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MICROFINANCE AND POVERTY REDUCTION: THE CASE OF NORTHEASTERN MINDANAO, THE PHILIPPINES

By

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ABSTRACT

This thesis investigates the impact of microfinance on poverty and other key social wellbeing measures of health, education and women empowerment in Northeastern Mindanao, the Philippines. In the Philippines, poverty remains pervasive with microfinance often times remain the poor's only access to formal financing. A review of the literature reveal that rigorous empirical studies on microfinance impact remain few, often with mixed outcomes. This suggests a need to further understand the impact of microfinance in the Philippines.

To address the objectives of the study, a mixed method was employed. A one-time survey of 211 eligible households involving microfinance clients and non-clients was undertaken in both treatment and control areas. Further, a total of eight focus group discussions (FGDs) involving a random sample of clients who took part in the survey were also undertaken. Finally, a survey of key microfinance industry stakeholders via semi-structured interviews was also undertaken. The stakeholders include key government policymakers and officials, representatives from government and private financial institutions, donors, NGOs and other experts in the field. The quantitative and qualitative data were analysed using Eviews and NVivo, respectively.

The study reveals the following: Firstly, a positive and mildly significant impact of microfinance on per capita income. Secondly, the participatory FGDs suggest positive impacts of microfinance on clients' savings behaviour as well as on some social wellbeing measures of health, education and women empowerment. The Philippine microfinance industry however continues to face some key challenges, including a huge financing gap. This needs to be addressed by policymakers and other stakeholders in order for microfinance to become an effective instrument towards sustainable and more inclusive growth.

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LIST OF ABBREVIATIONS

4Ps	*Pantawid Pamilyang Pilipino Program* (Conditional Cash Transfer Program)
ACPC	Agricultural Credit and Policy Council
ADB	Asian Development Bank
AFC	Asian Financial Crisis
AO	Administrative Order
APIS	Annual Poverty Indicators Survey
ARMM	Autonomous Region in Muslim Mindanao
ASHI	*Ahon sa Hirap, Inc.* (To rise above poverty)
BMSMED	Bureau of Micro, Small and Medium Enterprise Development
BOP	Balance of Payment
BSP	*Bangko Sentral ng Pilipinas* (Central Bank of the Philippines)
CAR	Cordillera Administrative Region
CBI	Cantilan Bank, Inc.
CCT	Conditional Cash Transfer
CDA	Cooperative Development Authority
CGAP	Consultative Group to Assist the Poor
CIC	Credit Information Corporation
DCP	Directed Credit Program
DID	Difference-in-Difference
DOF	Department of Finance
DSWD	Department of Social Welfare and Development
DTI	Department of Trade and Industry
EIU	Economist Intelligence Unit
FGD	Focus Group Discussion
FIES	Family Income and Expenditure Survey
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GFI	Government Financial Institution
GNP	Gross National Product
HDI	Human Development Index
HH	Household Head

IC	Insurance Commission
IMF	International Monetary Fund
IPO	Initial Public Offering
ISI	Import Substitution Industrialisation
JMP	Joint Monitoring Programme
LBP	Land Bank of the Philippines
LGU	Local Government Unit
MBA	Mutual Benefit Association
MCPI	Microfinance Council of the Philippines, Inc.
MDG	Millennium Development Goal
MENA	Middle East and North Africa
MFI	Microfinance Institution
MFPC	Microfinance Program Committee
MIDAS	Microfinance Data Sharing System
MILF	Moro Islamic Liberation Front
MPI	Multidimensional Poverty Index
MSME	Micro Small and Medium Enterprise
MSMEDC	Micro Small and Medium Enterprise Development Council
NBFI	Non-Bank Financial Institution
NCC	National Credit Council
NCR	National Capital Region
NGO	Non-Governmental Organisation
NIC	Newly Industrialised Country
NLDC	National Livelihood Development Corporation
NSCB	National Statistical Coordination Board
NSM	National Strategy for Microfinance
NSO	National Statistics Office
OFW	Overseas Filipino Worker
OPHI	Oxford Poverty and Human Development Initiative
PCFC	People's Credit and Finance Corporation
PIDS	Philippine Institute for Development Studies
PPP	Public-Private Partnership
RA	Republic Act
RCT	Randomised Controlled Trial

SBGFC	Small Business Guarantee and Finance Corporation
SEC	Securities and Exchange Commission
SRA	Social Reform Agenda
SWS	Social Weather Stations
UN	United Nations
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
WB	World Bank
WHO	World Health Organization

CHAPTER ONE
INTRODUCTION

1.5 Background of the Study

Modern-day microfinance started in Bangladesh in the late 1970s through the pioneering efforts of Muhammad Yunus, a Bangladeshi economist and Nobel Laureate. Its aim is to reduce poverty through the provision of small loans to poor women (Yunus, 1999). The provision of small loans has evolved over the years and now encompasses the delivery of a multitude of financial and other non-financial services to the poor. The Philippines has been one of the earliest replicators of the aforementioned microfinance model and considers microfinance as an important development tool in reducing poverty. This policy agenda is based on anecdotal evidence and early studies showing small loans used to fund micro enterprises lifting people out of poverty by raising household income and consumption (Pitt & Khandker, 1998; Wright, 2000; Zaman, 2000; Khandker, 2001).

Rigorous empirical evidence on the impact of microfinance on poverty and living conditions however remains limited. Some studies claim microfinance has had a positive impact on reducing poverty and increasing income (Dupas & Robinson, 2013), education (Pitt & Khandker, 1996), health (Pitt et al., 1999), and women empowerment (Cheston & Kuhn, 2002; Pitt et al., 2003). On the other hand, recent studies have found no evidence of improvements on household income or consumption in the short run although they did find some other possible benefits (for a review, see Duvendack et al., 2011). The foregoing studies confirmed some early doubts regarding the impact of microfinance on household income (see for example, Hulme & Mosley, 1996; Rogaly, 1996; Copestake, 2002). The mildly positive results of the rigorous studies (see for example, Banerjee et al. 2010; Karlan & Zinman, 2011) have spawned heated debates between researchers and practitioners (see for example, Banerjee et al., 2009; Bennett, 2009; Hartford, 2009; Easterly, 2010) and some of the biggest microfinance network organisations (for a review, see Stewart et al., 2010).

Reflecting on these opposing views, it is therefore necessary to understand how microfinance can assist the Philippines reduce poverty. Further, given the steady growth of global microfinance portfolio and outreach – albeit at a now slower pace – during the last few years (MicroRate, 2011; Microfinance Information Exchange, 2012; Convergences 2015, 2013), it is imperative for the Philippines to capitalise on this trend. To achieve this requires a deeper understanding of the structure, conduct and performance of the Philippine microfinance industry. This research seeks to provide a critical review of Philippine microfinance policies and assess its impact on poverty. This research likewise aims to empirically investigate the impact of microfinance on household income and expenditures, as well as on the social well-being measures of education, health and women empowerment.

In the Philippines, microfinance has reached a significant portion of poor households (Micu, 2010; *Bangko Sentral ng Pilipinas*, 2013). There is evidence however, that some microfinance institutions (MFIs) appear to favour the 'less poor' (Ruben, 2007). Some studies even suggest that the poorest are being systematically excluded (Milgram, 2001; Ahmad, 2003; Coleman, 2006). Currently, MFIs in the Philippines are reaching only about one-third of poor households. To this end, it is crucial that we investigate the impact of socioeconomic attributes and demographic characteristics on the ability of households to access microfinance in order to ensure that microfinance programs are reaching its target beneficiaries. This will aid in formulating effective microfinance policies in the Philippines.

Since the onset of the global financial crisis (GFC) in 2008, few rigorous studies have been undertaken in the Philippines to examine its impact on the microfinance industry. Although MFIs have remained unaffected by financial crises of the past decades, the GFC this time has impacted negatively on MFIs and their clients because of the growing integration of microfinance with traditional domestic and international financial markets (Littlefield & Kneidling, 2009; DiBella, 2011). Given these developments, the understanding of the different roles and relationships of microfinance stakeholders is important.

