Comments on
"If the banks are doing so well, why can't I get a loan? Regulatory constraints to financial inclusion in Indonesia"

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Summarizing very crudely, Rosengard and Prasetyantoko (2011) present the following points:

- There is a large unmet demand for MSME loans.
- Regulations of BI reduced the bank supplies of MSME loans.

One must use a caution in agreeing with the first point, because it is difficult to show empirically the existence of an "unmet demand", or an economy is "underbanked", or some sector is under a "credit crunch". To show this, one must derive the level of loan supplies that "should have been" realized in the absense of issues raised by authors, which can only be done with a concrete set of assumptions and modeling whose validity is not necessarily agreed by everyone. In addition, data in Table 5 does not make a strong case for the first point. Total loan supplies by banks increased by 45% in real terms from 710 trillion rupiah (2005) to 1800 trillion rupiah (2010, or 1029.39 trillion in 2005 rupiah) and MSM credits keep relatively stable shares (see Figure 1). It may therefore not worth an effort to show the existence of unmet demand. Rather, as a reader, I would take it as a realistic assumption.[*1]

On the other hand, authors illustrate the second point persuasively. Their reference to key regulatory changes is an important contribution to a relatively unstudied area of regulations and microfinance development. However, some of the claims need to be backed with empirical evidence, whenever data permits. While contractionary monetary policies may have "contributed to the crowding out of MSME access to credit" (p.5), why would it explain the fewer MSME lending relative to non-MSME lending? With VMFIs and GMFIs converted to BPRs, can authors back their claim with evidence that it resulted in a "decrease in microenterprise lending" (p.11)? When banks comply with minimum LDR requirement, why would banks "increase credit without lending more to MSMEs" (p.12)? [*2]

Recognizing the impacts of these (re)regulations, authors recommend to intensify bank competition by removing entry barriers, and to diversify financial institution type by encouraging (re)establishment of nonbank lenders. Authors warn against BI and government's further involvement on directed credits, and argue for smarter regulations.

As authors point, BI regulations that may have reduced bank loans to MSMEs were placed out of concerns over financial stability. In a sense, a slow growth of bank loans were the costs incurred for financial stability. However, regulators do not seem to make the tradeoff explicit, despite they have

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All comments reflect my own views and not of affiliating organizations. All the errors are mine.

[*1] At the micro level, identification of a credit constraint is difficult without a use of panel data (Bigsten et al., 2003) or randomization (Banerjee et al., 2010), and not all "potential borrowers" are in need for credit. One should also note that distinction between productive and consumptive loans can become more *ad hoc* for micro and small enterprises because funds are fungible.

[*2] Interested readers may refer to the earlier version of my comments (Ito, 2011).

chosen a certain combination of the tradeoff. It may therefore be instructive to frame regulations in loan supply - stability tradeoff, and balance deregulation recommendations against financial stability concerns. For example, regulators may want to know competition impacts on bank asset soundness, or may worry about potentially slacker monitoring/oversight by local governments of nonbank lenders which can compromise the prudential regulation framework. If authors show the stability implications of their recommendations, and/or derive complementary measures to keep financial system stable, it will allow all stakeholders to share the policy options more clearly.

References

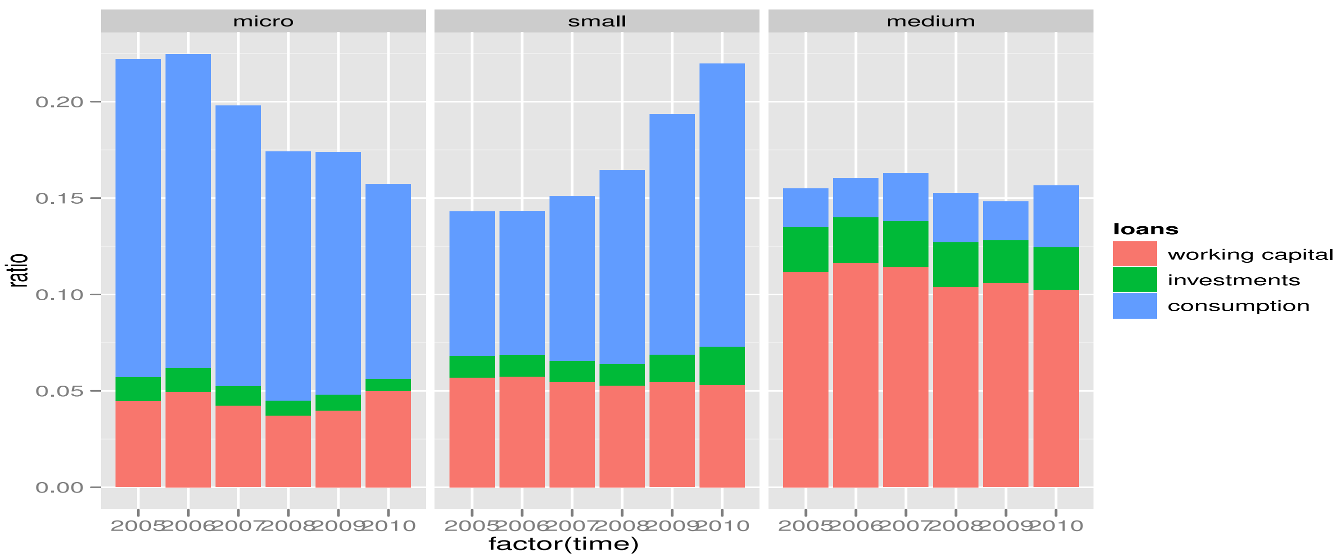
Banerjee, Abhijit, Esther Duflo, Rachel Glennerster, and Cynthia Kinnan, "The miracle of microfinance? Evidence from a randomized evaluation," *Working Paper*, 2010.

Bigsten, Arne, Paul Collier, Stefan Dercon, Marcel Fafchamps, Bernard Gauthier, Jan Willem Gunning, Abena Oduro, Remco Oostendorp, Cathy Patillo, Mans Soderbom, Francis John Teal, and Albert Zeufack, "Credit Constraints in Manufacturing Enterprises in Africa," *Journal of African Economies*, 2003, *12* (1), 104–125.

Ito, Seiro, "Comments on Rosengard and Prasetyantoko (2011), first version," *Proceedings of Twelfth Asian Economic Policy Review Conference*, 2011. available at `http://www.ide.go.jp/English/Researchers/ito_seiro_en.html`.

Rosengard, J. K. and A. Prasetyantoko, "If the banks are doing so well, why can't I get a loan? Regulatory constraints to financial inclusion in Indonesia," *Asian Economic Policy Review*, 2011, *6* (2).

FIGURE 1: RATIOS OF MSM CREDITS IN TOTAL BANK LOANS, 2005 - 2010



Source: Table 5 of Rosengard and Prasetyantoko (2011).

Note: Classification by loan size, not borrower size.