

NATIONAL STRATEGY *for* MICROFINANCE

The Problem

One of the major socio-economic problems besetting the Philippine economy is the pervasiveness of poverty. Based on the 1994 Family Income and Expenditure Survey (FIES), there are about 4.7 million poor Filipino households. This translates into a poverty incidence of 35.7 percent, with rural poverty incidence (53.7 percent) significantly higher than urban poverty incidence (28.8 percent).

A good number of poor households below the poverty line are engaged in microenterprises. A perennial problem of these microentrepreneurs is the lack of access to financial services. The latest NEDA survey indicated that less than 12 percent of low-income rural families borrowed since 1991. Of these, nearly two-fifths sourced their loans from relatives and friends while another one-third borrowed from private moneylenders and cooperatives. Only a small percentage relied on banks (government or private) for loans.

Because of information problems, inadequate collateral and the high transaction costs associated with processing small loans, private banks rarely, if at all, lend to microentrepreneurs. The borrowers themselves do not approach the banks due to burdensome requirements, high interest rates, lack of collateral and lack of information on possible sources of financing. As a result, the microenterprise credit market consists mostly of credit cooperatives, credit unions, some rural banks, and a handful of credit NGOs. Government agencies implementing various loan programs are also present.

In general, these microfinance institutions (MFIs) have limited outreach. Among MFIs, Cooperative banks and credit cooperatives have the widest estimated outreach. Recent field observations show that these two groups, together with rural banks and credit unions, have the network necessary to provide microfinance on a national scale.

Attempts to Address the Problem

One of the government's strategies to alleviate poverty is to provide poor households engaged in microenterprise activities access to production and consumption-smoothing credit. Hence, in the 1970s and 1980s, the government created a number of directed credit and guarantee programs, especially in the agriculture sector. Some common features of these programs are:

- a) funding came from government budgetary appropriations, the Central Bank's rediscounting window and foreign borrowings;
- b) funds were provided through specialized banks (e.g., rural banks, development banks, and government financial institutions) for direct availment by the targeted borrowers; and
- c) funds were given at highly concessional rates.

These programs provided massive credit subsidies to bring down the cost of borrowing for the targeted sectors. But instead of benefiting small borrowers, the

eventual credit rationing and high loan defaults enabled large-scale borrowers to capture the subsidies. Moreover, due to the availability of cheap loan funds, deposit mobilization was neglected leading ultimately to the weakening of rural banks.

These experiences, coupled with the fiscal costs of the programs, led the government to pursue financial market reforms in the mid-1980s. These reforms included:

- a) adoption of market-oriented interest rates;
- b) termination of subsidized rediscounting programs at the Central Bank;
- c) consolidation of existing agricultural credit programs into the Comprehensive Agricultural Loan Fund (CALF) which served as a loan guarantee fund for agricultural loans granted by banks; and
- d) termination of direct lending by government agencies implementing agricultural credit programs.

While these reforms were introduced and implemented in the agricultural sector, there was a proliferation of programs in other sectors. Subsidized credit programs for small and medium-scale enterprises as well as for livelihood projects multiplied. Many of these were implemented through government agencies. At the same time, laws were passed mandating loan quotas for targeted sectors. These include the Argi-Agra Law (PD717), the Magna Carta for Small and Medium Enterprises (RA6977) and the Magna Carta for Small Farmers.

With the Ramos Administration came, increased emphasis on private sector participation. The 1991-1998 Medium-term Philippine Development Plan articulated the government's twin strategies of global competitiveness and people empowerment. In the financial sector, these meant the implementation of market-based financial and credit policies and the increased participation of the private sector in the marketplace. The government will only play an enabling and strategic role through the provision of an appropriate policy environment for markets to function efficiently. Government financial institutions, on the other hand, will be re-oriented toward supplementing the private sector's initiative in providing financial services to microentrepreneurs.

Even as the government pursued reforms to enhance market efficiency, it adopted the Social Reform Agenda (SRA) to address the poverty problem in the country. Among others, the SRA's action agenda include providing the poor access to economic opportunities within a liberalized and deregulated market. This has encouraged a number of financial (rural banks, cooperatives, etc.) and non-financial (credit NGOs) institutions to engage in innovative lending techniques to address the credit demand of microentrepreneurs. However, despite the avowed market orientation of financial and credit policies, there is still pressure from various interest groups for government to provide credit subsidies and create a more directed credit programs.

The result is a basic inconsistency between microfinance policies and credit programs intended to support those policies. The policy-program inconsistency creates a flawed incentive structure that encourages various players in the microfinance market to pressure government for more credit subsidies, loan quotas and other distortionary measures. The end product is a microfinance market that appears more constrained in providing the target clientele access to financial services.