In this regard, the need to formulate effective policies requires an understanding of how the industry works. It is also crucial that policy interventions be based on an in-depth understanding of the dynamics of the microfinance industry (Gonzalez, 2011). This is in order to avoid implementing policies that are likely to have negative impacts on society such as payment moratoriums (Rozas, 2011), interest rates caps (Gonzalez, 2011) and extremely conservative regulatory actions (Littlefield, 2008). A critical review of these policies within the framework of government macroeconomic policy will be undertaken. This is expected to aid in policy formulation and assist the microfinance industry in further expanding financial inclusion to poor households as well as help MFIs provide better products and services.

1.6 Problem Statement

The initial success of the 'classic' Grameen Bank group-lending model in Bangladesh during the late 1970s up to the 1980s led to the replication of similar microcredit and microsavings programs in many developing countries. In addition, the widespread appeal of the microfinance movement and its narrative – which perpetuates the idea that it can lift poor people out of poverty through simple access to formal financial services – have drawn the attention and support of governments, donors, financial institutions and non-governmental organisations (NGOs). This resulted in the allocation of vast resources – from both public and private sources – to various microfinance programs and initiatives in many developing countries. Microfinance however, currently faces many challenges and questions abound regarding its true impact on poverty. Despite the abundance of anecdotal evidences regarding its perceived positive impacts, there is little undisputed evidence that microfinance reduces poverty on average.

Many academics, researchers and microfinance practitioners have contradictory views on the beneficence of the microfinance model as a poverty reduction tool. Microfinance proponents and practitioners highlight the success stories of many microfinance clients – showing how they are now less poor and have more control of their lives – through simple program participation. They likewise claim that access to microcredit results in higher income and improvements in human development indicators such as education, health and women empowerment.

Nevertheless, some cast serious doubts on the success of the microfinance movement, contending that it does not address the poverty situation of the poorest nor does it empower women, two of the strongest arguments for the existence of microfinance. They further claim that many microfinance programs benefit only the 'middle' and 'upper' poor and not the poorest of the poor (Mosley & Hulme, 1997; Kondo et al., 2008; Banerjee et al., 2010).

Reflecting on these differences, this study analyses if microfinance helps to reduce poverty in the Philippines and explores its impact on household income and expenditures as well as on other social well-being measures such as education, health and women decision-making. It likewise examines the impact of microfinance on some basic household poverty indicators. Given the foregoing, it is therefore necessary to fully understand how microfinance can assist the Philippines achieve significant gains in its poverty reduction initiatives. The Philippine government's adherences to microfinance as a development tool for the poor needs to be supported by a proactive approach in order to keep abreast with a rapidly evolving microfinance industry.

During the last few years, the volume and outreach of microfinance activity in the Philippines has grown considerably (*Bangko Sentral ng Pilipinas* 2013). Microfinance has reached more households, however, many MFIs appear to favour the 'less poor' and not the poorest in the community. Some studies even suggest that the poorest are being systematically excluded from microfinance programs. Currently, MFIs in the Philippines are only reaching about one-third of total poor households. It is thus critical to determine if microfinance clients actually belong to the poor in the community. To this end, it is crucial that we have a clear picture of the socioeconomic attributes of microfinance clients to ensure that the treatment is actually reaching its target beneficiaries.

Rigorous empirical studies on microfinance impact remain few and their results are often highly provocative. Some studies indicate that poorer households tend to use the loans for consumption purposes, thus, it should be expected that there would only be a minimal increase – if at all – in household income as a result (Gulli, 1998). Some studies likewise suggest that access to microcredit has no discernible impact on measures of health, education and women empowerment (Banerjee et al., 2010). On the other hand, some studies claim positive impact on measures of personal income (Dupas & Robinson, 2013), education (Pitt & Khandker, 1996), health (Pitt et al., 1999) and women empowerment (Cheston and Kuhn, 2002; Pitt et al., 2003). Given the mixed outcomes of microfinance impact, it is imperative that more research be conducted towards not just finding specific results but also to apply and analyse the results in the sociocultural and economic conditions from which they were taken. This kind of future research will enrich and further contribute to knowledge regarding the impact of microfinance.

Recent evidences suggest a need for understanding further the impact of microfinance on poverty reduction in the Philippines. Given the recent global financial crisis and the limited rigorous research on the impact of microfinance on poverty reduction in the Philippines, it is important that we look deeper into the practices and behaviour of poor households in order to help them weather future economic shocks. Likewise, it is imperative that we investigate the perceptions of microfinance institutions as to their role in delivering microfinancial services that are appropriate to the needs of their poor clients. This would aid in policy formulation and implementation and assist the microfinance sector as a whole in expanding financial inclusion to the poor. This would likewise assist MFIs in providing better services and achieving financial sustainability. This is necessary to foster a sustained bottom-up socioeconomic development for the Philippines.

1.7 Research Questions

Given the linkages between microfinance and poverty, the main tasks of the study is to answer the following research questions:

1. To what extent does the socioeconomic and demographic characteristics of households impact on their ability to access microfinance in the Philippines?
2. To what extent does participation of households in microfinance programs improve their livelihood?
3. What are the challenges and opportunities facing the Philippine microfinance stakeholders?
4. What are the policy prescriptions that can be drawn from the implications of the study results and how would it help improve the impact of microfinance in reducing poverty?

1.4 Objectives and Hypotheses of the Study

The main objective of the study is to empirically investigate the impact of microfinance on poverty reduction in the Philippines. The specific objectives are as follows:

1. To develop a model for explaining the impact of microfinance on poverty reduction in the Philippines.
2. To empirically investigate the effects of socioeconomic and demographic characteristics on households' ability to access microfinance in the Philippines.
3. To investigate the impact of group-based lending participation on the livelihood of poor households in the Philippines.
4. To investigate the challenges and opportunities facing Philippine microfinance industry stakeholders, namely, government policymakers and officials, government and private financial institutions, donors and NGOs.
5. To make recommendations to assist in policy formulation and implementation for improving the impact of microfinance on poverty reduction in the Philippines.

Following from above, the hypotheses to be tested are outlined below.

The empirical findings of the impact of microfinance on the poor is mixed. On the one hand, proponents of microfinance argue that microfinance is reaching the poorest of society (Grameen Foundation, 2011; Maes & Reed, 2012). On the other hand, emerging empirical evidences suggest that microfinance is less successful in targeting and reaching the poorest (Amin et al., 2003; Coleman, 2006; Kondo et al., 2008; Adjei & Arun, 2009). The question that arises is to what extent does the socioeconomic and demographic characteristics impact on the ability of households to access microfinance particularly within the context of the GFC. Considering the foregoing, this research hypothesise that:

H1: The socioeconomic and demographic characteristics of households will have a direct impact on their ability to access microfinance.

The joint liability condition in group-lending contracts is often credited as the key innovation that led to the expansion of credit to the poor (Morduch, 1999; Armendariz & Morduch, 2010). In addition, group lending has been proven successful in solving failures in credit markets by mitigating problems created by information asymmetries, such as adverse selection and moral hazard (Stiglitz, 1990; Varian, 1990; Van Tassel, 1999; Armendariz de Aghion & Morduch, 2004). Based on these findings, this research proposes to test the hypotheses related to group lending. The hypothesis is stated as follows:

H2: Group-based lending contract enhances the livelihood of households.

According to Goldberg (2005), the quality and rigor of microfinance impact evaluations vary and their results should be interpreted with caution. For example, Hossain (1988), Chen and Snodgrass (2001), Dunn and Arbuckle (2001), and Khandker (2005) found that microfinance program participants, on average, earned more per year than non-participants across villages in India, Peru and Bangladesh. In addition, the studies by Khandker (1998) and Pitt and Khandker (1998) found that access to credit has led to substantial increases in the income of borrowers. Given the above findings, the question that arises is to what extent does household participation in microfinance programs improve their livelihood. To test the hypothesis related to microfinance program participation, it is hypothesised that:

H3: Participation of poor households in microfinance programs increases household income.

Many studies argue that increased income and access to formal financial services due to microfinance has enabled the poor to invest in education and health thereby improving their wellbeing (DeLoach & Lamanna, 2011; Littlefield et al., 2003). In addition, Pitt et al. (2003) argue that credit provided to women clients improves measures of nutrition and health of households. In a later study, Pitt et al. (2006) found that participation in credit programs led to a greater role for women borrowers in terms of household decision-making and access to financial resources. Based on these findings, this research hypothesises that:

- H4: Participation of poor households in microfinance programs will have a positive impact towards the education of their children.
- H5: Access to microfinance programs enables poor households to invest in the health of their children.
- H6: Participation of poor households in microfinance programs enhances their ability to make decisions at home.

