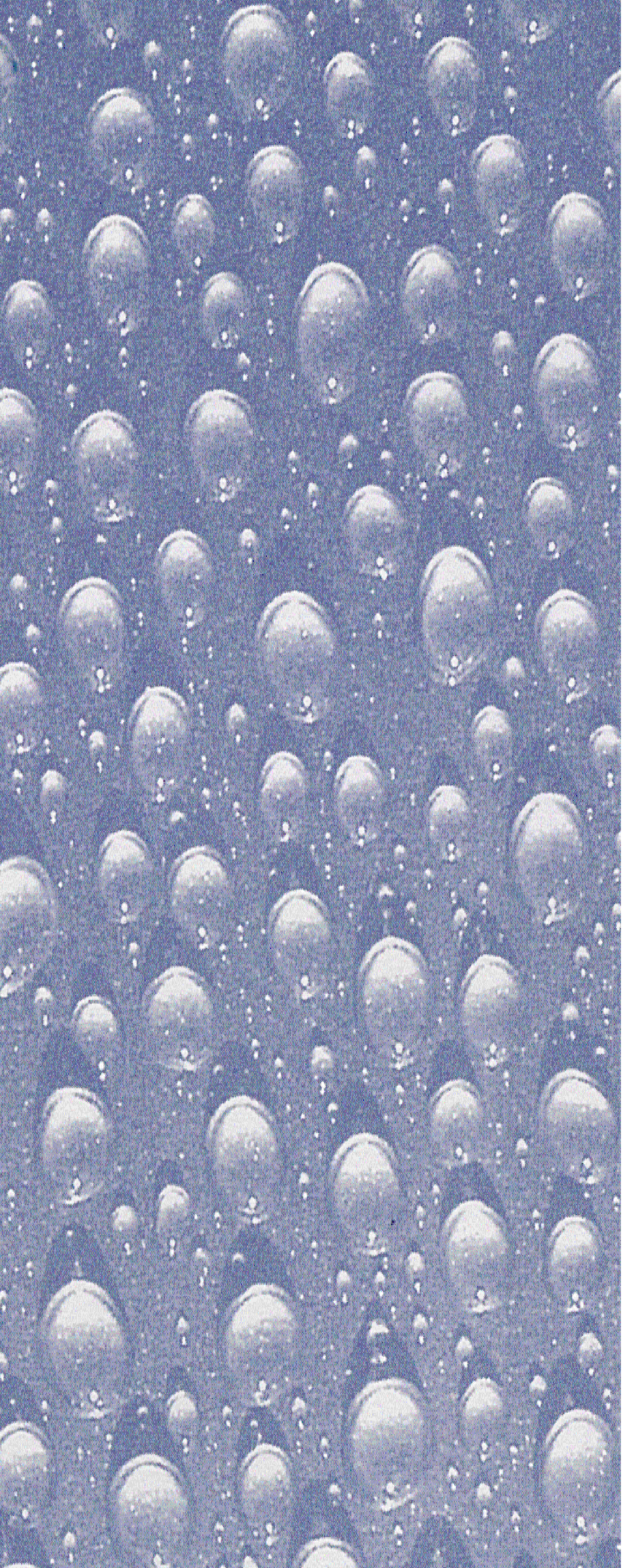

EMPLOYMENT SECTOR
– SOCIAL FINANCE PROGRAM –

Trade Unions and Financial Inclusion

The case of South Africa

Cédric Ludwig

Working Paper N°51

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Table of Contents

Foreword

South Africa is a country where social partners have historically been involved in tripartite consultations on economic and financial policy choices, particularly in the context of the National Economic Development and Labour Council (NEDLAC). The experience of trade union involvement is relevant beyond this particular country inasmuch as it shows the relationship between policy choices in domains, which may seem unrelated to the issues of conventional in social dialogue, and employment, its quality and the protection of wages.

The report by Cédric Ludwig[*] (University of Lausanne) shows that the participation of South African trade unions in the consultations of NEDLAC led them to position themselves on matters of monetary and fiscal policy. Three key issues are addressed: the level of interest rates, access to financial services for the poor and risks of over-indebtedness. The report appraises the actions taken by the unions in these three areas and the changes they were able to obtain from public authorities.

This paper is part of a series of analytical work of the Social Finance Program on the involvement of trade unions in financial sector issues. Given the rapid globalization of financial markets and its effects on employment, this analysis is very much relevant for the ILO and its constituents.

The views expressed here are those of the author and do not necessarily reflect the views of the International Labour Organisation.

Bernd Balkenhol
EMP/SFP

[*] The translation into English was done by Anne-Lucie Lafourcade.

Abbreviations and acronyms

ABSA :	Amalgamated Banks of South Africa
ANC :	African National Congress
AZACTU :	Azanian Confederation of Trade Unions
CGAP :	Consultative Group to Assist the Poor
COSATU :	Congress Of South African Trade Union
CUSA :	Council of Unions of South Africa
DTI :	Department of Trade and Industry
FATF :	Financial Action Task Force
FEDUSA :	Federation of Union of South Africa
FSB :	Financial Services Board
ILO :	International Labour Organization
LSM :	Living Standard Measure
MFRC :	Micro Finance Regulatory Council
MLA :	Micro Lenders Association
NACTU :	National Council of Trade Unions
NALEDI :	National Labour and Economic Development Institute
NCR :	National Credit Regulator
NEDLAC :	National Economic Development and Labour Council
NUM :	National Union of Mineworkers
RDP :	Reconstruction and Development Program
SACP :	South African Communist Party
SAPO :	South African Post Office
SASBO :	South African Society of Banking Officials
SACCO :	Savings And Credit Cooperative
SACCOL :	Savings And Credit Cooperative League
SATLC :	South African Trades and Labour Council
SMME:	Small, Medium, and Micro Enterprises

Introduction

The purpose of this report is to better understand the interaction between social partners – specifically trade unions – and the development of the financial system, which consists of access to financial services, costs related to this access and the ensuing risks of household over-indebtedness. Through this analysis, the report attempts to answer the following questions:

- What role have trade unions played in this process
- What positions do trade unions hold in addressing these problems?
- And what influences and roles do trade unions wish to have in this area?

This report focuses on the case of South Africa for two reasons. Firstly, South African trade unions have a strong presence in consultations on political, economic and social issues even outside of formal collective agreements. Secondly, "financial exclusion" is particularly topical in this country illustrated by a modern, competitive and international market-oriented banking sector and operating side by side with a large informal financial sector catering to the large banked population.

This report is primarily based on a literature review of the banking system development in South Africa. It also took into account, publications issued by the trade unions themselves on this issue, as well as official country statistics. A few interviews with some trade unions provided additional insights on their positions and their involvement in this area.

