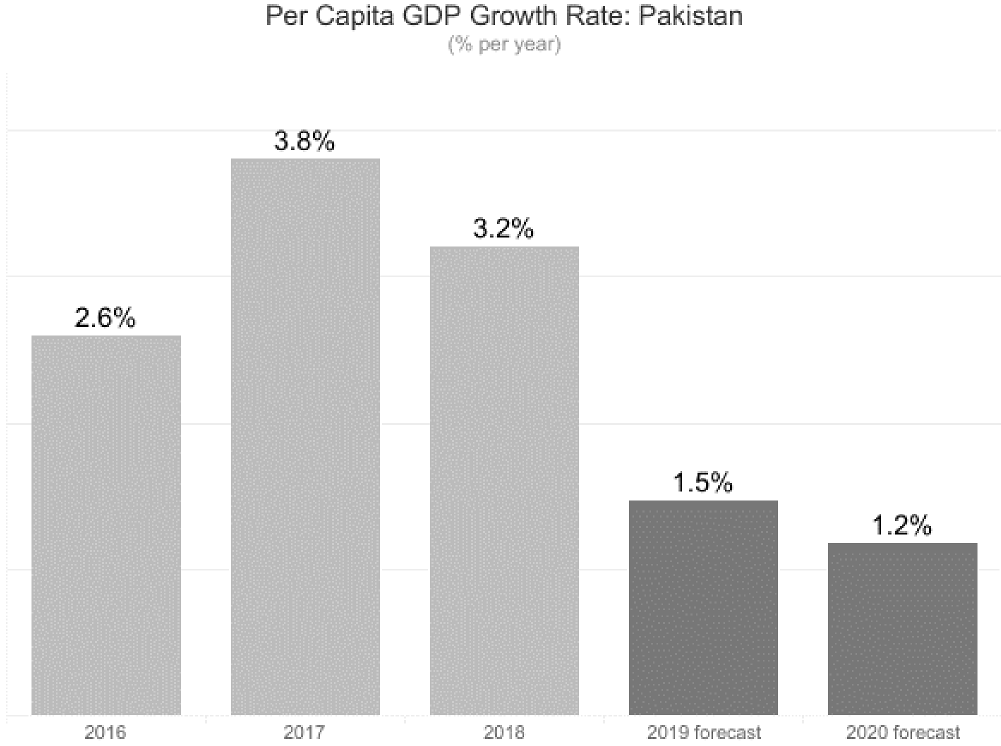
APPENDICES

APPENDIX A: INTERVIEWS

Organisation	**Description**	**Head Office**
Bank Islami	Islamic commercial bank	Karachi
CDC	Development finance institution owned by the UK government: investment arm of DFID	London
Enclude	Advisory firm dedicated to building more sustainable businesses and institutions	Islamabad (regional head office)
Finja	Fintech working on payments and e-commerce platforms.	Lahore
First MicroFinance Bank	Deposit taking microfinance bank, indirectly owned by a global development agency, directly owned by large Pakistani commercial bank.	Karachi
Habib University	Private university collaborating on financial inclusion project with Institute for Money, Technology & Financial Inclusion UCI School of Social Sciences, University of California, Irvine.	Karachi
HBL	Large Pakistani commercial bank	Karachi
JS Private Equity	Private equity and venture capital firm specialising in investments in expansion capital, growth capital, and buyout investment opportunities.	Karachi
Oraan	Fintech startup focused on conventional saving mechanisms and financial technology to provide simpler financial access and money-management tools.	Karachi
Paysys Labs	Fintech/ Digital Financial Solutions Company	Karachi
Planet N	High-tech and social impact investment firm dedicated to development through digitalization	Karachi