Government policymakers are faced with many challenges. Early policy interventions involving heavily subsidised directed credit programs by governments in a number of developing countries have failed (Von Pischke et al. 1983; Morduch, 1999; Robinson, 2001; Sonne, 2010). However, the shift to a market-based paradigm has spurred the growth of self-sustainable MFIs (Otero & Rhyne, 1994; Hulme & Mosley, 1996). The changing global market conditions imply that policymakers need to continually adopt an active stance towards evaluating the impact of government policy on the performance of the microfinance industry by remaining attuned to global developments as well as to the nuances of local markets. To this end, this research proposes to test the following hypothesis:

- H7: An enabling policy and regulatory environment for microfinance under a market-based paradigm is perceived to have positive effects on the performance of the microfinance industry.

1.5 Methodology of the Research

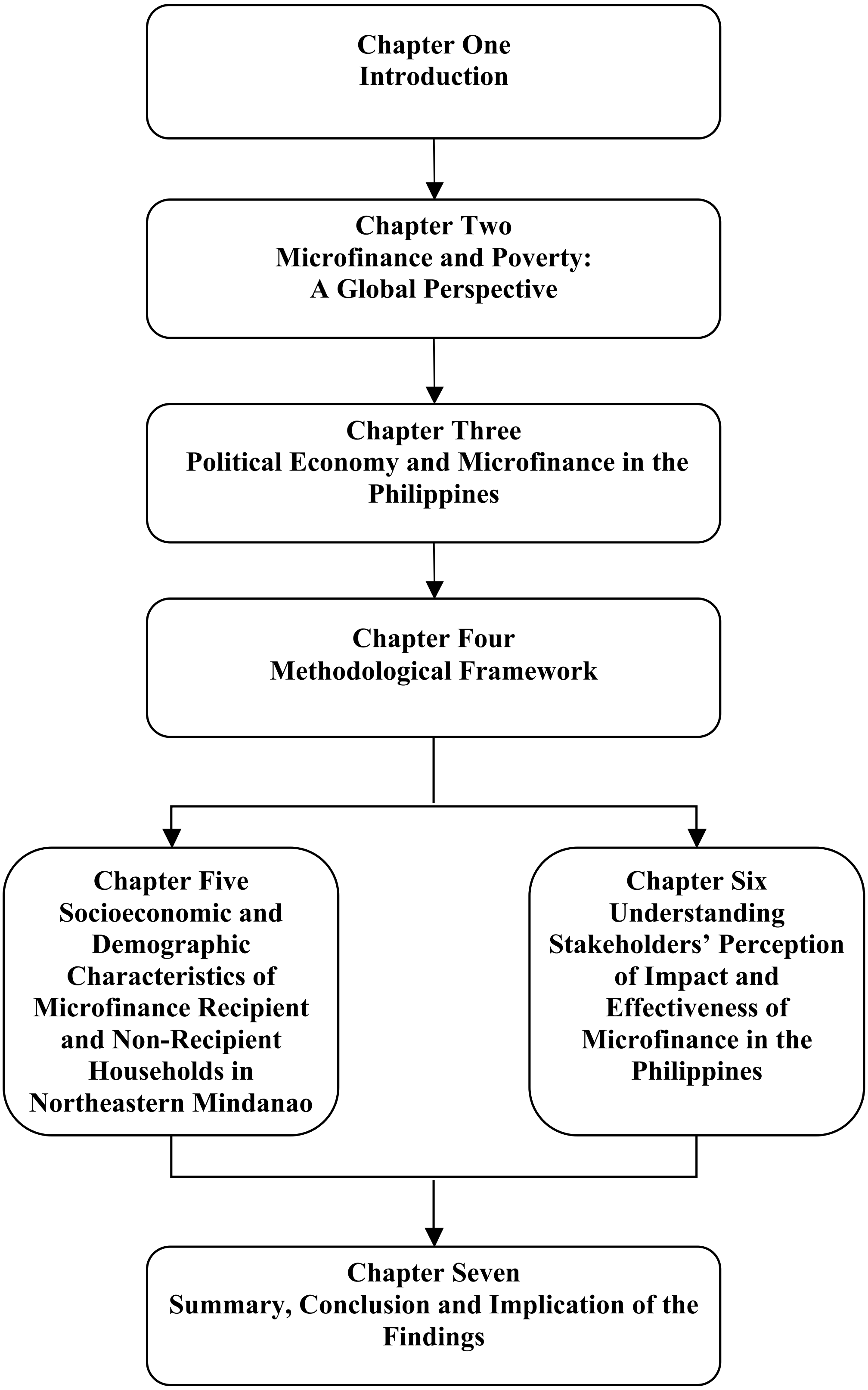
To address the objectives of the study, the research will use a mixed method approach. Primary qualitative data such as field notes, audio recordings and transcripts will be collected through focus group discussions (FGDs) and semi-structured interviews. The semi-structured interviews will be used to elicit information on the challenges and opportunities facing the Philippine microfinance industry. Interview respondents will include representatives from all levels of the Philippine microfinance industry infrastructure, namely: government officials and policymakers, government and private financial institutions, microfinance institutions, non-governmental organisations and microfinance clients (both current and prospective). On the other hand, FGDs will be used to elicit information on the borrowing behaviour of poor households as well as to obtain information on issues and constraints with regards to access to microfinance. The data collected through FGDs will be analysed individually for each focus group.

Further, primary quantitative data on biographical information (e.g., age, educational attainment, employment, etc.), household characteristics (housing quality, assets, household decision-making, etc.) income and expenditures will be gathered through structured interviews with a personally administered questionnaire to a random sample of poor households in various randomly selected villages. The structured questionnaire contains a series of questions that were compiled following the determination of information needed for the study and the review of previous randomised evaluations on microfinance and its impact on poverty (see for example Banerjee et al., 2010; Augsburg et al., 2012). The structured questionnaire will be pre-tested for clarity of understanding and ease of response before the execution of the full-scale study. The data obtained through a personally administered questionnaire will be used to analyse the socioeconomic and demographic characteristics of poor households in the Philippines through a probit model.

1.6 Organisation of the Study

The study consists of seven chapters (see Figure 1.1). Chapter 2 provides a critical review of the literature on microfinance by looking into various theoretical and empirical studies, in particular its link to poverty reduction. Chapter 3 reviews the major developments that have taken place in the Philippine political and economic landscape since the turn of the 20th century. This chapter also provides an overview of microfinance in the Philippines. Chapter 4 describes the methodological framework that will be used to analyse and measure the impact of microfinance on poverty reduction. Chapter 5 will report and discuss the results of the analysis of impact of socioeconomic and demographic characteristics on borrowing behaviour of the poor. Chapter 6 will report on the analysis of microfinance practice in the Philippines. Chapter 7 will then provide conclusions and will draw some implications of the empirical results for policy formulation and implementation in the microfinance sector in the Philippines.

Figure 1.1 Chapters Summary



CHAPTER TWO
MICROFINANCE AND POVERTY: A GLOBAL PERSPECTIVE

2.1 Introduction

Microfinance has been proposed and used as a development tool for alleviating poverty for more than three decades now. As a result, billions of dollars have been pumped into the industry and loaned out to the poor who prior to the introduction of microfinance had little access to the services provided by formal financial institutions. Microfinance typically involves the provision of small loans by microfinance institutions of often less than $100 to $200 to poor individuals and groups composed mostly of women in order for them to start or expand their microenterprises. According to MFI reports, microcredit are usually repaid at remarkably high rates of 95 per cent or higher, leading credence to the premise that the poor are in fact credit-worthy (Gibbons & Kasim, 1991; Morduch, 1999; Datar, Epstein & Yuthas, 2008). Further, to some, the high repayment rates is proof that the small loans have been for the most part beneficial to the poor as it could make the difference between a life trapped in abject poverty and a life of dignity, hope and promise.