The report is structured as follows: Parts 1 and 2 provide a general description of *trade unions* and the *development of the financial system* in South Africa. In the third part, the report presents the trade unions positions on access to financial services, on the costs of financial services as well as on over-indebtedness. The last section analyzes the impact of trade unions' actions and theirs consequent results in the development of the South African financial system.

1. The trade union environment in South Africa

1.1 History of trade unionism in South Africa

The origin of trade unionism in South Africa dates back to the 1840s[1]. The first unions were reserved for white South Africans and defended employment policies based on racial discrimination. It was not until the 1920's that trade unions formed by black South Africans were created. In the 1930s, white and black unions joined under the SATLC organization which, unlike other entities, did not apply racial discrimination policies.

1948 saw important changes as the Nationalist Party rose to power and established the apartheid regime, which declared all black unions illegal. Soon followed the repression of attempts to create associations made up of black, Asian or coloured people. This changed only in 1979, when President Pieter Botha recognized the existence of unions open to all races. For these reasons it is obvious that, the labor movement played a crucial role in the political conflict and in the opposition to the discriminatory regime of apartheid. The growth of trade unions open to all led to a

[1] Byrnes R. M. (1996) "A country study: South Africa" Library of Congress

growing number of labor disputes and strikes. Within a few years, the proportion of unionized whites and blacks reversed[2]. In 1985, the Congress of South African Trade Unions (COSATU), composed of the most powerful unions in terms of number of workers was founded[3]. This union had close links with opposition parties such as the African National Congress (ANC) and the South African Communist Party (SACP), representing a credible and powerful anti-apartheid movement; while it did not yet hold the key to political power, this alliance had strong economic leverage owing to the threat of strikes. The ANC-COSATU-SACP alliance contributed to the Nationalist Party's loss in the 1994 elections which meant the end of the apartheid regime. Through the electoral victory, the ANC obtained the majority in the government, and trade unions became the principal organs of civil society, having influence far beyond the workplace.

1.2 The different trade unions

Today, South Africa counts 3.11 million organized workers[4] or 25.3 percent of the country's labor force. They are represented through three main trade union confederations, which alone account for about 89 percent of the unionized population. They are in order of importance: COSATU, FEDUSA and NACTU.

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2 In 1981, whites accounted for 45 percent of all members of trade union organizations. In less than two years (by 1983), this figure dropped to 34 percent, while that of unionized blacks rose to 40 percent.

3 At its inception, COSATU had half a million members in 33 affiliated unions, including the powerful National Union of Mineworkers (NUM)

4 Statistics South Africa, 2005, "Labour force survey"

1.2.1 COSATU (Congress Of South African Trade Union)

Among the three major trade union federations in South Africa, COSATU is by far the most important. Its 21 affiliated unions have each at least 50,000 members. Overall COSATU has 1.8 million workers[5], which is 57 percent of all union members. COSATU plays a predominant role in the trade union movement.

Established in 1985 following talks between unions and workers' federations, COSATU witnessed one of fastest growth of labor movements in the world. Representing a mere half a million workers at its beginning, it rapidly reached its current size of 1.8 million members. Since the fall of the apartheid regime, while the overall trend in workers has unionized workers has declined in South Africa, yet COSATU's continued to grow. In 1995, COSATU integrated the South African Society of Banking Officials (SASBO) composed predominantly of white South Africans. SASBO is the only union of its kind to be affiliated with COSATU, raising some differences of opinion with the manual workers' unions within COSATU. [6]

After having played an important role opposing the apartheid regime, COSATU pledged to continue its efforts for a non-racist, non-sexist and more democratic South Africa fighting working class exploitation. To achieve these goals, COSATU continued to work in the tripartite alliance with the African National Congress (ANC) – the majority party in government since the end of the apartheid regime – and the South African Communist Party (SACP).

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5 http://www.cosatu.org.za/affiliates.html

6 Malcolm, R. (1998) "Chalk and Cheese: SASBO and COSATU". South African Labour Bulletin, 22, 34-48.

In recent years the “Alliance”, and more particularly the role of COSATU in this alliance, has been the subject of heated debates, since the Government is now identical with a former member of the Alliance. With the disappearance of the Apartheid regime, the Alliance lost its common enemy and conceivably, it is rational. Does COSATU not represent a strong rival to the ANC who might be tempted to muzzle or dilute it? Or vice versa?

COSATU's position on this matter is that the “Alliance”, via the government, remains the only vehicle able to bring South Africa the fundamental changes necessary to overcome the legacy of the apartheid system, all the while acknowledging that its transformation was necessary.

1.2.2 FEDUSA (Federation of Union of South Africa)

Unlike COSATU, FEDUSA emerged only in 1997 and therefore was not instrumental in the collapse of the apartheid regime. With its 26 member unions, which together represent 0.55 million workers[7], FEDUSA is the second central trade union organization in the country. It represents 17.6 percent of unionized workers.

FEDUSA is not associated with any political party, thus the union relied on the National Economic Development and Labour Council (NEDLAC) as a means of communication to assert its ideas. Established in 1994, NEDLAC is a platform for social and economic negotiations, composed of government, businesses and trade unions.

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[7] http://www.fedusa.org.za/Fedusa.asp

1.2.3 NACTU (National Council of Trade Unions)

NACTU is the third largest trade union in South Africa in terms of membership. The union is the result of a 1986 merger between CUSA and AZACTU. The council is made up of 17 unions, which together represent 0.4 million workers. Like FEDUSA, NACTU refuses to be affiliated with a political party in order to retain its independence.

2. The South African financial system

The financial system of South Africa is a two-tier system. On the one hand, South Africa is home to highly developed, competitive financial sectors, one of the ten largest financial markets in the world.[8] Its high quality financial products are tailored to privileged elite and large companies. At the same time, nearly half of the adult population has no access to basic financial services.[9]

2.1 History of the financial system in South Africa

2.1.1 During apartheid

The entire economic system set up by the apartheid regime displayed enormous inefficiencies and the financial sector was no exception. Closely linked and controlled by the government, the financial sector followed much the same discriminatory policies. Indeed, the apartheid regime erected multiple barriers against blacks such as the ban on land ownership which deprived them of guarantees and access to credit.

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8 https://www.cia.gov/cia/publications/factbook/geos/sf.html

9 FinScope 2003, a FinMark Trust initiatives, http://www.finscope.co.za

The Usury Act passed in 1968 did not facilitate the access to credit for low income populations. Concerned with consumer protection, this law introduced an interest rate cap based on the key interest rates to ensure borrowers were not subjected to exorbitant financial charges. The Act led to a reduction in the supply of financial services to the poor, because financial institutions could not cover their costs with small loans. By linking the ceiling rate to the key interest rate, the Usury Act had an unintended discriminatory effect on the supply of micro-loans. Thus, as a result, the poor were left with only informal financial solutions.