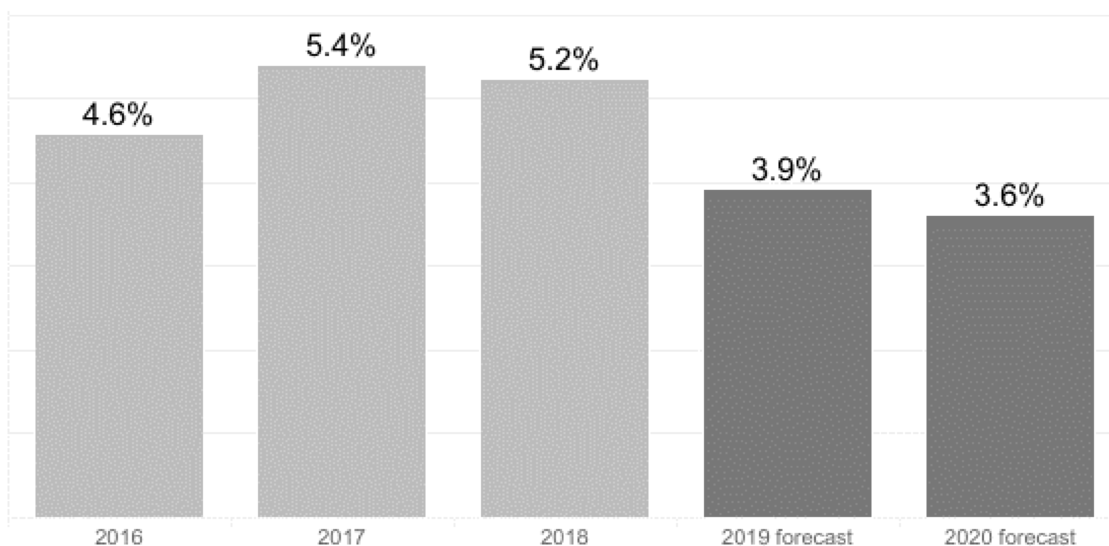
PMIC	Investment Finance Company offering financial and institutional services to individuals, micro-entrepreneurs and micro-enterprises	Islamabad
PMN	Policy institute to support the financial sector, especially retail financial service providers, to enhance their scale, quality, diversity etc.	Islamabad
State Bank of Pakistan	Central bank	Karachi
Telenor Microfinance Bank	Deposit taking microfinance bank, largely fintech and telecom owned.	Karachi
Up Trade	Social enterprise focused on energy solutions for off-grid, water stressed communities.	Karachi
WomenX World Bank	Women's entrepreneurship programme conducted by World Bank	Islamabad

APPENDIX B: PAKISTAN KEY ECONOMIC DATA



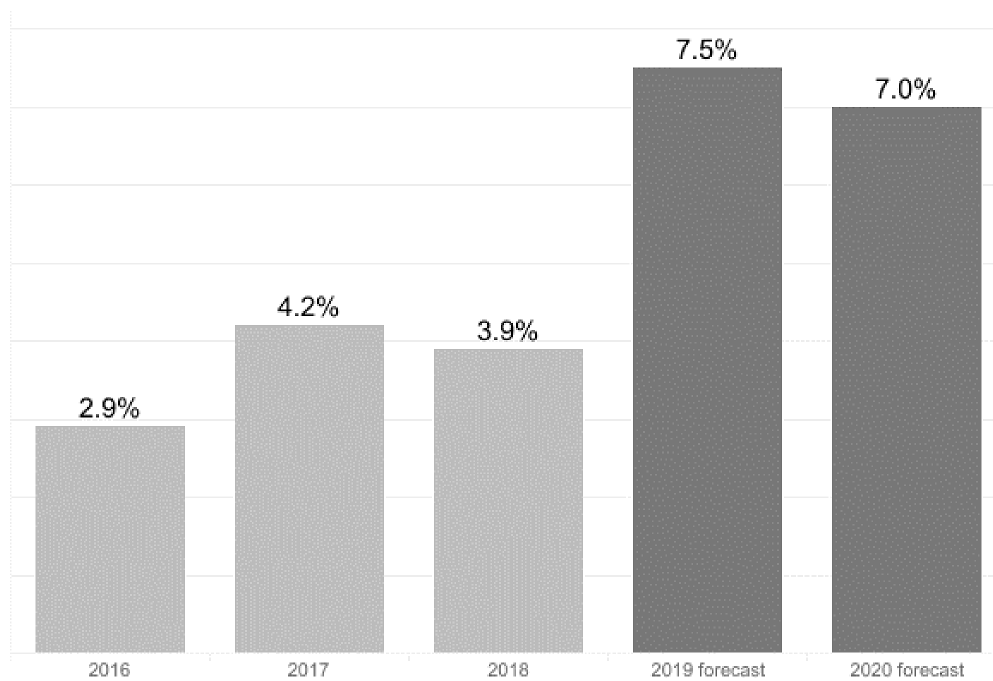
Source: Asian Development Bank. *Asian Development Outlook 2019*