The success of the microfinance model and of the MFIs themselves in reaching the poor have further driven expectations on microfinance as a panacea to global poverty. As famously uttered by Mohammad Yunus (Yunus Centre, 2013), “I strongly believe that we can create a poverty-free world, if we want to.... In that kind of world, [the] only place you can see poverty is in the museum. When school children will be on a tour of the poverty museum, they will be horrified to see the misery and indignity of human beings. They will blame their forefathers for tolerating this inhuman condition to continue in a massive way.” This strong rhetoric has resonated with governments and the donor community for much of the last three decades. Yet, despite this particularly solid claim about the beneficence of microcredit, there is little rigorous evidence to back up such claim outside of anecdotes and success stories. Notwithstanding the lack of rigorous evidence, the fact remains that microfinance was able to circumvent many long-standing theories on how financial markets work by successfully reaching the poorer strata of society more than any development tool had ever done before. It is thus imperative to examine how microfinance can serve as an important vehicle to make an even larger impact and contribution towards alleviating global poverty.

The aim of this chapter is to provide an analysis of the development and growth of the microfinance theoretical literature that has helped lay the foundations of modern microfinance. This chapter will also review the extensive critiques of the original theories and provide empirical evidence from previous studies supporting these criticisms. The chapter begins by providing a brief overview of recent trends in global poverty and its link to microfinance. It then provides definitions generally used in the Philippines to define microfinance and to compare it with other countries with strong microfinance presence. It then reviews the political economy of microfinance and reflects on how the different ideologies of the time influenced microfinance policies. After which, it examines the main theories explaining the growth and development of microfinance as well as the various empirical evidences supporting and also challenging these theories. Towards the end, it will systematically review studies measuring microfinance impact as well as the different methodologies used in their analysis.

2.2 Recent Trends in Global Poverty and its Link to Microfinance

Poverty is a pervasive problem throughout the world especially in developing countries. According to one of the key findings[1] by Chen and Ravallion (2008), in 2005, 1.4 billion people in the developing world or 25.2 per cent of total population (see Table 2.1) are living below the international poverty line of US$1.25/day or equivalent to US$1.00/day in 1996 US prices (World Bank, 2010). The revised poverty line represents the average poverty line found in the poorest 10-20 countries (Chen and Ravallion, 2008). This resulted to an additional 400 million extremely poor people vis-à-vis the 2004 estimate of 984 million poor people living in the developing world.

[1] According to the World Bank (2010), the 2008 paper by Shaohua Chen and Martin Ravallion entitled *"The developing world is poorer than we thought, but no less successful in the fight against poverty"* represents the latest comprehensive estimate of poverty in developing countries.

The 2005 figure of 1.4 billion poor people is however already significantly lower than the 1.9 billion (51.8% of total population) recorded in 1981. Nonetheless, at an average aggregate poverty rate decline of one percentage point per year from 1981-2005, the developing world as a whole is on track for attaining one of the Millennium Development Goals (MDGs) of halving extreme poverty and hunger between 1990 and 2015. This is despite significant setbacks in the efforts to reduce poverty after the economic downturn brought about by the 2008 Global Financial Crisis (GFC). The MDGs are globally adopted targets made by 189 nations to reduce extreme poverty and multiple deprivations by 2015. The eight goals are the following: 1) eradicate extreme poverty and hunger; 2) achieve universal primary education; 3) promote gender equality and empower women; 4) reduce child mortality; 5) improve maternal health; 6) combat HIV/AIDS, malaria and other diseases; 7) ensure environmental sustainability; and 8) develop a global partnership for development (Millennium Project, 2006).

Table 2.1 Percentage of population in least developing countries living below US$1.25/person/day

Region	1981	1984	1987	1990	1993	1996	1999	2002	2005	2008	2010
East Asia & Pacific	77.7	65.5	54.2	54.7	50.8	36.0	35.5	27.6	16.8	14.3	12.5
Latin America & Caribbean	11.5	13.4	12.6	9.8	9.1	10.8	10.8	11.0	8.1	6.5	5.5
Middle East & North Africa	7.9	6.1	5.7	4.3	4.1	4.1	4.2	3.6	3.6	2.7	2.4
South Asia	59.4	55.6	54.2	51.7	46.9	47.1	44.1	43.8	40.3	36.0	31.0
Sub-Saharan Africa	53.4	55.8	54.5	57.6	56.9	58.8	58.4	55.0	50.1	47.5	48.5
All Least Developing Countries	51.8	46.6	41.8	41.6	39.1	34.4	33.7	30.6	25.2	22.4	21.0

Source: Chen and Ravallion (2008); World Development Indicators, World Bank (2012; 2013)

In fact, based on the latest estimates from the World Bank (2013), the number of people living below the international poverty line further fell to 1.2 billion in 2010 from 1.4 billion in 2005. This represents 21 per cent of the total population living in the developing world, which is likewise a sizeable reduction from the 2005 figure of 25.2 per cent. Given these recent estimates, the overall poverty rate is expected to fall under 15 per cent by 2015 (United Nations, 2011). This is way below the MDG target of 23 per cent, indicating that the MDG of eradicating extreme hunger and poverty have already been met in 2010 or five years ahead of schedule (United Nations, 2013). Given uneven economic growth performance, some regions are however projected to fall behind their target with as many 900 million people still likely to remain in extreme poverty by 2015 (United Nations, 2011). One region expected to fall short of its target is Sub-Saharan Africa, with extreme poverty rate projected to be below 36 per cent by 2015 – not enough to meet its target of 29 per cent. On the other hand, East Asia & Pacific is expected to make the sharpest reductions with extreme poverty expected to fall from 60 per cent in 1990 to only below five per cent by 2015 (United Nations, 2011).

One of the key poverty alleviation tools identified under the MDGs is microfinance. The MDGs do not formally set targets for financial sector access for the poor, however, microfinance underpins the achievement of several of the targets and plays a key role in many of the strategies to achieve them (CGAP, 2002; United Nations, 2005). In addition, microfinance is likewise firmly linked to the goal of poverty reduction (Moll, 2005). To further stress the important role of microfinance, the United Nations General Assembly designated 2005 as the International Year of Microcredit.

At the time, it was widely believed that access to formal financial services reinforces the ability of the poor to improve their lives in ways that mirror the multidimensional aspects of poverty (CGAP, 2002). Thus, many governments, donor agencies (local, international and multilateral), non-governmental organisations (NGOs) and even private philanthropists and celebrities have moved to support microfinance as a way out of poverty for the poor in the developing world. Microfinance institutions (MFIs) were therefore seen as important vehicles to expand access to financial services to those that remains largely ignored by the conventional financial system.

Reflecting on the possible multiple positive effects of microfinance on the multidimensional aspects of poverty, the hopes placed on microfinance went way beyond the provision of access to formal financial services. Microfinance proponents believe that the provision of credit and savings services can help the poor increase and diversify their meagre income by taking advantage of potentially profitable business opportunities as well as to build up funds for future investments and provide cushion for sudden shocks. They likewise deem that microfinance empowers women and promotes gender equality, improves health status and raises the education levels of children.

Given high expectations on the positive impact of microfinance, it is not surprising that the number of very poor families with microcredit has grown tremendously from only about 7.6 million in 1997 to more than 125 million in 2011 (Banerjee et al., 2013; Reed, 2013). At an average of five persons per family, the small loans affected around 621 million poor household members. In addition, from 1999 to 2011, the number of poorest women reached by microcredit has increased from 10.3 million to 102.7 million (Reed, 2013). The massive growth in the number of borrowers likewise shows how adept MFIs have been at expanding financial services to those previously unbanked at such a short time (Crepon et al., 2011). Reed (2013) notes however that for the first time since 1998, there are fewer poor families and women clients who received access to microfinance from one year to the next, in particular from around 138 million 2010 to only about 125 million in 2011. Most of the decline in the total poorest clients happened in India – where almost half (47.9 per cent) of the total poorest clients reside – as a direct result of the Andhra Pradesh crisis.

Notwithstanding the continued growth of the global microfinance portfolio during the last 15 years or so, critics claim that evidence of positive impacts of microfinance on poverty reduction is weak and that microcredit can hurt the poor by causing indebtedness (Bateman, 2011; Crepon et al., 2011). Furthermore, the real impact of access to micro credit in women empowerment as some anecdotal evidences suggest was likewise placed in doubt (Crepon et al., 2011). These views were further supported by many academics that understood the limited statistical evidence of microfinance beneficence (Armendariz & Morduch, 2010; Banerjee et al., 2010; Karlan & Zinman, 2011). Despite these recent criticisms, the microfinance industry continues to grow and reach more ‘unbankable’ people in hard to reach areas in many developing countries.