From the mid-1980s, the financial sector began to undergo reforms. The consolidation of the system into a few major banking groups occurred, along with measures of supervision and regulation. Because of an existing and well developed legal and accounting system, these measures contributed to the sector's greater efficiency and modernity. Nevertheless, these actions were again geared towards the protection and benefits of wealthier segments of society, overlooking better access to financial services for poorer populations.

2.1.2 After apartheid

In 1994, the financial landscape of South Africa underwent major changes and rapid transformation. After years of isolation and economic sanctions, the country opened itself to the world. During this process of integration into the global economy, the banking sector was at the forefront of transformation. This new integration started with the liberalization of capital mobility. This measure modified the economic climate in two ways:

- First, it injected foreign capital into the national economy, thanks to the lower return on capital (machinery, infrastructure) in developed countries. South Africa was able to invest more than their domestic savings and therefore boosted growth.
- The second impact of this liberalization was the appearance of new banks in the market. Between 1994 and 2000, 15 foreign banks opened branches in South Africa and another 60 operated through representative offices[10]. These mergers, acquisitions or creations of banks boosted and improved the efficiency of the banking sector through increased competition and the provision of technology and expertise.

In general, capital mobility leads to a higher efficiency of the system, but also brings greater vulnerability. In the case of South Africa, no post-liberalization financial crisis occurred and the country is still experiencing growth and efficiency in its economy.

Despite these accomplishments in the economic and financial environment in South Africa, half the country's population still lives below the poverty line (2000)[11] and the unemployment rate is over 25 percent (2006). The country is segmented between rich and poor and the divide between blacks and whites has not disappeared. Hence, the first phase of financial liberalization did not bring the expected result of better access to formal financial services for small businesses and the poor. In 1994, 60 percent of the adult population did not own a bank account or were excluded from any formal financial service. The challenge for the new government was not only to

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[10] Mboweni, T.T., 2000, "South Africa's integration into the global economy". South African Reserve Bank. Octobre

[11] World Bank, 2000, Findings No 134. February

modernize its financial system, but also to broaden it by opening the access to financial services with the introduction of appropriate infrastructure and technology.

One such measure was adopted in 1992: it was to reduce the extent of the 1968 Usury Act, eliminating the interest rate ceiling for all small loans. The effects were immediate. Micro-lending grew rapidly to meet the excess demand and thus integrate sections of the population who are at the margins of the financial system. This proliferation of micro-lending institutions led an increasing number of money lenders charging very high interest rates and apply abusive recovery methods. To overcome these problems, the government – through its Ministry of Trade and Industry – published the 1999 Exemption Notice which involved the reintroduction of an interest rate cap on a declining loan basis. At the same time, the Micro Finance Regulatory Council (MFRC) was created to regulate the system and provide better protection to microcredit consumers. Loans below R10,000 are exempt from the rate ceiling under certain conditions, one of which is the registration of the credit provider with the MFRC.

Meanwhile, in 1994, the recently elected ANC party adopted the Reconstruction and Development Program (RDP) as part of a policy to transform a divided South Africa into a more equitable society. This program contained a specific section on reforms of the financial system[12]. In particular, the main issues to be tackled by the RDP were: improved access to financial services, the reduction of racial, geographic or gender discrimination in accessing these services, and better cooperation and involvement of the private sector in the development of the financial sector. The

[12] Reconstruction and Development Program (RDP): Section 4.7 Reform of the Financial System.

role of community banks of various types, as well as of the central bank are also referred to in view of better integration of representatives of trade unions and civil society.

By October 2000, as the situation of poverty, inequality and discrimination had not improved, especially for blacks, the government started to become exacerbated by the reluctance of banks to provide credit to poor communities. Known as the Red October Campaign, workers, trade unions, small businesses and other actors launched an operation to bring banks to the negotiating table at the 2002 summit organized by the NEDLAC whose aim was to reform the financial sector. The discussions led to the creation of the *Charter of the Financial Sector* in 2003. This charter is a commitment on the part of all financial actors (banks, insurance companies and brokers) to work cooperatively with the government, workers and civil society organizations to achieve specific goals concerning the access to financial services for individuals with low income[13], the employment of blacks and the support of black entrepreneurship. The Charter also formulates the gradual introduction of various insurance products[14].

In the event financial institutions failed to achieve these goals, their contracts and agreements with the government would be re-assessed. This charter is a vast undertaking with very ambitious targets aiming to be a giant step in the development of the South African financial sector and calling on all financial services companies to abide by these goals. For instance, one of the targets stipulates that by 2008 80 percent of the low-income population should own a current and savings account with a formal

[13] Defined as households earning less than US$ 340 per month)

[14] Marié K. (2006) "Policy initiatives to expand financial outreach in South Africa". Development Bank of Southern Africa. Prepared for *Access to Finance: Building Inclusive Financial Systems*, 31 May 2006. World Bank.

institution, an ambitions goal considering that in 2003 only 30 percent of this population had access to these services.

Financial Sector Charter - Access Targets

PERCENTAGE OF LSM 1 – 5 WITH EFFECTIVE ACCESS TO:	2008 ACCESS TARGET	2003 ACTUAL USAGE
Transaction Accounts	80%	32%
Bank Savings Products	80%	28%
Life Insurance Products	23%	5%
Collective Investment Savings Products	1% plus 250 000	Negligible
Short Tern Risk Insurance Products	6%	Negligible

Source: Napier, M. 2005

At the end of 2004, in order to meet the objectives established in the charter, banks united to create a common brand of bank accounts for the poor, known as Mzansi accounts. These are cheap and somewhat informal accounts which can be opened simply by presenting an identity card. These accounts are limited to deposits, withdrawals, transfers and credit card payment with an average balance of US$ 50. Mzansi accounts allow to link financially excluded people to formal banks. This measure turned out to be a true success: two years later, six percent of the South African population held a Mzansi account – a 250 percent growth rate since 2005. In addition, Mzansi accounts successfully reach their targeted population as 60 percent of users are first-time bank account owners and that blacks and coloured are the largest proportion of account users.[15]

[15] Finscope surveys, 2006. FinMark Trust. December

Another measure was the 2005 launch of MTN banking and WIZZIT Bank. Both are virtual banks which have agreements with mobile phone operators and major banks in South Africa. WIZZIT and MTN use mobile telephone technology and its network to provide financial services, such as savings and money transfer, without the use of ATMs or bank branches. This low cost service is geographically accessible throughout the country, allowing poor and rural populations to take a first step in the formal financial system. Such a system is even cheaper than Mzansi accounts and provide greater accessibility since of those excluded from the South African banking system 31 percent have a mobile phone and an additional 17 percent have access to it. Cell phone banking shows much potential and growth: 50,000 have become customers of the WIZZIT Bank since its inception in 2005. [16]

2.2 Measures and implications for the development of the financial sector

The development of the financial system, including access to financial services, is an essential factor in the development of a country (Schumpeter, 1911). At the household level, access to financial services enables the family to invest, save, insure their property or borrow. At the small business level, access to financial service increases productivity, promotes entrepreneurship and thus contributes to job creation. These positive outcomes create a favorable economic environment and improve economic growth.

