

## Governments in microfinance: threat or opportunity?

State intervention in microfinance could bring resources and services to millions of poor people and improve the industry's institutional framework — or deliver a knockout punch to private MFIs

By Peter Bate

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It would seem that the pink tide that swept several Latin American countries in the 2006 elections is about to hit the region's microfinance industry. In January 2007 the state-owned Banco Industrial de Venezuela announced its plans to purchase Prodem, one of the most important microfinance institutions in Bolivia. In April Venezuelan President Hugo Chávez proposed a US\$1 billion bond to fund soft loans for small businesses in Ecuador, Nicaragua and Haiti. Nicaraguan President Daniel Ortega applauded the idea. And in May, the Bolivian government headed by Evo Morales established Banco del Desarrollo Productivo with a US\$60 million credit line for low-interest microloans.

Will Latin America's "21st-century socialism" end up nationalizing microfinance institutions? Perhaps the fact that Colombian President Álvaro Uribe launched his own program to promote microcredit, Banca de las Oportunidades, suggests that the growing government activism in microfinance is less driven by ideological principles than by the goal of cutting the cost of financial services to reach as many poor people as quickly as possible.

For even though microfinance has developed remarkably in Latin America, serving some six million people and generating US\$6 billion annually in loans, after nearly three decades hardly 10% of the potential demand is being met, according to the Inter-American Development Bank's Multilateral Investment Fund (MIF).

For many people who have spent their lives building this industry, direct government intervention in microfinance is anathema. Warnings were heard even before socialist candidates prevailed in last year's elections. At the Microenterprise Forum held in September 2006 in Quito, several panelists expressed concern about the signals coming from the public sector.

Ernesto Aguirre, World Bank consultant and former banking superintendent from Colombia, summed up the industry consensus on the state as microfinance provider as "thanks, but no thanks." This perception is based on the experiences in the 1970s and 1980s, when governments tried to popularize credit programs using subsidies that turned out to be unsustainable and generated a culture of non payment among borrowers.

Government intervention can happen in different ways that end up reducing incentives for private sector involvement, according to Pedro Arriola, general manager of Banco ProCredit Ecuador. Some countries may impose caps on interest rates; others may have banking rules and regulations that stifle the industry; others may have a strong tradition of state-run banking. "As private operators, we want the government to work with us instead of competing against us," said Arriola. However, microfinance practitioners find that traditional government-run programs tend to hinder more than help the industry.

At the same time, there is broad agreement on what governments could do to support microfinance development, from ensuring macroeconomic stability and legislative clarity to promoting specific activities. Pilar Ramírez, former president of FIE, a leading Bolivian microfinance institution, pointed out that governments can promote training for microfinance institutions' staff, support access to cost-cutting technologies and set rules on flexible banking hours. In 2006 President Evo Morales appointed Ramírez to run a state-owned bank with a mandate to expand microfinance services, particularly to sectors such as manufacturing and agroindustry.

Even though Bolivia developed one of the world's most successful microfinance industries, Ramírez said that perhaps she and her colleagues were too proud of their achievements. Many Bolivian microfinance organizations that started up as nonprofits suddenly became lucrative businesses with shareholders. Their high interest rates, although technically sound, turned out to be politically unsustainable.

When governments intervene in microfinance they tend to point to the industry's slow expansion, particularly in rural areas. But, as IDB microfinance expert Sergio Navajas argues, two decades ago this industry did not have great presence in urban areas either, and today nobody disputes that achievement.

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Paradoxically, the microfinance industry appears to be a victim of its own success. The institutions that led its development filled a void left by the failure of state-run loan programs. NGOs started to experiment with microcredit, without any sort of state support, in the 1970s. By the 1990s, a regulated industry of financial services for low-income people began to take shape. The prestige of microfinance put the industry on government agendas throughout the region.

Will government intervention place Latin America's microfinance industry at risk? The answer to that question will depend on what governments do and how much they do. According to Navajas, the industry will not be undermined by isolated initiatives that, when added up, represent only a fraction of the US\$6 billion a year in loans mobilized by the region's microfinance institutions. "I don't think these initiatives, which don't come up to US\$1 billion, can make a dent," he said.

In a study of the outlook for the global microfinance industry, last year the Consultative Group to Assist the Poor (CGAP) outlined two potential scenarios for state intervention that could arise by 2015. On the programs launched by governments in this region the report stated: "The potential damage of these populist approaches in Latin America is particularly worrisome because a number of countries have large and sustainable private microfinance sectors."

Under the most optimistic of the two scenarios, CGAP envisioned some governments following best international practices in providing microfinance services efficiently through large state banks with vast geographical coverage. Other governments could decide to offer basic banking services to large segments of the population through poverty reduction programs. A remarkable case is Mexico's Programa Oportunidades, which has opened banking accounts for more than one million indigent families. Other governments could concentrate on creating better conditions for microfinance development through improved regulations, institutions and access to modern technologies.

Under the more pessimistic scenario, however, governments will spurn the lessons learned by the industry and push microcredit programs based on the political urgency of expanding services and creating jobs. With their subsidized interest rates, these "banks for the poor" would crowd out private microfinance institutions, becoming the only alternative for low-income people -- at least while subsidies and political interest subsist. The title for this scenario? "Flood, distortion and collapse."