This brings up the question as to what role microfinance plays in reducing poverty and improving the lives of the poor. Is microfinance a sustainable poverty reduction and development tool, as its proponents would like us to believe? If it is not, can the microfinance model evolve to a point where it can eventually make positive and sustainable impacts backed up by rigorous evidence? Given the magnitude of global poverty that remains to date – despite positive strides in recent years – it is critical that these questions be answered and the causal link between microfinance and poverty is clearly determined.

2.3 Definition of Microfinance

The definition of 'microfinance' is less than clear and people tend to agree that there is no one definition of microfinance. Further, the literature regularly uses the term 'microcredit' and 'microfinance' interchangeably. It is important however to highlight the difference between the two because they are different from one another. The following are some of the useful definitions of microfinance and microcredit.

In the Philippines, the central bank of the Philippines otherwise known as the *Bangko Sentral ng Pilipinas* (BSP) defines microfinance as the "provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance products to the poor and low-income households and their micro enterprises". Microfinance is targeted towards the "economically active, entrepreneurial poor" including "clients who have a stable economic activity and will be able to sustain and enhance these if they are provided with even a small amount of readily available funds" (*Bangko Sentral ng Pilipinas*, 2010). Microfinance is therefore seen as providing an important financial intervention for the entrepreneurial poor.

According to the United Nations (2005), "microfinance refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients" while "microcredit is a small amount of money loaned to a client by a bank or other institution. Microcredit can be offered, often without collateral, to an individual or through group lending." Further, the United Nations (UN) classifies microfinance clients as those who "are generally poor and low-income people" who "may be female heads of households, pensioners, artisans or small farmers." On the other hand, according to the Microcredit Summit Campaign (no date), "microcredit is the extension of small loans to the very poor, in combination with other financial services, such as savings facilities, training, health services, networking, and peer support. This allows them to pursue entrepreneurial projects that generate extra income, thus helping them to better provide for themselves and their families.”

Another definition of microfinance as provided by Robinson (2001) is, “microfinance refers to small-scale financial services for both credits and deposits – that are provided to people who farm or fish or herd; operate small or microenterprises where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries, in both rural and urban areas.”

For the purpose of this paper and unless mentioned otherwise, the use of the terms ‘microcredit’ and ‘microfinance’ will be based on the definition and distinction provided for by both the UN and the BSP – that microfinance is a much broader concept than microcredit and that microcredit is just a sub-component of a full range of financial products and services under microfinance.

2.4 Political Economy of Microfinance

2.4.1 Birth of Microfinance: The ‘Classic’ Grameen Bank Model (Mid 1970s – Late 1980s)

The concept of microfinance is not new. The history of today’s microfinance can be traced as far back as the 1800s when savings and credit institutions in Europe began providing small loans to the rural poor. Around the same time, in response to famine in the 1850s, Germany’s credit cooperative movement began (Roodman, 2011). Meanwhile, some acknowledge the ideas of Akhtar Hameed Khan in the 1950s as pioneering the idea of microcredit. In 1959, the Pakistan Academy for Rural Development founded by Khan (later renamed in 1971 as the Bangladesh Academy for Rural Development) originated and pioneered a rural development approach in underdeveloped areas in Comilla, East Pakistan. In Khan’s ‘Comilla Model’, microcredit was disbursed to the poor in rural communities through village and sector-based cooperatives (Bateman, 2010). Nevertheless, the person most associated with the term ‘microfinance’ is Muhammad Yunus, a Bangladeshi economist and founder of the Grameen Bank.

The birth of modern-day microfinance as we know it started in 1976 when Yunus, appalled at his growing awareness of the near slavement of the poor to moneylenders, provided a US$27 loan to 42 women in the village of Jobra, Bangladesh (Yunus, 2003). In December 1976, Yunus was able to convince Janata Bank, a local Bangladeshi bank, to lend microcredit to the poor people of Jobra. Yunus acted as the guarantor of all the loans. To his surprise, 98 per cent of those who borrowed without collateral paid back their loans. At the time, the repayment rates achieved by government banks in Bangladesh was only around 40 to 60 per cent.

In October 1983, Yunus formally established the Grameen Bank. The bank was set up as a non-governmental organisation (NGO) with an authorised capital base contributed by members (40 per cent), the Bangladeshi government (40 per cent) and two state banks (at 10 per cent each). Its mission is to provide microcredit to poor women entrepreneurs at affordable interest rates. Grameen Bank's idea, as influenced by Yunus, was that the poor should be encouraged to engage in small income-generating activities as a way out of poverty. Not long after, Grameen Bank took off. The number of clients grew rapidly with repayment rates remaining impressively higher than those whose borrowings were secured by collaterals. It was not too long until the 'classic' Grameen Bank model of microfinance became popular and was replicated in other countries throughout the developing world. Grameen Bank's 'classic' group lending contract differs from a standard banking contract for micro enterprises. Grameen clients come from low-income households and have no means to offer any collateral to secure their loans. In the absence of collateral, the 'classic' Grameen contract takes advantage of their clients' close community ties. The loan contract consequently involves groups of clients who form voluntarily. While loans are given to individual borrowers, all members are expected to support each other in repaying the loan particularly during difficult times. Thus, the almost universally irresistible microfinance narrative – that small amounts of credit provided to very poor people, particularly women, can help them get themselves out of poverty if given an opportunity to access formal financial services – was born.

The microfinance narrative has been further strengthened by hundreds of inspiring stories of microcredit recipients who used the tiny loans to be successful micro entrepreneurs. The individual anecdotes were so compelling – even though the microfinance narrative that so little can achieve so much remains unsubstantiated by rigorous evidence – the idea quickly spread to other countries in different parts of the world.

Given the popularity of the 'classic' Grameen Bank model in the 1980s, most microfinance institutions (MFIs) established in different developing countries replicated the Grameen model and operated as non-profit NGOs. In keeping with the model, MFIs likewise maintained affordable interest rates to their poor clients. The 1980s thus saw the growth of the microfinance movement. Aside from the Grameen Bank, BancoSol in Bolivia and Bank Rakyat Indonesia are just a few celebrated examples of how microfinance took off in the 1980s (Chamlee-Wright, 2005). Microfinance managers, such as Yunus, successfully projected the image of the movement as one that promotes poverty reduction, individual entrepreneurship, self-help, women empowerment and financial self-sustainability of MFIs. The movement was also initially aided by the rise of neoliberal political ideas in the late 1970s particularly the firm belief in the "financial self-sufficiency of all institutions that operate in the economy and society" (Bateman 2010:13). Thus, the financial self-sufficiency of financial institutions under the 'classic' Grameen Bank model of microfinance greatly appealed to international donor agencies. The donors saw the MFIs as agents for promoting a market economy and in the diminishing role of government in the economy – both core principles of neoliberalism.

For the microfinance industry however, it gradually became apparent that it was not always possible for MFIs to remain financially self-sufficient even with very high repayment rates. Still, some MFIs claim operational and financial self-sufficiency while a vast majority remain dependent on donor subsidies to cover their costs (Chamlee-Wright, 2005). In the late 1980s, meanwhile, even Grameen Bank was finding it difficult to survive without constant external financial support from the Bangladesh government and international donors. As Morduch (1999) observes, the 'profits' reported by Grameen Bank during the late 1980s up to early 1990s are actually losses when slight adjustments are made to standardise the bank's accounting practices and take into consideration its philanthropic subsidies on capital.

The collapse of the belief that the initial pump-priming initiative from governments and donor agencies would lead to financially viable and operationally sustainable MFIs led to a change in the political economy of microfinance. The international donor community was no longer keen on providing subsidies to MFIs in their supposed social mission of reducing poverty in the poorest communities. The market-based interest rates which were disregarded at the beginning of the microfinance revolution in the late 1970s and early 1980s were slowly entering the microfinance landscape. Given the slowly turning ideological shift, by the late 1980s microcredit and microenterprise development had become the international development community's anti-poverty policy intervention of choice (Levitsky, 1989). This is despite the serious lack of rigorous research on the impact of microfinance in reducing poverty.