[16] Ivatury, G., Pickens, M.,(2006) “Mobile Phone Banking and Low-Income Costumers”. CGAP.

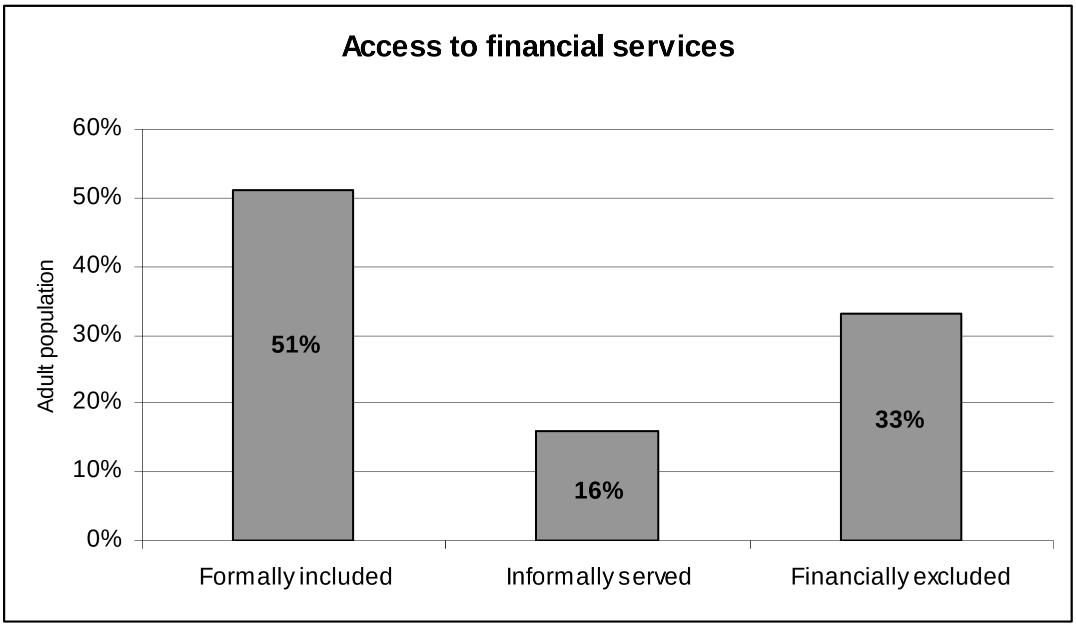
Among the factors limiting access to such formal services is the physical distance of bank branches from clients' residence, particularly in rural areas. Another cause for financial exclusion is the high transaction and management costs of these services, both at the bank and client level.

Also, the level of formality and the legal framework can be limiting factors in access to financial services. With high illiteracy rates among poor populations in developing countries, the paperwork and necessary supporting documents required in financial transactions are significant barriers. An adapted legal framework and a well-developed land law can help provide evidence on the factual ownership of assets pledged as guarantees set out in a loan application.

The level of accessibility to financial services is described by three concepts - "inclusive", "excluded" and "informally included":

- Formally included: individual using banks, financial institutions or any product supplied in a legal framework.
- Informally served: individual with no access to formal services and thus using financial tools which are not controlled by a legal framework.
- Financially excluded: individual who does not use any financial service of any kind.[17]

[17] Survey Highlights, FinScope South Africa 2006.



3. Positions of South African trade unions on specific issues of the financial system

Financial inclusion, especially among low-income populations, is an issue that engages South African trade unions: it represents part of the fight against poverty, improve working conditions and increase social security. Financial inclusion is mainly influenced by three factors: interest rates, access to financial services (including cost and the level of formality) and the risk of over-indebtedness.

3.1 Position of trade unions on interest rates

3.1.1 Central Bank, monetary policy and key interest rates

The interest rate[18] is a key determinant for the performance of the overall economy. Regulating money supply, it has a bearing on investment, savings, aggregate demand for goods and services, the demand for money, the exchange rate, etc. Due to its importance for investment and job creation it is perfectly understandable that unions take a position on the matter and make it known.

Some of the trade unions' and primarily COSATU's main criticisms are addressed directly to the Central Bank and its monetary policy.

First of all, critics focus on the Central Bank's objectives to protect the value of the Rand relative to foreign currencies, thus to maintain a high exchange rate. To achieve this, the Central Bank pursues a tight monetary policy, resulting in high interest rates. As the interest rate is higher than the average yield on assets applied in other countries, capital from abroad is attracted to South Africa.

Trade unions strongly oppose this objective because of negative distributional effects, slowing down development. They support their position with four arguments:

- First, a high exchange rate leads towards diminishing growth and job loss. The country becomes less competitive in international markets, creating a negative current account via falling exports and rising imports.

[18] In the section 3.1.1, the term "interest rate" is understood as the "key interest rate", i.e. the rate determined by the Central Bank at which commercial banks can be refinanced.

The overall effect is a slowdown in production, impacting negatively on the employment situation in the country.

- The second argument is that high interest rates cause negative impacts on growth and employment. According to several studies on South African businesses[19], the level of interest rates has a predominant influence on businesses' level of investment. If the financial cost is high, it is less attractive to borrow to invest towards increased production.

- The third argument relates to the influx of foreign capital of a speculative nature, mostly invested in the short term, making the country's financial system more volatile and vulnerable to global financial crises.

- The last argument stresses the benefit of a lowered interest rate for the state by reducing its debt servicing. Indeed, since more than 20 percent of the state budget is used to pay interest on public sector debt, a decline in interest rates would ease the amount payable, and allow the state to use more of its resources for social development and employment promotion.

These arguments put forward by the trade unions against a restrictive monetary policy are synonymous with the improvement of workers' welfare and employment. Trade unions consider that the Central Bank's current main objective, i.e. the protection of currency on the foreign exchange market, be aligned to a job-creating

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[19] Study conducted in 1998 by the National Labour and Economic Development Institute (NALEDI) as well as a 1998 report done by the Department of Trade and Industry (DTI) entitled "Financial Access for SMMEs".

policy. This amounts to a shift in the country's monetary policy from a restrictive policy to an expansionist policy. An increased money supply   The creation of currency would result in lower interest rates, thus encouraging investment, resulting in increased production and employment.

The recommendations put forward by trade unions are considered inapplicable by the Central Bank. According to the latter, an expansionist monetary policy would entail major risks of inflation combined with a cut in savings, which are at low levels already. Therefore, a reduction in interest rates certainly would increase the level of investment, but simultaneously decrease the level of deposits. Thus, with savings already at a low level, the increased demand for borrowings could not be satisfied and result in financial repression, causing credit rationing.