GDP Growth Rate: Pakistan
(% per year)

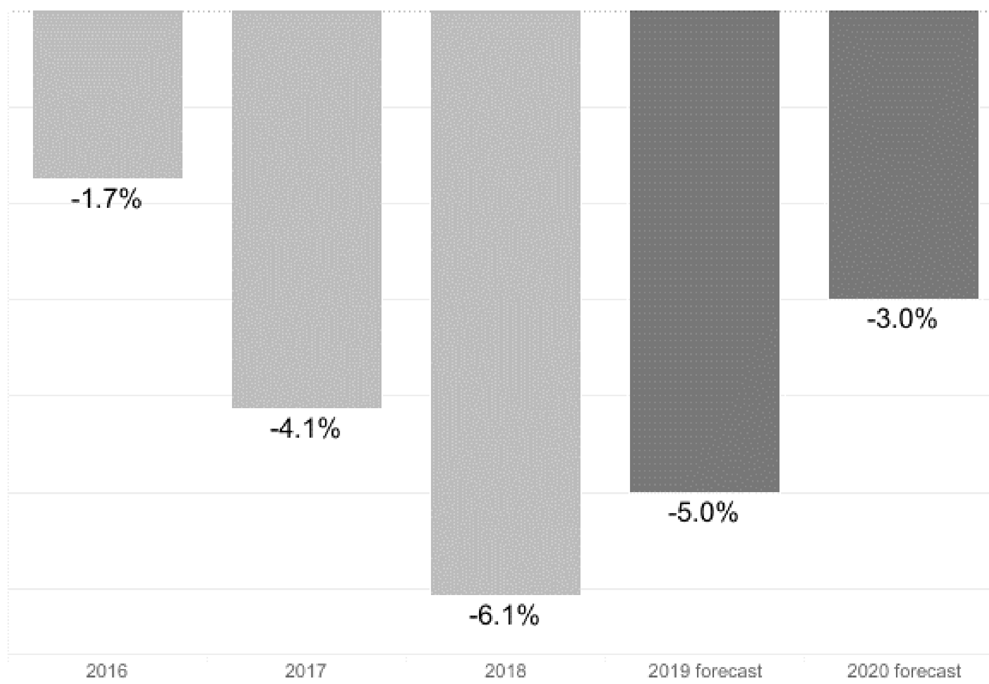


Source: Asian Development Bank. *Asian Development Outlook 2019*

Inflation Rate: Pakistan
(% per year)

