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Distinctive Features of Rural Financial Markets in Asia

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Introduction

Rapid development in Asia has increasingly attracted worldwide attention, and has been especially impressive because it occurred under a variety of political regimes, was accompanied by modest inflation, and its fruits have been relatively equitably spread. Asia's growth stands in marked contrast to economic stagnation or decline in many African countries, the turmoil that dominates Middle-Eastern countries, and the uneven economic performance in Latin American. Creativity, organizational ability, and hard work explain part of Asia's growth, but in addition, a significant part of this exceptional performance has been due to policies that are growth-promoting. Policies that strangle agriculture--food price controls, overvalued exchange rates, and lack of investment in agricultural technology and infrastructure--have been less common in Asia than in other regions. Many policies have benefited agriculture directly or indirectly, and, as a result, rural development also has been impressive in the region. Asian cases can be cited to support the view that most countries must have a healthy agriculture before other parts of the economy grow rapidly.

Because of the impressive overall economic growth, and the differences in the performance of financial markets within the region, important lessons can be learned by studying Asia's rural financial markets (RFMs). Five distinctive features of RFMs in Asia will be highlighted in the following discussion: (1) the substantial amount of research that has been done on problems of RFMs in Asia compared to other regions; (2) the tremendous diversity that is found in Asian RFMs; (3) the large amount of innovation and change that is occurring in these markets; (4) the emphasis placed on rural savings mobilization in some of the most successful RFMs; and (5) the ability of RFMs in Asia to serve large numbers of borrowers and savers of small amounts. After discussing these distinctive features, I draw conclusions about what can be learned from RFMs in Asia. I open with a brief overview of the contributions of financial intermediation to development as a backdrop for my presentation.

Functions of Financial Markets

While poorly understood, the normal functions of unmolested financial markets are simple. Their primary contribution is to intermediate among surplus and deficit firms or households (units). A unit may have resources that exceed its attractive intra-firm investment or consumption opportunities. (In economic jargon, the unit faces low marginal returns on investments or low marginal utility from additional current consumption). Financial intermediation allows the surplus firm or household to earn a higher rate of return on its excesses or to postpone consumption until additional goods would yield more satisfaction. As Gonzalez-Vega has pointed out, when surplus units voluntarily deposit money with a financial intermediary, they are avoiding lower return investment and consumption alternatives within their own unit. They would be forced to use these low-return alternatives if financial intermediation was not available. It is often overlooked that most firms and households are surplus units for at least short periods of time, while other units, even in the poorest society, have surpluses for longer periods (Von Pischke, 1978). This means that a properly functioning financial market can serve a large number of inhabitants by providing extensive and attractive deposit services.

At the same time, financial intermediaries can use the claims-on-resources mobilized from surplus units to issue loans to a smaller number of creditworthy deficit households or firms. Especially in dynamic economies, and even in those that are relatively static, there are large numbers of units that are unable to capitalize on high return investment options or attractive consumption alternatives. (In economic jargon, these units are facing a binding liquidity constraint in their consumption or investment activities). Loans allow deficit units to increase production or consumption and to boost income or current satisfaction. Financial intermediation transfers claims-on-resources from surplus to deficit units, and the spending of these claims, in turn, transfers resources from surplus to deficit units. Both savers and borrowers gain from the process, even after intermediaries withhold a small percentage of the transactions for their service. Compared to barter, or where financial markets are fragmented, society also realizes more efficient resource use and increased output when financial system are well integrated.

A secondary contribution of financial intermediation is allowing units to more efficiently manage uncertainty. This is particularly important for farmers. Because of vagaries of the weather, pests, and governments farmers commonly experience wide swings in prices received, crop yields, and incomes. To survive, they must adjust to these risks by holding surplus crops, livestock, gold, money, or other forms of savings--including deposits--that can be easily liquidated. Unutilized credit reserves with family, friends, and intermediaries are also important ways to manage uncertainty. To be useful in risk management a financial system must offer a large number of people convenient deposit services and also be flexible enough to provide a large number of creditworthy people access to loans.