Trade unions reject the direct relationship between expansionary monetary policy and inflation, arguing that inflation is not just a monetary phenomenon, but also heavily depends on structural factors in the real economy such as unemployment. [20]

The trade unions also question whether, which consider that a reduction in interest rates would really to financial repression. According to the unions, the correlation between interest rates and the level of savings is empirically difficult to demonstrate. Also the majority of savings in South Africa is held by companies which are more influenced by the economy's growth than by interest rate levels. Thirdly, trade unions maintain that savings are not a simple constraining factor for investment, but that on the contrary growth in investment positively influences the level of savings.

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[20] COSATU (1998) "Budget hearings on the Role of the South African Reserve Bank and Monetary Policy". March

Generally trade unions question the self-determining policy followed by the Central Bank and request a greater alignment of monetary policy to other macroeconomic policies. The unions base their arguments on the South African constitution, which stipulates that the Central Bank may operate in an independent manner but must remain in regular consultation with the Minister of Finance. COSATU interprets this as the Central Bank having sufficient autonomy to manage its financial instruments to reach its set objectives, without having the power to define these goals. According to the constitution, the main objectives of the Central Bank are the protection of the national currency on the foreign exchange market, as well as the creation and preservation of sustainable economic growth. Trade unions want to see the Central Bank attach greater importance to the second goal. To help the Central Bank better consider other economic and social players in the country, COSATU suggested establishing a dialogue with the Central Bank through the "Alliance."

By attempting to reduce the independence of the Central Bank, trade unions wish also to restrict those practices that tend to protect businesses and financial interests at the expense of South African workers. [21]

3.1.2 Interest rates on loans and deposits

Profits which banks derive from interest income are considered excessive by trade unions in South Africa. All condemn the exorbitant effective rates paid to banks and question the high lending rates applied especially on microloans.

[21] The union COSATU used two examples to illustrate these practices of the Central Bank. The first example is the scandal at the Amalgamated Banks of South Africa (ABSA.) The second example relates to the rapid depreciation of the Rand in 1995. The Central Bank had then made every effort to preserve the value of the Rand at its initial value to protect investors and the banking sector from considerable losses.

The Usury Act introduced in 1968 was intended to set an interest rate ceiling on all loans, with the intention of protecting the consumer. In 1994, the Act was revised by removing all interest ceilings on microloans (below R6,000). In 1999, this partial liberalization of borrowing rates was put into question. Debates rose between those seeking the reinstatement of the Usury Act and those advocating an increase in the threshold amount. These debates led to the adoption of an Exemption Notice, a compromise reinstating a ceiling rate for all loans but allowing an exemption for amounts up R10,000 under certain conditions[22].

The debate also took place among trade unions. While all agreed that the banks were taking too big a margin, their opinions differed on how to resolve this issue. COSATU pushed for the reintroduction of Usury Act and against the interest cap removal. In COSATU's view better access to credit was just a pretext for exorbitant to charge interest rates. This put workers, low-income individuals and small businesses at the mercy of unscrupulous lenders. In addition, COSATU rejected the argument that by allowing high interest rates banks would reach high-risk customers (i.e. the poor or low-income people) and thus improve the access to financial services among the population.

By contrast, there were also voices in the trade union movement that called for a liberal approach in interest rate setting, SASBO (the Finance Union[23]), notably claimed the best solution was borrowing rate determined with flexibility by banks themselves:

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[22] The main conditions are:
- the lending institution should be registered with the MFRC
- the amount of the loan should not exceed R10,000
- the loan repayment period should not exceed 36 months.

[23] "The Impact of Interest Rate Ceilings on Microfinance", CGAP, May 2004.

- Microcredit, being a high-risk business with prohibitive administrative costs due to poor economies of scale, requires larger margins; hence banks need to apply higher interest rates than in other markets segments and to manage larger volumes to cover their expenses. If financial service providers fail to fully cover their costs – a common case in an interest-cap system – then they abandon the market in which would only make losses. In other words, the supply of financial services to low income workers would decrease or stagnate. These push clients into the arms of informal financial service providers which are even costlier.

- Interest rate ceilings also would lead to less transparency on the part of financial institutions, which attempt to conceal information to clients to circumvent interest caps and thus cover their costs. This imperfect information given to consumers hinders price comparison; this reduces the effectiveness of competition and makes the banking industry less efficient.

- It is precisely on the effect of competition that is based the third argument against interest ceilings. Caps will not stimulate cost-reducing innovations among micro-lenders. It is only by allowing competition between banks or microfinance institutions that interest rates will eventually come down.

COSATU, on the other hand, brings into question the level of competition in the South African banking sector. The union considers competition between banks to be low, reflected in the very wide banking margin and the differential between the commercial banks' interest rate on loans and the Central Bank's key interest rate. In a competitive market, this difference would be slim. COSATU strongly opposes uncapped interest rates and, citing a report commissioned by the Micro Lenders Association (MLA)[24], advocates generally let market forces influence and set the appropriate interest rate; however, it would be unrealistic to expect such a model to work in an oligopolistic environment such as that of the South African banking sector. Self-regulation by market forces would operate only in an environment with perfect competition. Under the banking system in South Africa, lack of competition should be compensated by regulation and compulsory registration of financial institutions. Registration would allow for better monitoring and transparency of financial services, promote competition and prevent abuse.

These two conflicting views expressed within the trade union movement were taken into account as part of the Exemption Act of 1999. On the one hand, the law imposes an interest rate cap on those institution that do not reach the transparency and standards required by the MFRC; on the other hand it offers a system of autonomous interest rate setting for institutions meeting these conditions and accepting compliance with MRFC rules.

Still, despite the regulation of interest rates on loans by the Usury Act and the Exemption Notice, the costs of financial services remain extremely high in South Africa.

[24] Report written by Professor P.G. Du Plessis, University of Stellenbosch

3.2 Trade unions' position on access to financial services

COSATU points out the overall failure of commercial banks to improve financial inclusion of low income people since the 1994 market liberalization. Poor South Africans are still deprived of basic services such as savings, credit insurance and transfers. COSATU suggest this failure to live up to banks' "social mission" is not due to their lack of competence, but a lack of willingness to tackle this exclusion, which is reflected by the absence of effective competition amongst banks in microfinance. Lack of competition affects prices as well as the setting up of points of services: very few new branches opened in South African cities of black majority although there existed a real market potential, while a number of new entities opened tax havens such as the Cayman Islands, Panama and so on.

According to COSATU this ultimately pushed low-income workers into the arms of informal financial service providers and promotes loan shark practices.