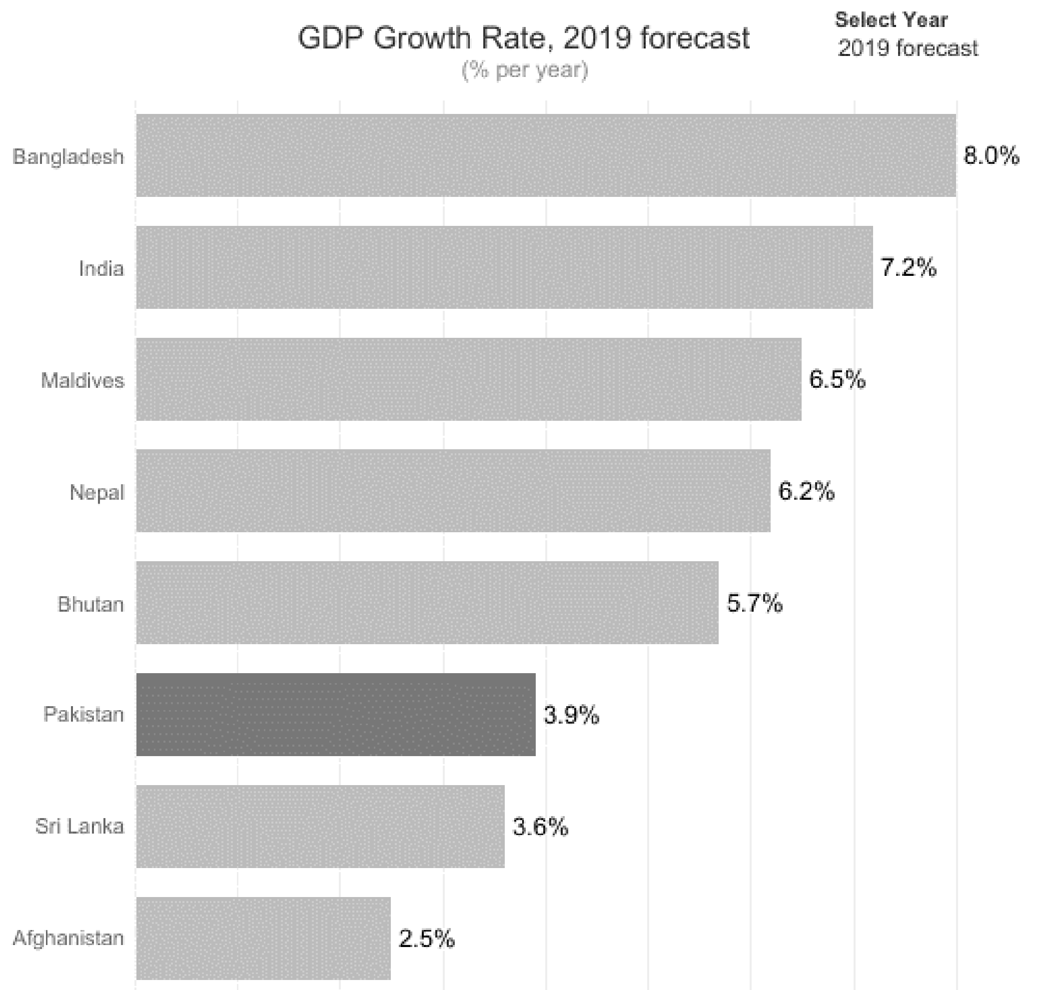


Source: Asian Development Bank. *Asian Development Outlook 2019*

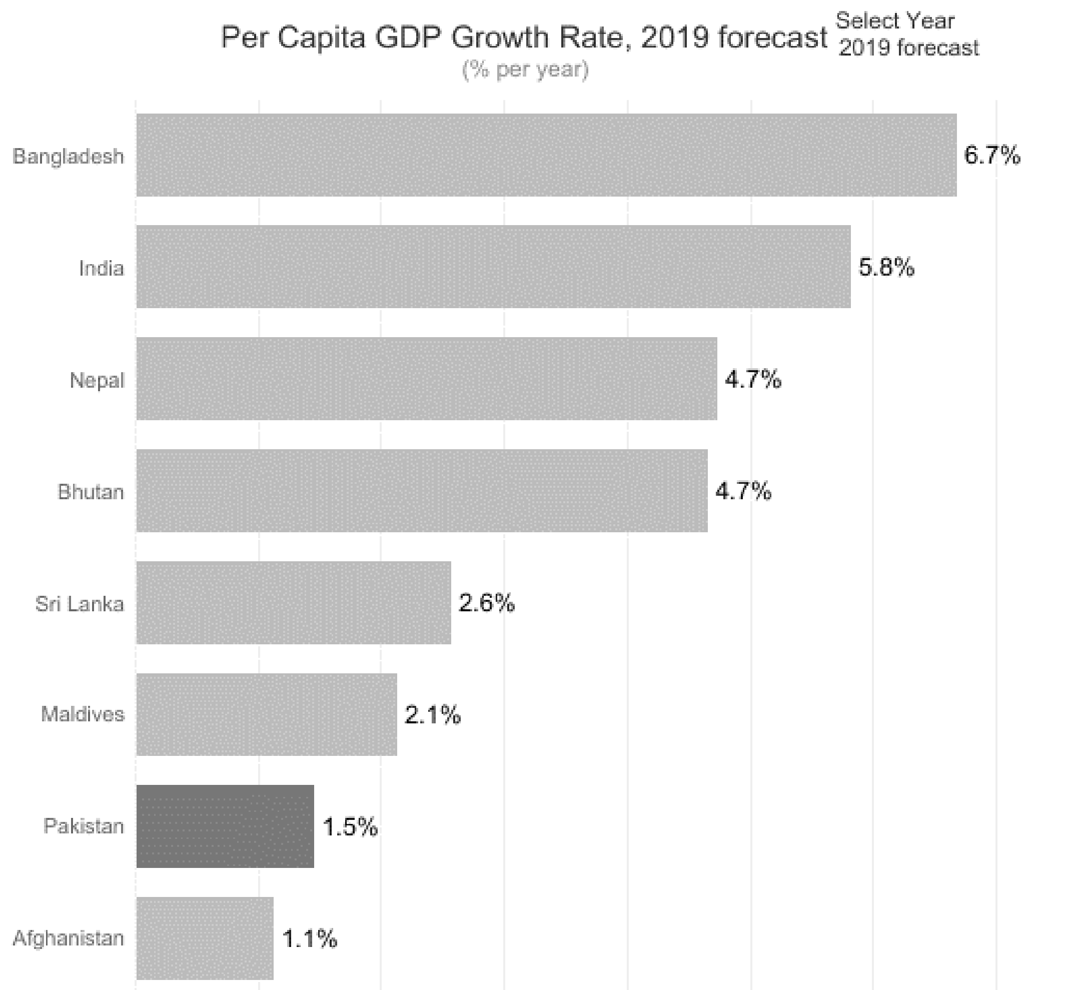


Source: Asian Development Bank. *Asian Development Outlook 2019*