In addition to the resource allocation and risk management roles that financial intermediaries normally play, governments and donors regularly distort financial markets through loan targeting: to speed development in a given area, to help a certain group of people, or to boost a particular activity (Sacay and others, Fry). Policymakers also manipulate credit programs to compensate individuals for the effects of natural disasters or for other government policies that adversely affect a target group's income.

Numerous governments also attempt to reallocate income and assets to target groups through credit programs and use cheap credit and timid loan recovery to allocate political patronage. Some financial markets are mauled near-to-death by amorous policymakers, politicians, and donors. These actions fragment financial markets and seriously undermine their normal functions. These intrusions also cause savings mobilization to atrophy and overload financial markets with data about targeted loans that crowds out useful information (Adams and others).

Literature on RFMs in Asia

Many publications are available on rural financial markets in Asia (see References) and the volume and quality of this literature is quite distinctive compared to what is found in other Third World regions. For several decades the RFMs in Taiwan, Japan, and South Korea have been extensively described and diagnosed, although relatively few of the resulting publications are in English. Numerous recent publications on RFMs have resulted from efforts by the Asian Productivity Organization (APO), FAO and the Asian and Pacific Regional Agricultural Credit Association (APRACA), several government and donor agencies, and researchers. There are in excess of 1,500 publications that treat RFMs in India alone (Grewal). Even relatively poor countries such as Bangladesh have a rapidly increasing list of publications on rural finance (Esguerra, Bangladesh Bank). The Technical Board on Agricultural Credit (TBAC) has also produced a large number of excellent publications that detail RFM problems and progress in the Philippines. Recent publications by APRACA and the World Bank provide additional fascinating insights into rural credit-savings operations in the Peoples' Republic of China (PRC). The amount of literature on RFMs in Indonesia, Thailand, Nepal, Sri Lanka, and Pakistan is also extensive (ADB).

Most of this literature is descriptive and provides information on numbers and amounts of agricultural loans made by specific lenders or by entire formal RFMs (AID, APO, APRACA). The past several years increasing numbers of publications describing savings deposit activities have also appeared. Overall, this growing literature shows that a number of countries in Asia have recently rapidly expanded both the nominal and real amounts of formal agricultural credit. Rural savings mobilization in Taiwan, the PRC, South Korea, and Japan has also been reported to be impressive. During the 1970s Indonesia, Thailand, and Pakistan were among the leaders in terms of percentage increases in volume of formal agricultural loans. Despite overall rapid increases in the volume of these loans in most Asian, there has likely been a decrease in the real value of formal agricultural loans during the last few years in at least three countries: the Philippines, Sri Lanka, and Vietnam. Publications on India show that, in addition to a substantial increase in the volume of formal agricultural loans, there has been an even more dramatic increase in the number of rural bank branches since the early 1970s. Less dramatic, but important, increases in the numbers of formal financial outlets have recently occurred in the Philippines and Bangladesh (Meyer and Esguerra).

Another sizable part of this literature focuses on the uses made of loans and the demand for credit: measuring the impact of loans at the borrower level, evaluating the overall results of a credit program or policy, or estimating loan demand. Credit impact studies have been particularly prominent in India. Some attention has also been given to these issues in the Philippines, Indonesia, Thailand, and Bangladesh. Much less attention has been given to evaluating the sources of financial services and describing and explaining lender behavior. There has also been little research done on how government financial market policies, overall economic policies, and donor agencies affect RFMs.

A small, but interesting, body of literature has emerged on informal rural finance in Asia. This includes pieces on rotating savings and credit associations in Vietnam, Sri Lanka, South Korea, Indonesia, and India. Additional papers on informal lenders in Malaysia, India, and the Philippines describe the operations of a variety of informal rural lenders. It is interesting to note that informal lenders are given a more positive interpretation in the literature than is heard in lay discussions in the region, especially in Southern Asia.