To develop an all-inclusive financial system, for consideration by NEDLAC, COSATU suggests the government intervene on several levels[25]:

- First, COSATU advises the government to reform the financial system through more efficient regulation. Regulations should take place both in the commercial banking sector and in the microfinance sector – objectives which were achieved in 1999 with the creation of the MFRC and improved in 2005 with NCR. These new regulations should focus on charges in the broad sense, i.e. debt interest rates, money transfer costs,

[25] Recommendations made in "Bank Charges, Microlending and the Usury Act" by COSATU in March 1999 and then presented at the *Portfolio Committee on Trade and Industry*.

account management costs, repayment costs and withdrawal costs, as well as on loan appraisal criteria to reduce discriminatory behaviour.

- Increased transparency of banks through compulsory and clear information given to clients on the costs and requirements of a loan should also be subject to law. These consumer protection measures should allow clients to access more information in order to compare products from different banks and would thus encourage the effects of competition.

- On the subject of competition, COSATU is critical of the recent trends stated in the 1990s in mergers and acquisitions in the financial sector leading to market oligopoly. Bank concentration reduces the number of jobs, decreases competition and consequently lowers financial inclusion of low income populations. COSATU puts forward the implementation of a legal framework which imposes standards for banks' social responsibility and limits abusive business practices, such as banks' refusal to use ID cards as loan collateral for clients.

Beyond the legal reform of the financial system, COSATU recommends that the state be directly involved in the provision of financial services to the poor. Public services such as the post office could be restructured as a financial service provider, via *Postbank* or *Telebank*, to reach the historically disadvantaged and rural populations who are difficult to serve.[26]

[26] "COSATU Paliamentary Submission on the Postal Services Bill [B97 -98]" (1998) Presented at the *Portfolio Committee on Communication.* September

Since the end of apartheid trade unions have been fighting for better access to financial services for the poorest workers by encouraging formal financial institutions to address the problem. Gradually observing that these institutions were failing in this task, unions encouraged the development of financial cooperatives. These types of institution hold values and principles of solidarity, non-racism, non-sexism and democracy, and apply a fair redistribution of income. For trade unions, cooperatives have become an increasingly attractive tool to end the exclusion of workers from formal financial institutions and build a stronger working class.

By 2002, COSATU had moved to a strategy of development and promotion of cooperative banks (savings and credit cooperatives) as well as insurance cooperatives. At the 2002 Financial Sector Summit and the 2003 Growth and Development Summit, COSATU called for the promotion of cooperatives along the lines of the ILO Recommendation on the Promotion of Cooperatives (2003). COSATU requested NEDLAC to reach an agreement to reduce legislative barriers impeding the development of cooperative banks. COSATU's aim is to work directly with these cooperatives and promote them amongst their member unions and their consumers.

Trade unions submitted other positions and agreements on basic financial access to all. Trade unions' involvement in the "Red October Campaign" (2000) for social integration and equality brought the debate with banks up to NEDLAC. Taking integral part in the negotiations, unions won the assurance that banks would commit to the Charter of the Financial Sector (2003). Thanks to this cooperation between the private sector, the government and trade unions, access to financial services improved

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COSATU (1999) "Bank, Charges, Microlending and the Usury Act". March 1999. Presented at the *Parliamentary Hearing* gradually. The creation of Mzansi[27] accounts in 2004 following these common resolutions gave a tremendous momentum for low income populations to hold a bank account.

3.3 Trade unions' position on overindebtedness

By 1999, trade unions, especially COSATU, positioned themselves more clearly on client overindebtedness, condemning the excessive discretion left to banks in charging loans and current accounts. Unions denounced the high interest rates in conjunction with misinformation given to clients, which made them gradually dependent on the financial institution to the point of over-indebtedness.

In 2002, the issue was brought before NEDLAC during which different actors drew attention to the alarmingly high levels of over-indebtedness among poor workers. Actions were to be taken to cope with problems arising from the microcredit crisis.

COSATU believed that microloans alone are not effective in lifting workers out of poverty and that to the contrary they could lead to even greater hardship. COSATU wanted to change course and move away from more commercially oriented unions, such as FEDUSA. Wanting to emphasize its original union character COSATU made a number of proposals to protect households from microcredit overindebtedness:

[27] Bank account provided by commercial banks. These accounts are tailored to serve low income people with basic financial services at preferential prices. Banks do not try to make any profit on these accounts. In order to cover their costs, they rely on the association of eight major banks to make economies of scale and minimize expenses.

- Firstly, COSATU encouraged its affiliated unions to no longer excessively promote microcredit (in the sense of "private lender"), and even asked them to discourage it.

- To compensate for the existing microcredit system which it considered deficient COSATU recommended turning to savings cooperatives. Promoting a system based on community and mutual solidarity would reduce the risk of excessive debt and lead to better results in pulling workers out of poverty.

- Furthermore, COSATU requested an agreement within NEDLAC that would review the legislation to better promote the development of cooperative banks and credit cooperatives.

- To complement the above measures, COSATU wished to provide capacity building and training to workers to educate them on problems of indebtedness so as to prevent these individuals from hardship.

By 2005, the problem of over-indebtedness in South Africa had taken impressive proportions. More than two million people found themselves blacklisted by credit bureaus, depriving them once again of accessing credit, or 10 million if the surrounding families of those listed are taken into account. This debt trap which affects low-income workers was denounced by the Alliance[28] of which COSATU is part. The Alliance felt it unfair that low-income workers pay an average 175 percent interest rate per year on their loan, while high-income workers pay only 26 percent. They believed it

[28] The Alliance is a partnership between two political parties – the African National Congress (ANC) and the South African Communist Party (SACP) – and the central trade union COSATU.

was inevitable that low income workers should fall into a spiral of debt and eventually be blacklisted. The Alliance formed a protest march in 2005 demanding general amnesty for workers and poor people blacklisted by credit bureaus and published a subsequent report[29]. Today, the amnesty has not yet come into effect and the number of blacklisted people has increased to 5.5 million[30].

4. Actions proposed by unions: impact and outcomes

Having examined the viewpoints of trade unions on key issues of financial sector development in South Africa, this report will (a) discuss the actions they took to promote their interests and (b) analyze the impact and effective results of their actions on financial services development in the country.

4.1 Methods used by trade unions

Trade unions have a variety of different means of action to intervene and influence political and social life[31].

- The first level of intervention includes communications on specific issues through publications and presentations. These standpoints may be limited to the simple denunciation of a problem or claims and recommendations for action among stakeholders. Depending on the trade union's implication solving the problem, such incentives may pave the

29 Report from COSATU presented at *Potrfolio Committee for Trade and Industry* on "National Credit Bill B18-2005". August 2005.

30 SACP (2007) "Declaration and Press Release of the SACP Western Cape 5th Provincial Congress". March

31 Classification inspired by: Gloukoviezoff, G., 1996, "Surendettement des particuliers en France: Quels rôles pour les syndicats?". Social Finance Program Working Paper n°43. ILO

way for dialogue or negotiations with the various parties linked to the problem.