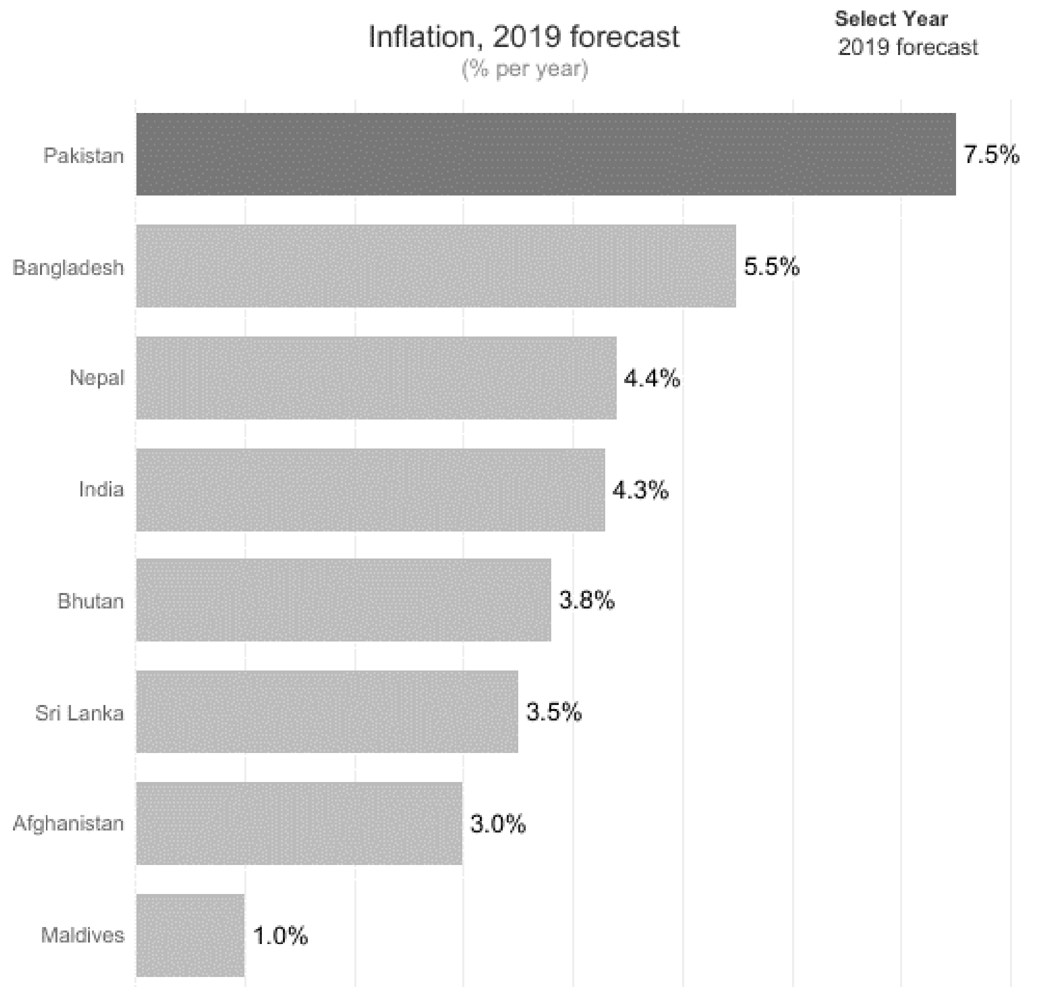
APPENDIX C: REGIONAL COMPARISONS WITH PAKISTAN DATA



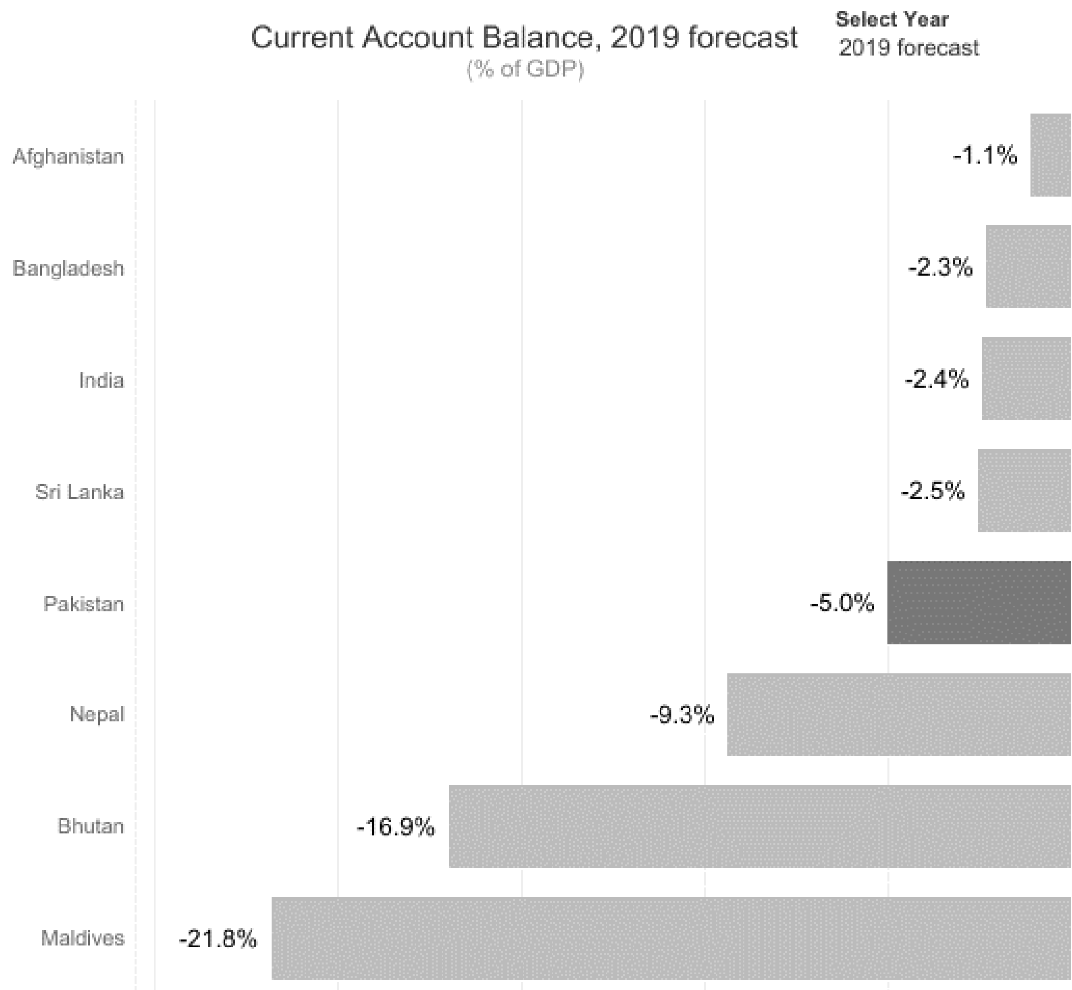
Source: Asian Development Bank. *Asian Development Outlook 2019*



Source: Asian Development Bank. *Asian Development Outlook 2019*



Source: Asian Development Bank. *Asian Development Outlook 2019*



Source: Asian Development Bank. *Asian Development Outlook 2019*

APPENDIX D: PAKISTAN KEY COMMERCIAL BANKING DATA

(Billion Rs.)

