

Governments Give Credit

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New study examines the increasing trend of government funding of retail microfinance

["Government plans to set up two funds on Microfinance"](#) (October 10, 2007, *The Indian Express*)

["Govt has P90B for microfinancing"](#) (May 9, 2008, *Inquirer.net*, Philippines)

["Govt to Set Up Microfinance Bank"](#) (July 14, 2008, *This Day*, Nigeria)

Recent headlines such as these show an increasing trend of developing country government commitments to fund retail microfinance. The amount of government funding announced is often staggering, with [Nigeria's declaration](#) to fund \$400 million for microfinance topping the list.

Government announcements are generally made in high-level speeches or press releases, which means details on how the money will be channeled, over what time period, or even whether these funds are actually disbursed are difficult to find. Information on the performance or impact of these government-sponsored programs is rarely disclosed.

To investigate the trend of governments directly funding retail microfinance, CGAP conducted a small study in early 2008. This study focused on government-sponsored initiatives destined for retail microfinance funded through national budget resources, rather than development aid from donor countries. The review combined desk research with interviews of 18 regional experts from donor agencies, networks and independent consultants. Self-reported data on government-funded programs around the globe was also collected.

The results confirmed that governments are a substantial source of funding in microfinance, possibly at levels equal to or much higher than other sources such as developed country donors.

Where are governments funding microfinance?

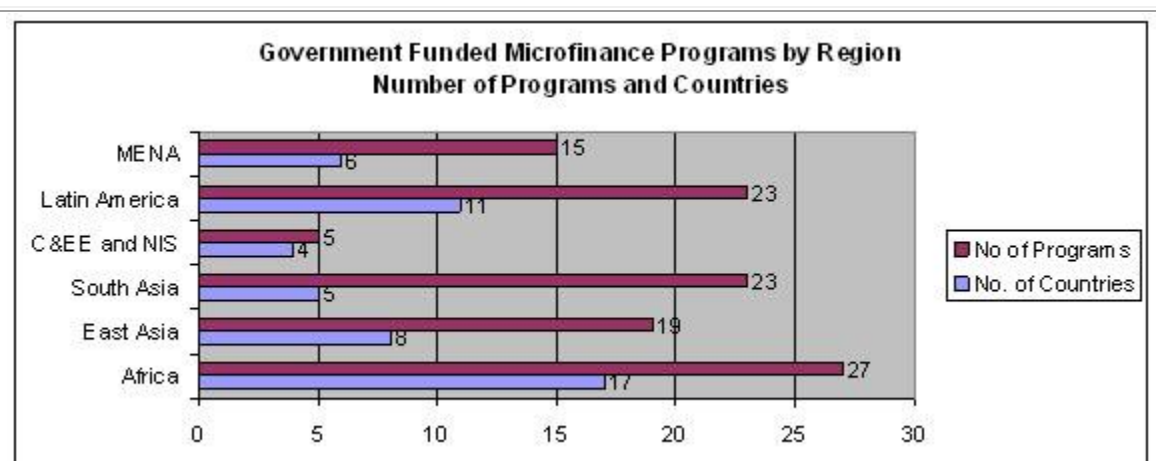
The easy answer is everywhere. CGAP's research revealed that there are at least 51 developing country governments that directly fund retail microfinance. Within each of these countries, most governments fund several programs. In some countries, funding passes through local or regional government agencies, so capturing national-level information is difficult. One of the most intriguing players is Mexico, with over 30 different government programs. Many Asian countries fund an equally impressive number of programs. There are at least five government programs in China, six in Nepal and Bangladesh, seven in India and eight in Pakistan.

Technology Fund and Financial Inclusion Fund Launched in India

At the 2007-08 budget presentation of Indian Finance Minister P. Chidambaram, it was announced that the government would set up a Financial Inclusion Fund (FIF) and a Financial Inclusion Technology Fund (FITF), with a total outlay of approximately \$100 million for the next five years.

The FIF will focus on economic improvement for the poor, while the FITF will invest in information technology to promote financial inclusion.

Read the [press announcement](#).



Source: CGAP Research on Government Funding of Retail Microfinance, 2008

Why do governments fund microfinance?

Most governments fund microfinance for a specific social or policy objective. CGAP research revealed that the most commonly cited objective was to combat poverty. Rural development was the second most frequently cited objective. Regional differences emerged around this issue. While poverty reduction was most frequently cited Africa and South Asia, employment creation was predominantly cited in the Middle East and North Africa (MENA) region. In East Asia and Central & Eastern Europe (C&EE) and the Newly Independent States (NIS), rural development was cited as the primary objective. Diverse motivations were cited in Latin America, with poverty reduction at the top. Local elections, the global debate on poverty and the Year of Microcredit also triggered programs in various regions.