- The second degree of involvement is concrete actions aimed at widely disseminating information on a problem. This can be done in the form of circulated documents or training. The target audience are usually workers, consumers or institutions representing or supporting them.

- The final level of intervention is to openly deal with the problem on the ground. This suggests a direct involvement of trade unions in solving the problem, in the form of service provision.

In South Africa, the involvement of trade unions in the development of the financial system took place at the first level, while second level actions are rare and those of third level virtually nonexistent.

The majority of the actions undertaken by unions are carried out by COSATU, through which affiliated unions make their voices heard Sectoral unions undertake few individual actions themselves.

Among the means of action used by COSATU for the development of the financial system, some policy positions were distributed through general documents adopted by the internal organs[32], for example:

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[32] The highest decision-making body in COSATU is the National Congress, which meets every three years. The second decision-making group in the union is the Central Committee.

- Action program adopted by COSATU during the *Inaugural Central Committee*. June 1998.

- Declarations and Resolutions of the *COSATU Special Congress*. August 1999.

- Resolutions of *COSATU 7th National Congress*. September 2000.

- Resolutions of *COSATU 8th National Congress*. September 2003.

Furthermore, some of these positions became the subject of special reports submitted to the parliament and its committees, commissions or departments. These reports have different tones ranging from merely encouraging and advising to protesting and critical. Amongst the reports submitted to the government on the development of the financial system are notably:

- Memo submitted to the *Parliamentary Finance Committee* on "Budget hearings on the Role of the South African Reserve Bank and Monetary Policy". March 1998.

- Recommendations presented to the *Portfolio Committee on Communication* on "The Postal Services Bill". September 1998

- Report submitted to *Parliamentary Hearing* on "Bank, Charges, Microlending and the Usury Act". March 1999.

- Proposal of COSATU submitted to *Department of Trade and Industry* on the report "Examination of Costs and Interest Rates in the Small Loans Sector". September 2000.

- Report presented to *Portfolio Committee on Housing* on "Home Loan and Mortgage Disclosure Bill". September 2000.

- Recommendations of COSATU submitted to *Department of Trade and Industry* on "The Consumer Affair Committee's report and proposed regulations of Credit Bureaus". July 2003.

- Report of COSATU presented to *Portfolio Committee for Trade and Industry* on the "National Credit Bill B18-2005". August 2005.

Beyond communicating its positions, COSATU took part in negotiations and sought to create a real dialogue with influential players involved in the issues. COSATU used its alliance with political parties for better support from the government. COSATU, FEDUSA, NACTU also used the negotiation platform NEDLAC, which is a unique instrument to interact and cooperate government (including the Central Bank as non-voting member), the private sector and individual communities (Financial Sector Coalition and SACCOL).[33]

COSATU also took actions with more practical implications such as those related to the promotion of cooperative banks. This translated into partnerships for training cooperative employees as well as regular information campaigns for

33 http://www.nedlac.org.za

cooperative clients.[34] COSATU and FEDUSA are also involved in financial training initiatives run by the Financial Services Board (FSB)[35]. Both take on the role of program initiator and information dissemination vehicle. [36]

4.2 Impacts and results

One of the initial impacts of trade unions on the financial system took place after the democratization of 1994, when COSATU guided the ruling party (ANC) into adopting the Reduction and Development Program (RDP). This program aimed at tackling the economic and social legacies of apartheid, and thus also dealt with financial sector reforms[37]. It provided a framework for COSATU's objectives in the years to come. The demand to limit banks' charges and to implement a regulatory and monitoring body for the financial sector was strengthened in the years that followed, especially during the submission of "Bank Charges, Microlending and the Usury Act" to Parliament in 1999. COSATU's pressure resulted shortly thereafter into the "Usury Act: Exemption Notice" and the creation of the Micro Finance Regulatory Council (MFRC) [38]. In 2006, this supervisory body was incorporated into a new institution, the National Credit Regulator (NCR), with the aim of extending credit consumer protection (transactions, mortgages, credit cards, microcredit, overindebtedness) and improving

34 Resolutions of *COSATU 8th National Congress.* September 2003.
35 http://www.fsb.co.za: "The Financial Services Board is a unique independent institution established by statute to oversee the South African Non-Banking Financial Services Industry in the public interest."
36 Piprek,G., Dlamini, P., Coetzee, G.,2004, "Financial Literacy Scoping Study & Strategy Project". FinMark Trust. March
37 http://www.williambowles.info/articles/rdp.doc. *RDP:* section 2.5.15 et 4.7
38 See section 3.1.2: *Interest rates on loans and deposits*

information and transparency on loans. These recommendations were supported by COSATU in 2003[39] and more intently again in 2005. [40]

Another significant impact of trade union actions (mainly by COSATU) was the adoption of the "Financial Sector Charter." It stemmed from the 2000 "Red October Campaign" against banking industry abuse, which was launched by the SACP and strongly supported by COSATU. From this followed COSATU's proposals to reform part of the banking system. [41] This initiative was adopted in 2001 by the government under the" Home Loans and Mortgage Disclosure Act." This pressure on the banking sector led to more discussions and negotiations within NEDLAC leading to the "Financial Sector Summit" in COSATU's 7th National Congress' in 2000 whose charter was ratified by banks. The latter committed to numerous initiatives in achieving the requirements stipulated in the charter, such as the creation of "Mzansi" accounts or the mobile phone transactions by MTN banking and WIZZIT Bank . [42]

Other demands articulated by COSATU for improvements in the financial system have also been met, such as the effective competition between banks, of which COSATU denounced significant deficit resulting in high costs of financial services. Starting in 1996 in its report *Bank Charges, Microlending and the Usury Act* and again in 1999 COSATU suggested that the government carry out a survey of competitiveness

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[39] Recommendations of COSATU submitted to *Department of Trade and Industry* on "The Consumer Affair Committee's report and proposed regulations of Credit Bureaus". July 2003.

[40] COSATU report presented to *Potrfolio Committee for Trade and Industry* on "National Credit Bill B18-2005". August 2005.

[41] Report presented to *Portfolio Committee on Housing* on "Home Loan and Mortgage Disclosure Bill". September 2000.

[42] See section 2.2.2, p.12-14

in the banking industry. The survey was done by the Central Bank which published the results in 2004. [43]

The impact on the development of cooperative bank has been visible in recent years, since COSATU considers them as a solution to the problems of financial exclusion and excessive costs (resolutions of the 8th National Congress (2003)). COSATU strengthened its support for SACCOL (Savings and Credit Cooperative League) by commenting on the Draft Co-operatives Bill (2004) and during the 3th COSATU Central Committee (2005). The trade union's commitment to financial cooperatives was supported by the government which legislated the Co-operatives Act (2005) and the Co-operative Banks Bill.