Item	Jun-18	Dec-17	Jun-17
Number of All Banks	**33**	**33**	**34**
Public Sector Commercial Banks	5	5	5
Domestic Private Banks	20	20	21
Foreign Banks	4	4	4
Specialized Banks	4	4	4
Number of (Reporting) Branches	**13,692**	**13,628**	**13,039**
Total Liabilities/Assets	**28,815.0**	**27,553.4**	**24,618.6**
Cash	**1,424.8**	**1,258.7**	**1,215.1**
Total Deposits (Excluding Inter-bank)	**12,649.0**	**11,946.9**	**11,592.1**
Demand	4,740.7	4,186.6	4,209.4
Savings	5,415.4	5,129.3	4,940.5
Time	2,492.9	2,631.0	2,442.2
Number of Accounts of Deposit Holders	**53,111,547**	**50,565,334**	**49,006,112**
Average Deposits per Account (Thousand Rs.)	**238.2**	**236.3**	**236.5**
Total Advances (Excluding Inter-bank)	**7,122.8**	**6,306.5**	**5,965.9**
Number of Accounts of Borrowers	**3,298,472**	**3,555,512**	**3,327,343**
Average Advances per Account (Thousand Rs)	**2,159.4**	**1,773.7**	**1,793.0**
Bills Purchased and Discounted	**241.4**	**225.7**	**209.0**
Investments in Securities & Shares	**8,320.9**	**8,605.0**	**8,227.8**
Bank Loan (Advances + Bills)	**7,364.2**	**6,532.1**	**6,174.9**
Percentages:			
Deposits to Total Liabilities	43.90%	43.36%	47.09%
Cash to Deposits	11.26%	10.54%	10.48%
Advances to Total Assets	24.72%	22.89%	24.23%
Time Deposits to Total Deposits	19.71%	22.02%	21.07%
Advances to Deposits	56.31%	52.79%	51.47%
Investments to Deposits	65.78%	72.03%	70.98%
Bank Loan to Deposits	58.22%	54.68%	53.27%
(Loan + Investments) to Deposits	124.00%	126.70%	124.25%
Weighted Average:			
Deposits Rates (Excluding Zero Rate)			
• Overall	4.41%	3.93%	3.84%
• Interest Bearing	2.00%	0.72%	0.87%
• Profit & Loss Sharing	4.59%	4.21%	4.07%
Advances Rates	8.10%	7.76%	7.49%

Source: SBP (2018a)

APPENDIX E: PAKISTAN KEY MICROFINANCE DATA

Year	2013	2014	2015	2016	2017
Active Borrowers (in millions)	2.4	2.8	3.6	4.2	5.5
Gross Loan Portfolio (PKR billions)	2.4	2.8	3.6	4.2	5.5
Active Women Borrowers (in millions)	1.4	1.6	2	2.3	2.7
Branches	1,606	1,747	2,754	2,367	3,533
Total Staff	17,456	19,881	25,560	29,413	36,053
Total Assets (PKR billions)	81.5	100.7	145.1	225.3	330.4
Deposits (PKR billions)	32.9	42.7	60	118.1	185.9
Total Debt (PKR billions)	26.9	31.1	44.5	54.7	74.1
Total Revenue (PKR billions)	17.3	24.3	32.8	41.8	65.7
Operational Self Sufficiency (percentage)	118.1	120.6	124.1	127	124.7
Financial Self Sufficiency (percentage)	116.5	119.6	121	123.9	122.4
PAR > 30 (percentage)	2.5	1.1	1.5	1.2	0.5
Return on Assets (ROA)	3.3	3.5	3.6	3.4	3.2
Return on Equity (ROE)	16.1	16	15	18.9	19.5

Source: PMN (2017)