As an aside, I am impressed by the differences in views about the informal lenders that one finds in Asia. In most of East Asia very little is said about informal lenders and usury. In the Philippines and in West and South Asia policymakers are preoccupied with replacing informal lenders. Because of the lack of careful research on the economics of informal lending and on the transactions cost of borrowing from formal and informal sources, it is impossible to sort myth from reality in emotion-charged discussions about informal lenders. I am uncomfortable with arguments--like those about moneylenders--that stereotype groups of people and present a few horror stories to make a general point. Discussions of informal lenders are laced with anecdotes about interest rates that go as high as 400 percent per year, and evil moneylenders who take away the land of the borrower. There is very little information available that shows the <u>average</u> borrowing cost on informal loans, documents the average opportunity costs of funds handled by informal lenders, and details valuable services that informal lenders provide (exceptions are Singh, Harriss, Bouman, and Barton). Most discussions of informal lenders have ethnical and racial undertones that I find distasteful. Clearly, more objective research is badly needed in Asia on the economics, rather than the ethics, of informal lending.

Several other topics have received recent attention in the literature: loan recovery problems, and deposit mobilization. Some studies show that several Asian countries have chronic loan recovery problems, while lenders in other countries regularly recover a very high proportion of their farm loans. There is no accord on the primary causes of loan default. Some argue that the problems lie mainly with borrowers who are too poor to repay--or that defaulters have had bad luck and are unable to repay. At the same time, others argue that lender shortcomings reduce loan recovery. Still others argue that loans are part of a grants system in which neither borrower, lender, or the government is serious about loan repayment. Research on deposit mobilization provides equally ambivalent results. Some of the literature stresses the paucity of deposit mobilization due to the poverty of rural people, while other studies report large amounts of savings mobilized and emphasize the importance of the incentives and opportunities to save as determinants of savings behavior (Ong and others, Lee and others).

I am encouraged that a large amount of useful research and writing is being done on RFMs in Asia. It reflects the rapidly increasing capacity of Asians to ask and answer important questions about rural finance. It may also result from the presence of a relatively high proportion of successful RFMs that can politically withstand analysis and reporting. In some countries agricultural credit programs perform so poorly that researchers are afraid to report that, "the king is wearing no clothes." The volume of literature on RFMs in Asia is increasing to the point where consideration might be given to additional synthesis publications, multi-country analysis, and some discussion of overall research design to make research results more useful to policymakers.

Diversity

The literature also shows a greater diversity in rural financial markets among countries around the arc from Japan to Pakistan than is found in other regions of the world. Three types of diversity stand out: major differences in the sources of rural financial services, diversity in performance of rural financial markets, and diversity in the policy instruments used in RFMs.

Institutional Sources

A large variety of formal and informal sources of financial services can be found in Asia. In some countries (Indonesia, Bhutan, Burma, Bangladesh, and Nepal) informal loans bulk large in rural areas. In other countries the rapid growth in supply of formal loans has been accompanied by growth in informal financial services in rural areas (Taiwan). In other countries, rapid expansions in formal loans have probably caused a reduction in the volume of informal loans, at least for a while (Philippines and Sri Lanka). My guess is that every possible form of informal finance is found in some part of Asia. The diversity in informal finance reflect the creativity of Asians, the heterogeneity in financial needs that exist, and a reluctance by farmers to use formal loans.

The institutional make up of formal sources of rural finance is also diverse across Asia. Farmers' associations or cooperatives dominate formal rural financial activities in South Korea, Japan, Taiwan, and The PRC. Various types of cooperatives also provide lesser proportions of financial services to rural people in many other countries in the region. My impression, however, is that cooperatives have declined in their importance as sources of financial services in many Asian countries during the past 20 years. Pakistan, India, Sri Lanka, and Bangladesh, for example, have recently stressed agricultural lending through banks. Much of the cooperative credit system in the Philippines has largely disappeared and been replaced by loans from rural private banks and government owned banks. In at least India and Indonesia there are also a large number of semi-formal financial institutions that provide important and extensive financial services in rural areas (Gonzalez-Vega, Nayar). In several countries the private sector plays a large role in providing formal financial services in rural areas (The Philippines and Malaysia), while in other countries most formal credit comes from government owned intermediaries (Vietnam, Burma and Thailand).