2.4.2 Shift to Neoliberalism: 'New Wave' Microfinance (Late 1980s – Mid-2000s)

In the late 1980s up to the early 1990s, the international donor community led by the United States Agency for International Development (USAID) and the World Bank (WB) began the process of 'neoliberalisation' of microfinance. They started by preaching the neoliberal mantra of 'full cost recovery', which states that poor microfinance borrowers need to pay for the full costs or without any form of subsidy for any services or support that they receive. The process of 'neoliberalisation' of microfinance was likewise credited in part to the rapidly ascending neoliberal ideology that started in the late 1970s. As a result, the subsidies that characterised the 'classic' Grameen Bank model of microfinance were rapidly dismantled and gave way to the commercialised 'new wave' microfinance as the latest way of providing the poor access to finance (Hulme & Mosley, 1996).

The 'new wave' microfinance, also called the 'microfinance movement', has generated considerable support and interest from governments, donors, development practitioners and academics (Dichter, 1997; Montagnon, 1998). It aims to succeed where its predecessor has failed, that of ensuring self-sustainable MFIs that are thriving even without the need for subsidies from their respective governments or local and international donors. Under this 'new wave', MFIs were transformed into conventional profit-maximising financial institutions. This has led MFIs to push for full recovery of their own costs through greater commercialisation and a market-based interest rates regime. As Bateman argues (2011), it was thought that profit margins and market forces would ensure financial self-sustainability of MFIs. He added that this was conceived as a way of generating a cost-free increase in the supply of microfinance to the poor.

The ‘new wave’ microfinance likewise calls for the need to fully incentivise senior officers of MFIs as well as for them to be given the opportunity to obtain an ownership stake in their own MFIs (Bateman, 2010). By the early 1990s, the ‘new wave’ microfinance model has started to ease out the ‘classic’ Grameen-inspired microfinance model and has become the model of choice of the international donor community. One by one, microfinance NGOs the world over began to transition to the neoliberalism-inspired ‘new wave’ microfinance models. The early experience of a number of large MFIs, which successfully transitioned towards commercialisation, provided further momentum to the ‘new wave’ microfinance model. The international development community was further convinced that the neoliberal approach to microfinance was better than the heavily subsidised ‘classic’ Grameen-inspired model of the past.

According to Otero and Rhyne (1994), by the early 1990s, it can be argued that the ‘new wave’ microfinance model has become the ‘best practice’ microfinance model. On the other hand, Grameen Bank was becoming more and more marginalised within the microfinance industry and its model gradually being discredited. In 2001, under intense pressure for many years to move from the ‘old paradigm’ of government and international donor subsidy to the ‘new paradigm’ of financial self-sustainability, the Grameen Bank was relaunched into the Grameen Generalised System or ‘Grameen II’ – fully embracing the ‘new wave’ microfinance model. Grameen Bank has now become like any other profit-driven commercial bank. From its lofty poverty-reduction pursuits in the 1980s and 1990s, the bank has moved to a more modest goal of financial inclusion of poor women in Bangladesh. Thus, the original ‘classic’ Grameen Bank microfinance model was effectively relegated to history (Bateman, 2010) and the neoliberalisation of microfinance now complete.

A few years after the paradigm shift, Grameen Bank II became a very solid for-profit private financial institution. In August 2002, the last branch of Grameen Bank switched over to Grameen II, finally completing its full transition. To the international development community, the successful transformation of Grameen Bank provided proof that financial self-sustainability can be achieved, further reinforcing neoliberal ideologies in the international development community.

The mid-2000s saw the rapid ascent of the microfinance movement that culminated into two major feats. First, the United Nations designated 2005 as the International Year of Microcredit. Second, in 2006, the Nobel Peace Prize was jointly awarded to Muhammad Yunus and the institution he set up, the Grameen Bank, for their efforts to create economic and social development from the grassroots level. These events represent the peak of the microfinance movement.

To the neoliberals in the international development community, it seemed as though that the 'new wave' microfinance model has succeeded where all else have failed. The 'new wave' microfinance model was able to accomplish two things, namely: i) to provide a strong case for poverty reduction; and, ii) to continuously enforce upon developing countries its neoliberal policies. In the process, microfinance was able to attract two new and distinct funding sources, namely: i) rich philanthropists; and, ii) profit-seeking private investors. These new funding sources, however, will play a major role in possibly transforming yet again the dynamics of microfinance.

2.4.3 Microfinance Today: The Process of 'Accumulation by Dispossession' (2007 – Present)

From the peak of the 'new wave' microfinance model in 2005 and 2006, things quickly turned sour in 2007. This happened during the divisive and highly controversial initial public offering (IPO) of Banco Compartamos, the largest microfinance institution in Mexico. The IPO resulted in fierce discussions within the international development community and microfinance practitioners as to the real goal of microfinance. They debated over whether social enterprises such as MFIs should be turned into large-scale commercial operations. On one end, the supporters of traditional microfinance argue that the sole fundamental mission of microfinance is poverty reduction. They believe that the Compartamos IPO is symbolic of the "aggressive move of capitalists to profit from the poor" (The Economist, 2008). On the other end, Compartamos' co-CEOs, Carlos Danel and Carlos Labarthe and others who supported the IPO argue that the goal of microfinance is profit-maximisation in order for MFIs to extend more loans and other financial services to poor borrowers as well as reach frontier areas. They further argue in a public letter entitled ‘A Letter to our Peers’, that “above average profits are necessary to draw in investors and competition” under the conditions of a new industry (Compartamos Banco, 2008).

The Compartamos IPO led to the unmasking of the abuse of its directors and senior managers who reaped the rewards of going public. The practice of Compartamos of charging usurious rates – with some even reaching 100 per cent – have led to a serious mission drift. Instead of working for the poor microfinance borrowers in Mexico, Compartamos was found to have worked only to enrich its key directors and senior managers through very generous Wall Street-type salaries and bonuses as well as significant ownership stake in the MFI. As illustrated by Harvey (2005), this type of greed that happened in the microfinance industry in recent years is a form of ‘accumulation by dispossession’. Directors and managers of large MFIs who are charging very high interest rates in the guise of high operating costs in micro lending are quietly enriching themselves at the expense of the poor microfinance borrowers.

More worrisome, however, is the growing trend of MFIs going the IPO route. In an article that appeared in Microfinance Focus (2010), Yunus criticizes the SKS Microfinance IPO and believes that the IPO route sends a wrong message that there is an opportunity to make money out of the poor microfinance borrowers. However, since Compartamos Banco was able to demonstrate that there is a lot of money to be earned through an IPO when it went public in 2007, it is not a far-fetched idea that more large MFIs will follow suit. This is exactly what happened in 2010 as the Banco Compartamos IPO was followed by a much bigger IPO, that of SKS Microfinance in India. SKS Microfinance, which is one of the biggest players in microfinance, fuelled further controversy as to the growing commercialisation of microfinance. The SKS IPO brought huge windfall amounting into millions of dollars and its founder made approximately US$12 million from the sale of stock options. The Compartamos Banco and SKS incidents showed there is a promise of wealth and richness in microfinance. However, it was not the type envisioned by Yunus, of people moving out of poverty through the assistance of social enterprises such as MFIs. Quite strikingly, it was money redistributed from the poor to the rich through a global credit system called microfinance and not through a more equitable redistribution of wealth via economic growth and development. In this process of wealth creation through 'accumulation by dispossession', the dynamics of microfinance – founded on neoliberal ideas of self-sufficient private enterprises under a purely market-based paradigm – was used to justify the further exploitation of the poor in the guise of poverty reduction initially then financial inclusion afterwards.

2.5 A Review of Theoretical and Empirical Studies

2.5.1 Supply-leading Finance Theory

Conventional wisdom holds that financial sector development is important for economic development, and therefore leads to economic growth. The supply-leading finance theory denotes the provision of credit in advance of the demand for it for the purpose of inducing innovation, investment and economic growth. This paradigm arose in the context of the development of newly emerging nations in the aftermath of World War II in the late 1940s and the 1950s. The supply-leading finance theory maintains that finance or credit is a means to induce innovation, by way of an input to production.