What channels do government funds use to reach poor people?

State Banks: The “tried and true” state bank is still a favorite channel for government microfinance funding. The CGAP study identified 26 state banks, both old and new, that channel microfinance funds. Older institutions included Bank Pertanian in Malaysia, which started in the 1960s and the Agriculture Development Bank of Nepal created in 1975. Newer institutions included Yemen’s upcoming Bank Al Amal and the solidarity banks in Mali, Senegal, and Guinea Bissau, which have opened since 2004.

Apexes: Local wholesale facilities (apexes) were the next most common channel for government microfinance funding. The study found at least 19 apexes receiving direct government funding for microfinance. The main purpose of these facilities is to channel funding in the form of debt or grants to microfinance institutions. Apex institutions, which are sponsored by both national governments and international funders, usually serve as both technical assistance providers and wholesalers of capital to MFIs.

Independent Programs: The newest type of government microfinance program is the stand-alone model, independently administered through one or more government agencies. The study revealed at least 16 programs, mainly in Africa, C&EE and NIS, and Latin America built on this model. Examples include:

- *Ecuador:* The “5-5-5 Plan” launched in 2007 offers low-income people loans of US\$50 for 5 years at 5% interest.
- *Kenya:* The “Youth Enterprise Fund” helps youth groups set up enterprises through small loans at concessionary rates and without collateral. The Fund was announced in early 2008 and is administered by the Ministry of Women and Youth Affairs.
- *Tanzania:* The “Mwananchi Empowerment Fund” was announced in January 2008 allocating nearly US\$350 million with the aim to increase the number of small enterprises by offering guarantees to small enterprises seeking commercial loans from bank.

What does this all mean?

Government funding for retail microfinance is not new in Latin America and Asia. But in Africa and C&EE and NIS, donors have traditionally been the main microfinance funders with almost no direct government funding, except for Ethiopia. These regions are now witnessing a significant rise in government support for retail microfinance.

The recent publicity around government funding in microfinance has re-opened the debate on the appropriate role of government in providing financial services, especially credit.

Optimists in the microfinance community point out that governments are taking responsibility to address poverty, unemployment and inequity. These issues were largely neglected over the past several decades when the general focus was on economic growth. There is also hope that governments will design programs building on lessons learned from other initiatives and players.

Banca de las Oportunidades in Colombia

[Banca de las Oportunidades](#) (BDO) is a network of financial institutions set up by the Colombian Government in 2006 to help reduce poverty, promote social equality and stimulate economic development through access to financial services. The banks specifically target those not reached by the financial system, offering services such as payments and transfers, credit, savings and insurance.

The network also aims to instigate regulatory changes, coordinate financial education initiatives and provide incentives such as technical assistance for financial institutions to tap the unmet demand for banking services.

BDO has pushed for the use of retail agents, an important element in branchless banking. BDO estimates that, as a result of the regulatory changes in the works, banking services will be available in each of Colombia's 1,119 municipalities by 2010. (Today, 132 municipalities lack bank presence.)

A prime example is India's new government-sponsored technology funds which try to apply new ideas based on commercial technology funds in the UK. In Colombia, Banca de las Oportunidades has expanded the state bank's traditional focus on credit to offer insurance, small balance savings accounts, remittance and payment services.

Overall, however, the microfinance community is still largely skeptical about government funding for retail microfinance. The big concern is that governments will only repeat the mistakes they made in the past and not apply the good practices and standards established by the microfinance industry. Will governments impose financial discipline given the multitude of political pressures and goals? The impact of government programs has clearly been negative in some countries. For example, the Uzbek government imposed high tax charges forcing the closure of several strong NGO-MFIs and then opened its own MicroCredit Bank after hearing that several donors were considering the creation of a start-up microfinance bank.

Conclusion

It is too soon to know the effect of government funding for retail microfinance, in part because government declarations are not the same as actual loan disbursements. So the question remains -- will government funding to retail increase outreach, or will it detract from the move to commercialization and sustainable access which has been a hallmark of the modern microfinance industry? This first scan of government funding for retail microfinance certainly calls for taking a better pulse of the phenomenon.

CGAP welcomes your [thoughts](#) on this question and any further information you may have. This article was initially posted as a [Microfinance Gateway Highlight](#) on 31 Jul 2008.

Related Documents

- [Governments Give Credit \(French\)](#)
- [Financial Inclusion 2015: Four Scenarios for the Future of Microfinance \(Focus Note No. 39\)](#)
- [Good Practice Guidelines for Funders of Microfinance \(Microfinance Consensus Guidelines\)](#)
- [National Microfinance Strategies](#)
- [The Role of Governments in Microfinance \(Donor Brief No. 19\)](#)