<u>Performance</u>

There is a broad range in the performance of RFMs in Asia. Some of the world's strongest rural financial markets are there along with several of the weakest. Also, some of the most sophisticated and comprehensive rural financial systems are located there (Japan, Taiwan, and South Korea) along with the most rudimentary (Burma, Bhutan, and Nepal). It is useful to use five criteria when measuring the overall performance of RFMs: (1) the number and proportion of rural people who have regular access to formal loan and deposit services. (2) The amount and distribution of transactions costs involved in financial intermediation. (3) The extent to which financial intermediaries are self sustaining and generate enough revenues to cover their operating costs, losses due to defaults, and capital erosion due to inflation. (4) Loan recovery performance. And, (5) the extent to which RFMs are able to mobilize funds in rural areas.

Because most research in Asia has measured credit impact or has concentrated on credit projects, only fragmentary information on these five overall criteria is available. It appears, however, that formal RFMs in Taiwan, South Korea, and the PRC provide lending and deposit services to a larger proportion of the rural inhabitants than do formal RFMs in Nepal, Burma, Indonesia, and Pakistan.

Aside from India, Bangladesh, and the Philippines, there has been very little research done on transactions costs in RFMs in Asia. The Indian research, along with more extensive research done elsewhere on this topic, show that lender loan transactions costs often exceed interest charges, especially when small and new borrowers are involved. This research also shows that some lenders ration loans by shifting part of their normal loan transactions costs to non-preferred borrowers. Additional information on transactions costs and their distribution among the participants in financial intermediation would clarify the extent to which financial intermediaries cover their costs and maintain the purchasing power of their loan portfolios. Clearly, more research is needed on transactions costs in Asia.

There is more information available on loan recovery performance than on any of the other criteria. While the usefulness of some of this information is diminished by weak measures of loan recovery or by problems of unreported loan refinancing, clear patterns do emerge from this information. Several countries have chronic loan recovery problems, while other countries have few problems. Those countries that have low crop prices and yields in agriculture tend to have more loan recovery problems than do those countries that have high agricultural yields and attractive crop prices. Also, those countries that distort financial markets in attempts to target loans, to transfer income to certain groups, or who use these markets to allocate political patronage also tend to have serious loan recovery problems.

As will be discussed more in detail later, there is a great deal of difference among countries in the emphasis placed on mobilizing voluntary savings in RFMs. In several countries (Taiwan and Japan) rural savings deposits exceed the volume of formal agricultural loans made in the country. As Kato has pointed out, voluntary rural savings made a sizable contribution to the early financing of the non-agricultural sector in Japan. In other countries relatively few voluntary savings are mobilized in rural areas and most of the funds for agricultural lending come from governments or donors.

Policies

A wide range of government decisions affect RFMs. The diversity and number of these policies are too great to capture here. I'll only comment briefly on two types of policies: those that affect the yields and prices in agriculture, and those aimed at altering lender behavior.

It is clear that RFMs work better when farmers get relatively high yields and prices. It is easier for intermediaries to mobilize savings and find creditworthy borrowers when agriculture is growing vigorously. The strongest RFMs in Asia are in those countries with relatively high agricultural prices, relatively large government investments in rural infrastructure, and with high agricultural yields. Excellent natural endowments of soil, climate, and water reinforce positive government policies. Correct policies, however, appear to be more important than natural endowment: witness the prosperous farmers in South Korea with modest natural resources compared to the low productivity of farmers with far superior resources in the Mekong Delta. The recent dramatic increases in agricultural output in the PRC also demonstrate how sensitive agricultural prosperity is to government policies. It is typical for governments that abuse or ignore agriculture to also distort RFMs in attempts to right other wrongs. These distortions in RFMs are largely ineffective in offsetting the low prices and yields that farmers receive, and the losses from the damage done to the ability of the RFMs to carry out their normal functions are substantial (David).

A variety of policies are used by governments and donors in attempts to alter behavior of financial intermediaries. Policies in India and Bangladesh, for example, are aimed at forcing banks to open more rural branches. A number of countries in the region, including Thailand and the Philippines, require banks to lend a certain percentage of their loans to agriculture or to rural target groups. A number of countries in the region also use preferential rediscount lines in central banks to stimulate targeted lending. Most countries impose some limits on the interest rates that can be charged on formal loans and paid on financial deposits. These range from attempts to charge zero interest rates on loans in Pakistan to very few interest rate restrictions on regular credit lines in the Philippines. Some countries have had relatively inflexible nominal interest rates (India and the PRC), while other countries have been quick to change these nominal rates (Indonesia, South Korea, and Taiwan). Some governments also reward or penalize intermediary behavior through reserve requirement adjustments. In addition, governments and donors channel targeted funds into RFMs as a way of altering lender behavior.