Post-war development economists like Higgins, Leibenstein and Lewis described direct relationships between increased availability of technical knowledge and entrepreneurial and credit facilities on the one hand and increased income on the other (Penny, 1968). In particular, Higgins (1959) suggests that credit would be necessary for expansion in small agriculture and industry. On the other hand, Leibenstein (1957) concludes that income per head would rise with increased availability of capital, labour, credit, entrepreneurial facilities and technical knowledge. Finally, Lewis (1955) believes that farmers need more capital than they could afford to save from their income and that they could not afford the commercial cost of credit. In general, the assumptions of Higgins, Leibenstein and Lewis are that many farmers are liquidity-constrained and providing them with credit will allow them to make additional farm investments and to make use of modern farm inputs. This complements the 'efficient but poor' hypothesis formulated by Schultz (1964). Schultz argues that small-scale farmers in traditional agricultural settings are largely rational and reasonably efficient in allocating their resources. He further argues that the low-income levels in the agriculture sector of developing countries are actually a result of the low productivity of the factors of production available to them.

Patrick (1966) also shares these earlier views on supply-leading finance. Patrick conveys the idea that interventions in the financial system through supply-led credit would encourage economic growth and development. He adds that supply-leading finance has two functions. First, to transfer resources from traditional, non-growth sectors dominated by elements inherited from the pre-modern economy to modern sectors dominated by internationally modern technologies, rationality and modern institutions. Second, to promote and stimulate entrepreneurial responses in these modern sectors. Access to supply-leading funds opens new horizons to an entrepreneur. This enables an entrepreneur to have a more favourable expectation of the future and to 'think big' (Patrick, 1966).

Robinson (2001) adds that the supply-led theory emerged from the combination of three prevailing ideas at the time. First, that the governments of newly emerging nations held important responsibilities for their own economic development. Consequently, they prioritised initiatives to spur economic development, putting special emphasis on increased agricultural production. Second, that an increased food production was crucial for economic growth to happen. Hence, high yielding agricultural technologies were adopted rapidly and extensively. Third, most farmers – considered as the engine of economic growth – would require substantial credit subsidies to implement the agriculture-related innovation. This is since most farmers do not have the capacity to purchase the inputs for the new technologies and could not pay the full costs of the credit needed.

In this supply-led theory, it follows that if substantial credit subsidies were provided to farmers, agriculture-related innovation could be induced. Farmers who received credit at below-market rates would be spurred to purchase high-yielding agricultural technologies such as tractors and pump sets to increase production per unit area. As a result, agricultural growth was given high priority by national governments of low-income countries – with a strong emphasis on the high-yielding varieties employing a range of modern agricultural technologies.

An advantage of the modern agricultural technologies put forward at the time was that it was scale neutral – that it could be applied on farms of all sizes. However, the range of complementary inputs such as fertilisers, pesticides and irrigation were expensive, which poor farmers in rural areas could not afford. This provided the justification for the need for government intervention in the financial market and fund highly subsidised credit programs to encourage the use and dissemination of the new technologies (Koveos & Randhawa, 2004).

Further, another rationale for supply-led finance put forward at the time was that the only source of credit in rural areas – the informal moneylenders – would charge usurious interest rates. Given the unfavourable credit options faced by the rural poor, Von Pischke et al. (1983) argue the need for the creation of formal financial institutions that could provide credit at more affordable rates. Since private financial institutions do not typically engage in rural lending of any kind, the responsibility for the provision of credit was ultimately seen to be that of governments and donors, either directly or through financial institutions acting as conduits (Robinson, 2001; Sonne, 2010). This is because private financial institutions have an extensively held yet largely unproven belief that few rural households could afford or would be willing to pay commercial interest rates for loans. Hence, the intervention of governments and donors was considered essential to fill in the gap as cheap and abundant credit was regarded as essential for rural development (Adams et al., 1984).

The result of the prevailing views at the time was the spread of the directed credit approach in the 1960s and 1970s, where capital – used to finance specific sectors – was seen by governments and donors as the engine for economic growth. It was also during this time when national governments throughout much of the developing world implemented massive subsidised rural credit programs (Robinson, 2001). Hence, following this development paradigm, large numbers of targeted low-income and middle-income farmers would receive highly subsidised credit from their respective governments. The belief – based on the supply-leading theory – was that the targeted farmers, with the aid of modern production technologies availed through highly subsidised credit programs would produce higher yields and would increase their incomes.

The realities on the ground, however, were far different from the expectations, as it did not substantiate the theories of supply-led finance. Post program evaluations often indicated that it was a small group of affluent and politically connected elites who had reaped the benefits of the heavily subsidised credit programs and not the large group of poor rural farmers (Bouman, 1990). Further, the various credit programs typically experienced high defaults and registered huge losses. More importantly, the cheap credit programs resulted in the contraction of the volume of financial services for the poor in the long run because its very low interest rates regime did not permit full cost recovery and further roll-over of funds.

This substantiated the earlier criticisms of the supply-led finance theories by Galbraith, Li and Mellor. Galbraith pointed out as early as 1952 that credit systems could be a “means of progress as well as of stagnation and repression”. He likewise noted that credit could become a means for progress only after some level of development. Li supported Galbraith’s view and argued that farmers should have attained a certain level of development before government starts their credit programs. Finally, in 1966 Mellor wrote that credit programs would better serve its purpose if it would accompany or follow technological improvement programs instead of being supplied in advance (Galbraith, 1952; Li, 1952; Mellor, 1966). As concluded by Penny from the above minority views at the time on supply-led finance, subsidised rural credit programs will remain ineffective until “the role of credit in peasant economies” and “the attitudes of peasant farmers towards savings, investments and debt” are better understood by governments (Penny, 1968:33).

To test his hypothesis that peasant attitudes towards debt and credit are such that cheap credit is unlikely to stimulate agricultural growth, Penny (1968) studied eight villages in North Sumatra, Indonesia that are at varying stages of agricultural development. He found that subsidised credit programs are ineffective growth instruments. He likewise found that most farmers do not have to be coerced into borrowing cheap credit by the government for their own supposed good to adopt profitable innovations as long as there is a satisfactory market for the additional output. The results of his study further lend credence to the argument that much of the literature on the need for credit subsidies is based on faulty or untested assumptions (Sonne, 2010).

Nonetheless, despite criticisms of the supply-led finance theory the major turning point came with the publication of the 1972/73 Spring Review of Small Farmer Credit by the United States Agency for International Development in 1973. The review contains hefty volumes – with 300 or so pages per volume – on evaluations of efforts to spread credit through various credit programs to a broader rural clientele in more than 50 countries worldwide (Donald, 1976). It analyses the failures of the subsidised credit programs and indicates the misallocation of financial resources. The USAID publication was followed by a string of other critical reviews in the late 1970s and 1980s. Then, criticisms of the rationale behind subsidised credit programs filled the development literature. It is important to note, however, that even as early as the late 1960s, new views on the rural finance markets have already began to emerge, from a narrow focus on rural finance to a much broader view of the financial system (Robinson, 2001). As a result, evidence and studies showing that subsidised rural credit as inefficient and ineffective policy instruments quickly piled up. Some of the theoretical and empirical evidences why subsidised directed credit programs failed are discussed next.

First, according to the 'iron law of interest rate restriction' as formulated by Gonzalez-Vega (1977), interest rates subsidies redistribute credit portfolios, favouring "larger, safer and older borrowers over smaller, more innovative and riskier, newer clients and concentrate loan portfolios in fewer hands". Consequently, this ensures that institutional loans are normally channelled to large borrowers. Hence, the regressive redistributions attempted through directed credit programs in rural areas worsened income distribution in many developing countries – and this, coupled with default on the principal loan – resulted in more dramatic regressive redistributions (Gonzalez-Vega, 1984).

Blair (1984:183) supports this view when he wrote that the nature of rural finance works against the poor since *ceteris paribus*, it costs more to lend to administer small loans than big ones. Further, transaction costs, as a proportion of the total cost is much higher for smaller loans. Hence, large borrowers are more willing to incur the costs associated with the loans.

Nevertheless, evidence from India provides a more nuanced picture on the impact of misallocation of resources. In 1995, Binswanger and Khandker found that between 1972-1973 and 1980-1981 the supply-led finance approach to agricultural credit in India increased non-farm growth, employment and rural wages. Due to program inefficiencies – the monies originally targeted to the poor ended up somewhere else – they likewise found only modest impacts on agricultural output and no impact on agricultural employment. Hence, they conclude that the cost of this government policy including both the government cost and the social cost of credit provision were so high it would have exceeded the agricultural income benefit (Armendariz & Morduch, 2010) and did little to benefit the intended beneficiaries (Morduch, 1999).