The Vision and the Objective

The vision is to have a **viable and sustainable private (micro) financial market**. This will be achieved in a liberalized and market-oriented economy where the private sector plays the major role and the government provides enabling environment (through the appropriate policy and institutional (framework) for the efficient functioning of markets.

Specifically, the objective is to provide low income households and microenterprises access to financial services. The target group consists of those who live below the poverty line and are engaged in some form of business or economic activity, but who do not have access to or are inadequately served by the formal financial sector.

Realizing the Objective

The Policy Framework

In accordance with the vision, private microfinance institutions (MFIs) will provide microentrepreneurs financing services on a viable and sustainable basis while the government will provide a competitive and liberalized market environment. The government's microfinance policy is built on the following principles:

- greater role of the private sector (MFIs) in the provision of financial services;
- an enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
- market-oriented financial and credit policies, e.g. market-oriented interest rates on loan and deposits;
- non-participation of government line agencies in the implementation of credit and guarantee programs.

Hence, the government will avoid costly, unsustainable and distorting credit subsidies that, in the past, failed to reach their intended beneficiaries, led to the weakening of the rural banking system, and saddled the government with huge fiscal burden. Instead, emphasis will be placed on financial intermediation to ensure the efficient channeling of surplus financial resources to viable projects. A conscious effort will, therefore, be made to promote savings mobilization by MFIs.

Moreover, credit policy will be distinguished from welfare policy. Welfare assistance will be provided to address the needs of the really poor households through the appropriate government departments. Welfare will not be extended through financial institutions, whether government or private.

Credit demand of microentrepreneurs, on the other hand, will be met through a variety of innovative financial products provided by the private microfinance market. The government will assist in capacity building of MFIs and in providing the appropriate supervisory and regulatory framework to make markets more efficient and institutions, more viable.

The Institutional Framework

Given the policy framework, the respective roles of the various players in microfinance, based on their relative comparative advantages, are:

- **Microfinance Institutions (MFIs):** to engage in sound, sustainable and viable microfinance intermediation;
- **National Government through the National Credit Council (NCC):** to provide a market-oriented financial and credit policy environment which will promote efficient financial markets and will help MFIs broaden and deepen their microfinance services;
- **People's Credit and Finance Corporation (PCFC):** to provide wholesale funds and technical assistance to MFIs; to support the development of innovative financial products and services for microentrepreneurs;
- **Commercial and other private banks:** to provide wholesale funds and financial services to MFIs;
- **Government Financial Institutions (GFIs):** to provide wholesale funds (including those sourced from foreign borrowings) to MFIs that do not have access to funds from private commercial banks;
- **NGOs:** to facilitate linkages between microentrepreneurs on one end and MFIs and community organizations on the other end; to assist in capacity building of target clientele;
- **Donors:** to provide assistance for social preparation activities that will broaden and deepen microfinance services (e.g., development of microfinance products, training in microfinance technologies, and upgrading of performance standards, operating systems and procedures); to assist in areas that have been identified through a consultative process between the NCC and MFIs.

The Strategies to be Pursued

The following strategies, aimed at providing microentrepreneurs greater access to microfinance services, will be pursued:

- a) Provision of a financial and credit policy environment that is conducive to the effective and efficient functioning of the financial market. This will be done by:
 - Implementing a market-oriented interest rate policy
 - Pursuing financial policy reforms with the end view of removing existing distortions in the financial market (e.g., loan quotas, earmarking of public funds for direct lending, etc.)
 - rationalizing all existing government credit and guarantee programs towards encouraging greater private sector participation in a market-oriented setting
- b) Establishment of a market-oriented financial and credit policy environment which is conducive to the broadening (development of new product lines and services, implementation of new microfinance technologies and practices) and deepening (increased microfinance intermediation) of microfinance services. This will be accomplished by:

- Providing the appropriate supervisory and regulatory framework for MFIs that will enable them to develop new and innovative product lines and services to cater to the demands of poor households and microenterprises;
 - Establishing standards of performance and business practices to guide the operations of MFIs;
 - Promoting broad-based savings mobilization, linking banking technology with microfinance technologies;
 - Providing information and training to MFIs on best practices in microfinance.
- c) Implementation of a capacity-building program for MFIs. This will be implemented by:
- Providing technical assistance to MFIs, stressing (1) local deposit mobilization, (2) financial and project management, (3) use of information technology, (4) development and establishment of microfinance technology, innovative product/service lines.
 - Documenting, packaging and disseminating practitioner-based training and technical services to MFIs, through the PCFC.
 - Encouraging research and academic institutions to conduct studies and convene policy level discussions that will promote awareness of microfinance as a sound commercial investment. These institutions will identify best practices in microfinance, develop and install training and microfinance technology packages.

For further information, please contact

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