Why this tremendous diversity in the structure, performance, and policies in Asia, and what can be learned from it? In large part the structures of RFMs are diverse in Asia because the cultures and societies are diverse. This does not mean that little can be learned from looking across countries for common patterns. Many people become confused by stressing the differences in the institutions that provide financial services to rural people and searching for some unique institution. Instead, I feel primary emphasis should be placed on the performance of the financial intermediaries, and on how various types of policies affect this performance. This may lead to generalizations that are applicable across a large number of countries.

Innovation and Change

There is more innovation and change going on in RFMs in Asia than can be found in other parts of the Third World. This includes major adjustments such as the deregulation of interest rates in the Philippines, the reorientation of the PRC's RFMs from serving large production units to catering to small units, and the reverse in Vietnam. While these major changes make the headlines, I am even more impressed with the large number of small, often isolated, financial innovations in Asia. It is a veritable bubbling caldron of new ideas whose diversity and complexity can only be touched upon here.

Financial intermediaries create two types of innovations: those that dilute the effect of, or evade the intent of, some regulation or policy that adversely affects the intermediary; and inventions that reduce the costs of existing services or allow the intermediary to provide new services. The first class of innovations contribute little to the well-being of a country, while the cost-reducing innovations are vital for any modern economy. I see far more of the latter type of innovations in Asia. Many credit programs in Asia, for example, have experimented with various forms of group loans in attempts to lower transactions costs and improve loan collection (e.g. Thailand, Nepal and the Philippines). Numerous projects have also used mobile banks as a methods of extending financial services into remote areas (Bangladesh and Pakistan). Banks in several countries have opened pawnshops or issued passbooks with pictures and borrowing records as ways to speed securing small loans (Indonesia, Sri Lanka, and Pakistan).

A number of countries have experimented with loan, crop, and deposit insurance as ways of improving the quality and quantity of rural financial services (India, Japan, and the Philippines).. Several banks have also experimented with use of low-cost rural branches--barefoot bankers--as ways of bringing formal financial services to the poor (Sri Lanka and Pakistan). Other banks have set up small branches in urban central markets to serve the financial needs of agricultural merchants (The Philippines), or extended agricultural loans through informal lenders (Malaysia). I am also impressed with innovations in Bangladesh that have allowed a quasi-bank (Grameen Bank) to extend a large number of loans to low-income women, and with a number of projects in the region that are experimenting with savings mobilization schemes.

AFO and FAO/AFRACA have done a commendable job of assembling and reporting information on some of these innovations and changes. It would be useful if these efforts were continued and expanded. Carefully-done case studies of some of the most prominent types of RFM innovations could be very useful to those who are searching for ways to extend and improve RFMs. Those of us who work in the social sciences might emulate the experience of physical scientists who build seed-banks in international research centers. The "seeds" of the social science are ideas and innovations.

Savings Mobilization

Most of the formal RFMs in low income countries outside Asia rely on governments or donors to supply the majority of the funds lent in rural areas. The main exceptions being the involuntary savings mobilized by cooperatives through share purchases required to receive loans, and several rural banks in Latin America that have recently experimented with savings mobilization (Peru and the Dominican Republic). In contrast, RFMs in several Asian countries mobilize rural voluntary deposits in excess of agricultural lending needs

(Taiwan and South Korea), while RFMs in several other countries mobilize a substantial part of the money lent to agriculture (FRC, Bangladesh and India). Overall, the attitude toward mobilizing voluntary savings in Asia is much more positive than elsewhere in the world.