APPENDIX F: FOREIGN EXCHANGE RESERVES COMPARATIVE REGIONAL POSITIONS

Gross international reserves (USD million)

	2013	2014	2015	2016	2017
Central Asia					
Armenia	2,252	1,489	1,775	2,204	2,314
Azerbaijan	14,153	13,758	5,017	3,974	5,335
Georgia	2,800	2,695	2,500	2,800	3,100
Kazakhstan	24,715	29,209	27,871	29,710	30,745
Kyrgyz Republic	2,238	1,958	1,778	1,969	2,177
Tajikistan	636	511	494	653	1,272
Turkmenistan	29,300	32,400	…	…	…
Uzbekistan	22,515	24,149	24,300	26,428	28,076
East Asia					
Hong Kong, China	311,209	328,516	358,823	386,241	431,370
Mongolia	2,248	1,650	1,323	1,296	3,008
People's Republic of China	3,880,383	3,899,285	3,406,112	3,097,845	3,235,895
Republic of Korea	346,460	363,593	367,962	371,102	389,267
Taipei,China	416,811	418,980	426,031	434,204	451,500
South Asia					
Afghanistan	6,873	7,311	6,808	7,582	8,159
Bangladesh	15,315	21,508	25,025	30,168	33,407

Bhutan	917	998	958	1,119	1,078
India	304,223	341,638	360,176	369,955	420,758
Maldives	368	615	564	467	586
Nepal	5,614	6,939	8,148	9,737	10,495
Pakistan	6,008	9,098	13,525	18,143	16,145
Sri Lanka	7,495	8,208	7,304	6,019	7,959

Source: ADB (2018)

APPENDIX G: LIST OF ACRONYMS

ADB	Asian Development Bank
AFI	Alliance for Financial Inclusion
AKAM	Aga Khan Agency for Microfinance
AKDN	Aga Khan Development Network
AKFED	Aga Khan Fund for Economic Development
AKRSP	Aga Khan Rural Support Programme
APR	Annual Percentage Rate
ATM	Automated Teller Machine
BB	Branchless Banking
BTCA	Better Than Cash Alliance
CAR	Capital Adequacy Ratio
CDC	Commonwealth Development Corporation
CDD	Customer Due Diligence
CGAP	Consultative Group for Assisting the Poor
CNIC	Computerised National Identity Card
DEE	Developing or emerging economy
DFID	Department for International Development
DTA	Digital Transactional Account
ECE	Emerging country economy
EUR	Euro
FATF	Financial Action Task Force
FDI	Foreign direct investment
FfD	Finance for Development
FMFB	First MicroFinance Bank
FSB	Financial Stability Board

G-20	International forum for the governments and central bank governors from 19 countries and the European Union
G2P	Government to person
G-7	Group of seven largest IMF-described advanced national economies
GDP	Gross domestic product
GLP	Gross loan portfolio
GPF	Global Policy Forum
GSMA	Global System for Mobile Communications/ Groupe Spécial Mobile, Association
HBL	Habib Bank Limited
IFC	International Finance Corporation
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
JPY	Japanese Yen
KfW	German state-owned development bank, originally Kreditanstalt für Wiederaufbau
M&A	Mergers and acquisitions
MCR	Minimum capital requirements
MDG	Millennium Development Goal
MFB	Microfinance bank
MFI	Microfinance institutions
MSEL	Micro and small enterprise lending
NADRA	National Database and Registration Authority
NFIS	National Financial Inclusion Strategy
NPL	Non-performing loan
OECD	Organisation for Economic Co-operation and Development
OTC	Over the counter
OTD	Originate to Distribute model of banking
OTH	Originate to Hold model of banking

PKR	Pakistani Rupee
PMIC	Pakistan Microfinance Investment Company
PMN	Pakistan Microfinance Network
POS	Point of sale
PROPARCO	Private sector focused subsidiary of Agence Française de Développement
PTCL	Pakistan Telecommunication Company Limited
ROA	Return on assets
ROE	Return on equity
RSP	Rural Support Programme
SBP	State Bank of Pakistan
SDG	Sustainable Development Goal
SECP	Securities and Exchange Commission of Pakistan
SME	Small and medium sized enterprise
TMB	Telenor Microfinance Bank
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Commission on Trade and Development
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
USD	United States Dollar