The Reserve Bank of South Africa, often criticized by trade unions as pursuing a too restrictive approach to protect the value of the currency, did not remain in responsive to COSATU arguments in its report "Budget Hearings on the Role of the South African Reserve Bank and Monetary Policy" in 1998, and later in the 1999 *Bank Charges, Microlending and the Usury Act*. This was against the backdrop of a depreciating RAND from 4.5 R/$ in 1997 up to 11.5 R/$ in 2001. [44] After this peak, the Central Bank decreased its exchange rate to a stable value of 6.5 R/$[45], despite COSATU's critical observations expressed during its 8th National Congress.

Regarding access to financial services as a whole, there has been a steady growth since the end of apartheid. In 1996, there were only 7.8 million people using

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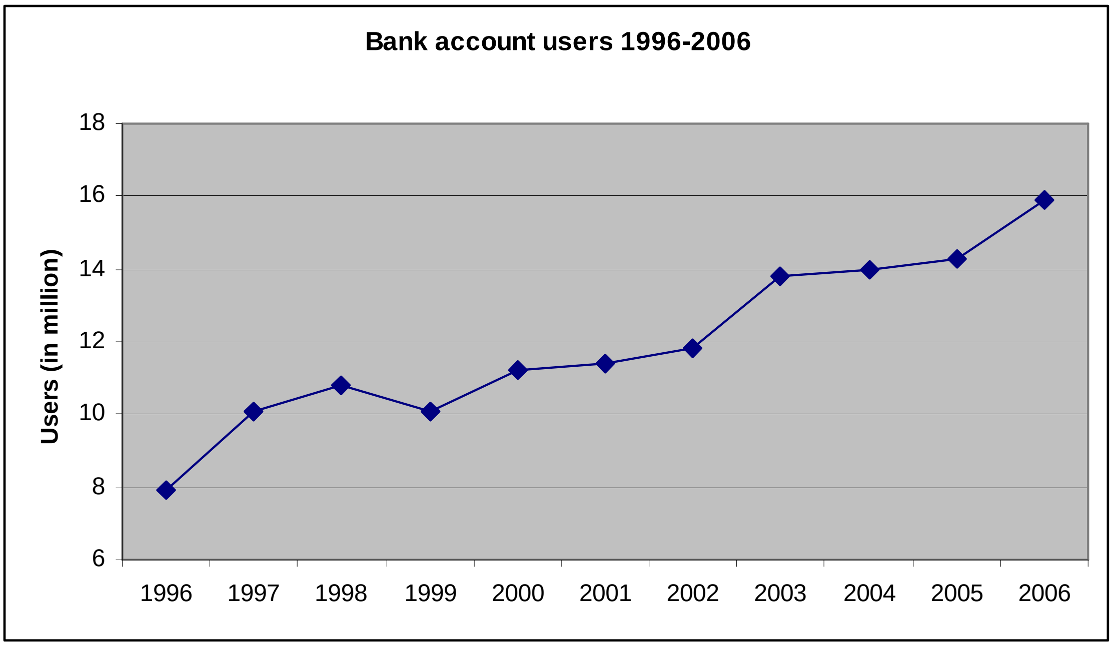
[43] Falkena, H., 2004, "Competition in South African Banking". Task group report for the National Treasury and the South African Reserve Bank. April.

[44] South African Reserve Bank.

[45] http://www.cia.gov/cia/publications/factbook/geos/sf.html

bank accounts, representing less than 30 percent of the adult population, whereas nowadays (2006) 15.9 million individuals (51% of the adult population) have access to financial services. [46]



This strong growth since 2002 has several causes: on the one hand voluntarist policies laid down in the Financial Sector Charter which pushed commercial banks to cater more to the un-banked: the Mzansi accounts reached 2 percent of the adult population in 2005 and 6 percent in 2006[47]. On the other hand, changes in technology promoted by FinMark Trust[48] and a better penetration of mobile banking technology. Thirdly, SACCOS (Savings and Credit Cooperatives) are emerging as a promising vehicle to increase access to financial services and are strongly supported by the South African trade unions, are experiencing impressive annual growth. Although the number

46 ACNielsen. FutureFact Marketscape Survey 2002. Johannesburg Finscope surveys, 2003-2005-2006. FinMark Trust

47 Finscope surveys, 2005-2006. FinMark Trust

48 Gibson, A., 2006, “Developing financial services markets for the poor: FinMark in South Africa”. The Springfield center. May

of clients reached by such institutions remains marginal (12,500 people in 2006), the loan and deposit volumes managed by SACCOS has grown since 2003 and is encouraging (30% per year). [49]

Likewise, low income people (LSM 1-5) [50], which are the primary target of trade unions, are most affected by lack of access to basic financial services. However, thanks to the work accomplished in recent years, the trend is improving. There were only 22 percent of LSM 1-5 holding a bank account in 2001[51]; in 2005, the ratio rose to 32 percent.[52]

For over half the population surveyed the greatest obstacle in accessing financial services is being unemployed and having very little regular income. [53] Since one of the main characteristics of the LSM 1-5 category is high unemployment rate[54], job creation would be a solution to the problem of access to banking services. Accordingly, trade unions' claims for employment creation are indirectly claims or solutions to the integration of people into the formal banking system.

5. Conclusions

This report found that the development of the financial system of South Africa as well as access to these services have significantly improved during the past decade, and that trade unions crdit for their contributions and active participation.

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49 http://www.saccol.org.za: SACCO Annual Statistics

50 The "Living Standard Measure" is a population segmenting tool, categorizing households into 10 groups according to their standard of living, in order to measure household wealth.

51 ACNielsen. FutureFact Marketscape Survey 2002. Johannesburg

52 Finscope surveys, 2005. FinMark Trust

53 Survey highlights, FinScope South Africa 2006

54 79 percent of people without access to financial services, the majority of whom belong to the category LSM 1-5, are unemployed. *ACNielsen. FutureFact Marketscape Survey 2002. Johannesburg*

Having successfully and effectively used NEDLAC as a platform to defend their interests, trade unions have managed to raise awareness in the banking industry on the importance of an efficient financial system that is accessible to all. The key initiative "Financial Sector Charter" of 2003 boosted the development of the financial system. Soon followed a growing number of projects – Mzansi accounts, WIZZIT, SACCOs – operationalising this development concretely and bringing significantly results in terms of financial inclusion.

South Africa is a special case. There is a very sophisticated financial sector side by side with an underdeveloped and informal system. Another specificity is NEDLAC as a tool for dialogue and negotiation between trade unions, employers, government and civil society. In the absence of such a platform it is doubtful whether trade union action had been as successful. Hence, any replication of the South African model would require a platform for consultations, such as economic and social councils.

Trade union interventions remain crucial for the future development of the financial system in South Africa. Without doubt trade unions have had positive effects on shaping the entire country's financial system making it more equitable and accessible to a greater number of people.

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