In part, the superior savings mobilization performance of RFMs in Asia has been due to the previously mentioned growth in rural incomes in many of these countries (Ong and others, and Lee and others). The widespread use of attractive incentives and opportunities to save in financial form, however, have also been important elements in this success story. The fact that inflation has been less severe in most Asian counties than elsewhere in the Third World has allowed many savers to realize positive real rates of interest on their deposits in Asia. Many rural depositors in Latin America, Africa and in the Middle East, in contrast, have received negative real rates of interest. Where inflation has been a problem in Asia (Taiwan, the Philippines, Indonesia, and South Korea), governments have allowed higher nominal rates of interest on deposits. Formal financial intermediaries in Asia also offer their depositors a broader range of savings instruments than is found elsewhere.

My guess is that savings mobilization has also been more prominent in Asia than elsewhere because less emphasis has been placed there on trying to lead various development efforts with massive amounts of cheap credit. Targeted government or donor money is usually fed into RFMs through concessionary rediscount windows in central banks. These facilities provide ultimate lenders with large amounts of loanable funds at interest rates that are lower than intermediaries must pay to mobilize voluntary savings deposits. Concessionary rediscount facilities provide intermediaries powerful incentives to ignore savings mobilization. Policymakers often overlook the fact that a normally functioning RFM will provide services to a much large number of savers than borrowers. When RFMs are drawn into patronal relationships with central banks and governments or donors, through extensive use of rediscount facilities, they are also encouraged to ignore the needs of surplus units in rural areas. This is particularly damaging to low income firms and households, since they often have few alternatives to hold small amounts of surplus, other than in accounts with financial intermediaries.

Using the performance criteria mentioned earlier, my impression is that those RFMs in Asia that perform well are those that also emphasize savings mobilization (Meyer). Not only do RFMs that mobilize large amounts of deposits provide a valuable service to a much larger number of rural people than those RFMs that do not, but they also appear to have a much larger measure of independence from corrosive political pressures. It is much more difficult for politics to intrude into the lending process if few of the funds lent are provided by the government. This, in turn, usually results in fewer loan recovery problems.

Small Borrowers and Savers

The most distinctive feature of RFMs in Asia has been their ability to serve a fairly large numbers of borrowers and savers of small amounts, and to often make a profit doing so. Formal intermediaries in most of the rest of the Third World shy from lending to borrowers of small amounts and seldom attempt to offer attractive deposit services to savers of small amounts. In many cases intermediaries may actively discourage new borrowers and borrowers of small amounts by imposing relatively large loan transactions costs on nonpreferred borrowers. At the same time the intermediary may also discourage depositors of small amounts by setting large minimum-balance requirements, sharply limiting the hours when funds can be withdrawn, and paying low--even negative--real rates of interest on small accounts. Understanding why many RFMs in Asia have succeeded in helping the rural poor, while RFMs in other countries have largely failed in this task, provides a deeper understanding of the worlings of financial markets.

In part, RFMs better serve the rural poor in Asia because borrowers and depositors of small amounts make up a large part of the rural population; poor people are the only-game-in-town in many areas! At the same time, there are a number of countries or regions outside Asia where the rural poor are a large part of the population, yet they have limited access to formal financial services (e.g. Bolivia, Haiti, and Northeast Brazil). Some have argued that these regional differences are largely due to cultural factors: e.g. that Asians will save while others won't, that Asians repay loans while others don't, and that Asians know how to use loans more wisely. While cultural factors affect all behavior, the ability of RFMs in Asia to serve the poor is largely due to the application of proagricultural policies. As mentioned earlier, governments in Asia have generally adopted policies that resulted in relatively high yields, prices, and incomes in agriculture. This, in turn, has created a broadly based demand for financial services in rural areas, and allowed many financial intermediaries to realize economies of scale and scope.

Policies directly aimed at rural financial intermediaries in some Asian countries have also been conducive to the development of dependable flows of credit and deposit services for low income people. Those governments that have stressed balanced development of RFMs, given little emphasis to targeting loans, avoided using RFMs as income transfer mechanisms, limited their use of concessionary rediscount facilities out of central banks, and allowed intermediaries to pay and charge positive real rates of interest generally have RFMs that do the best job of serving the rural poor.

One must be careful here to note the difference between policies that result in <u>transitory credit programs</u> for the rural poor and policies that help develop RFMs that provide <u>sustained financial services</u> to this group. Few people gain much from the opportunity to obtain one cheap loan or to not repay a single loan. Likewise, it is of little benefit to a person to be able to make a single deposit or withdrawal from a savings account. On the other hand, it is of great value to an individual to have a dependable and sustained relationship with a financial intermediary that allows borrowing and depositing, depending on the varying needs of the individual. Transitory credit projects for the rural poor, such as occurred in Sri Lanka in the late 1970s, give politicians short run advantages and make the news headlines, but leave the financial system less able and willing to provide sustained services to this group. Paradoxically, the rural poor are harmed in the long run by cheap credit projects that are ostensibly implemented for their benefit! They are harmed because cheap credit undermines the ability of the financial intermediary to sustain quality financial services, provides the financial intermediaries with the lowest returns on those very activities that are most expensive to carry out (new and small loans), and discourages intermediaries from offering attractive deposit services for the rural poor.

Because RFMs in Asia are less fragmented by repressive policies than is true in most of the rest of the third world, they do a more efficient job of intermediating between surplus and deficit units. This, in turn, results in additional output and income in rural areas over what would occur if financial markets were more repressed. Much of this additional output occurs in small farms and small non-farm rural enterprises, and enhances the additional output and income stimulated by other general economic policies in Asia favorable to agriculture. Thus, integrated financial markets lead to still further strengthening of the process of financial intermediation.

Conclusions and Implications

I come away from a review of the literature on RFMs in Asia with four strong impressions. First, financial markets are vital in supporting development, but are largely ineffective when used to lead development efforts. Product prices and yields are far more important in determining producer behavior than are interest rates and the availability of formal loans; at the same time interest rate regulations and other government regulations strongly and adversely influencing intermediary behavior. I am also convinced that concessionary credit programs, under any political regime, will always inflict more harm than good on the rural poor. Benefits from financial intermediation are always proportional to access to the services they provide. Access, in turn, is highly correlated with political power, income, and assets owned. Thus, income transfers through financial markets always have a regressive effect on income distributions and asset ownership. In addition, income transfer programs usually leave financial intermediaries weaker and less able to carry out their normal and important functions.

Second, I am persuaded that government policies and donor activities are important in explaining success or failure in RFMs. RFMs do not work well if governments abuse agriculture through low farm prices and lack of investments in rural infrastructure. RFMs work even more poorly if governments and donors abuse financial intermediation through concessionary rediscount lines, cheap credit policies, heavy use of loan targeting, and political meddling in the determination of who should receive loans.

Third, I am convinced that RFMs work more efficiently, and certainly more equitably, when both lending and savings mobilization are emphasized. Attractive and readily available savings deposit services will benefit far more of the rural poor than will transitory cheap-credit programs.

Fourth, I am also impressed by the excellent work that APO and FAO/APRACA are doing in improving communication among countries in Asia on issues of rural finance. Because of the diversity and changes that are occurring, international agencies have an excellent opportunity to continue to facilitate and coordinate communications, training, and evaluation in the area of RFMs. Fortunately, these activities need not involve large amounts of money. I suggest that international agencies focus on making contributions in three areas: (1) encourage the collection of literature on RFMs in Asia in at least one central library. This might include periodic issuing of associated bibliographies, and a Newsletter that briefly reports on some of the most interesting literature. APRACA is already doing some of this. (2) Encourage additional case studies on RFM policies and projects that succeeded or failed. Again, APRACA has done some excellent work in this area on loan recovery and savings mobilization. (3) Encourage more communication and coordination on issues of research and evaluation in the area of rural finance. While extensive research is being done in the region on this topic, some of it would be more useful to policymakers if it were diagnostic and less descriptive. A few regional workshops for researchers to share their results and learn about new techniques might also yield substantial benefits.

Asia is a unique laboratory for those of us interested in explaining the performance of rural financial markets. While failures in RFMs are abundant around the world, success stories are scarce and are largely found in Asia. Because the process of financial intermediation is simple and essentially the same, regardless of the culture where conducted, much can be learned from the Asian success stories that is useful for policymakers in other regions who want their RFMs to perform well.

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