Second, the targeted credit programs were infeasible because of the fungibility of credit (Von Pischke et al., 1983). Since it is difficult to manage whether the credit is used for its intended purpose or not, many were unable and sometimes even reluctant to repay the loans (Sonne, 2010). The fungibility of funds coupled with the absence of a test of credit worthiness because of the targeted nature of lending resulted in high default rates of subsidised credit programs especially those by state-owned financial institutions. Further, loan funds were often seen as political entitlements rather than as business transactions and often benefitted politically favoured non-poor households (Adams and Von Pischke, 1992). Hence, many government financial institutions exerted little effort to collect and were generally amenable to debt forgiveness programs. In rural India for example, government officials and politicians regularly announce 'loan forgiveness days' supposedly to mark some political milestone or event but in fact do so just to garner additional political capital. Consequently, some borrowers purposely delay loan repayment while waiting for the next 'forgiveness day' (Robinson, 2001).

Third, the subsidised credit programs' exclusive focus on credit over other forms of financial intermediations failed to take into consideration the heterogeneity of rural households as well as their varying needs over time. According to Meyer and Alicbusan (1984), there are two types of heterogeneity that facilitate rural financial intermediation. The first type of heterogeneity concerns firms and households that could benefit primarily from appropriately priced credit and those who have surplus funds who could benefit from safe and reliable savings facilities. On the other hand, the second type concerns the changing financial situation of households and firms over time. Thus, the scope of financial intermediation across firms and within firms over time is provided by the said heterogeneities. The failure to recognise these heterogeneities often lead to an impeded financial market as well as underdevelopment.

Finally, subsidised credit programs hinder the development of sustainable financial institutions. As demonstrated by the experience of many state-owned agricultural and development financial institutions, the provision of subsidised credit programs exposed them to political pressure and interference. Many of these institutions likewise suffer from poor and often corrupt management and officials as well as from unmotivated and untrained staff. In addition, the low interest rates regime under subsidised credit programs discourages the mobilisation of microsavings and microcredit. This is in sharp contrast to sustainable microfinance institutions, which can typically offer both savings and credit facilities and act as financial intermediaries.

In the 1980s, with the massive failure of various subsidised credit programs, the paradigm slowly shifted from the small farmer credit subsidies to financial access to specific groups of society, particularly small and micro entrepreneurs. This led to the rise of two different kinds of financial institutions. First, financial institutions that lend subsidised government or donor funds at below-market interest rates. Second, microfinance institutions primarily funded by low cost funds from governments and donors which lend at or near interest rates that would enable full cost recovery (Robinson, 2001).

The most successful of these financial institutions registered breakthroughs in terms of outreach and repayment rates. They however remained unsustainable and heavily dependent on continuing government and donor injections of low-cost funds and are normally incapable of meeting the growing demand for credit. An example of such financial institution was Grameen Bank during the 1980s. At the time, even with very high repayment rates, it remained dependent on injections of low cost funds from donors in order to remain operationally and financially sustainable. Hence, many governments and donors sustained their efforts to allocate huge amounts on credit subsidies with generally poor results, as would have been expected. Still, some supply-leading finance theorists believed that subsidised credit programs were essential to stimulate agricultural production and economic growth despite poor results during the 1960s and until the 1980s.

Nonetheless, to this day it has been alleged that some governments, namely India and China, continue to run state-sponsored subsidised credit programs. Fully cognizant of the failings of supply-led finance more than two decades ago, it is believed that these credit programs are being maintained for ideological reasons or as some form of a political tool (Robinson, 2001).

2.5.2 Theories of Group Lending with Joint Liability

The initial wave of theoretical work on microfinance focused primarily on joint liability or sometimes called 'group responsibility'. The joint liability condition in group-lending contracts is the most celebrated feature of the 'classic' Grameen contract and is often credited as the key innovation that led to the expansion of access to credit for the poor by opening up possibilities for microfinance (Morduch, 1999; Armendariz & Morduch, 2010:12). It has been proven successful in solving failures in the credit market by mitigating problems created by informational asymmetries such as adverse selection and moral hazard.

Under joint liability, borrowers now have an incentive to screen other borrowers so that risky borrowers are excluded from program participation. Likewise, borrowers have incentives to ensure that loans are used properly and that other borrowers who are also member of the group do not undertake extremely risky projects. Further, joint liability induces peer monitoring and enhances enforcement of contracts because borrowers face peer pressure to repay their loans.

According to Fischer and Ghatak (2011), joint liability can be lumped under two categories, namely: first, explicit joint liability; and second, implicit joint liability. Under explicit joint liability, group members are contractually obligated to repay the loan when one member does not have the capacity to repay the loan. Repayments by other group members can be enforced through the threat of denial of future credit to the whole group and not just the defaulting member or through withdrawals from the group's savings fund. On the other hand, the implicit conditions under joint liability is such that borrowers generally believe that the whole group becomes ineligible for future loans if a group member defaults, despite the absence of such stipulation in the lending contract.

The dynamics of joint liability contracts have generated a great deal of interest from economic theorists and have brought international recognition to the group-lending model or the 'classic' Grameen contract. Economic theorists like Stiglitz (1990) and Besley and Coate (1995) have sought to explain the economic foundations of the group-lending model of microfinance. Stiglitz (1990) in his study of the 'classic' Grameen model found that peer monitoring is mainly responsible for the bank's successful financial performance. This is because members of the peer group are jointly responsible for loan repayments and that they cannot gain access to further credit until all debts of the peer group has been honoured. This provides an effective incentive device to repay the loans. Further, he likewise found that the small size of the peer groups increased the incentives for monitoring and avoided the 'free-rider problem' existing in large groups. Hence, while the small group size increased the risk for the peer group from a single peer member's default, the gains from increased peer monitoring exceeded the losses from the increased risk.

Finally, Stiglitz (1990) concluded that the self-forming mechanism of the self-help groups (SHGs) provides strong incentives for people with similar risk characteristics to form. While it is apparent that those with high risk of default would like to join less risky groups, the availability of local information in self-selection leads to assortative grouping – individuals with low risks group themselves together and those with high risks are forced to group together.

Besley and Coate (1995) in their investigation of the impact on repayment rates of lending to groups with joint liability found both positive and negative effects. The positive effect is that successful peer group members may have an incentive to repay the loans of another peer who obtained poor returns to make repayment worthwhile. This however leads to higher costs for successful members and possible dropout in the future. On the other hand, the negative effect occurs when the entire group defaults, even when at least some members would have repaid their loans under individual lending. To mitigate this negative effect, Besley and Coate (1995) showed how harnessing social collateral could do it. The high level of social connectedness in the communities provides a powerful incentive device to repay, drawing upon the punishment mechanism to improve outcomes.

In a review article, Ghatak and Guinnane (1999) outlined the economic logic of joint-liability lending and showed how it can mitigate some problems facing lenders that lend to the poor without collateral – screening, monitoring, auditing, and enforcement problems. They identified four avenues through which joint liability could improve repayment rates, namely: i) adverse selection; ii) ex ante moral hazard; iii) monitoring; and, iv) voluntary default or ex post moral hazard. In theory, because borrowers have better local information, improved monitoring and can impose powerful social sanctions at low cost, group lending with joint liability contracts generate high repayment rates.

2.5.2.1 Adverse Selection

Asymmetric information in credit markets arises because borrowers typically have better information about their potential risk of default or repayment prospects than lenders. Adverse selection occurs when a lender is not capable of distinguishing and ascertaining the riskiness of borrowers when allocating credit (Ghatak, 1999). A lender can try to deal with this information problem by choosing to increase interest rates to compensate for the cost of gathering information about borrowers' types ('risky' or 'safe') or by offering loan terms that would attract only inherently 'safe borrowers'. In the absence of precise information, a lender must charge the same high rates to all potential borrowers, leading to the exit of 'safe borrowers' from the credit market (Armendáriz de Aghion & Morduch, 2004).

Some have argued that the self-selection of borrowing groups under the group-lending methodology reduces adverse selection problems because it can put local information to work for the outside lender (Ghatak, 1999; Van Tassel, 1999; Armendáriz de Aghion & Morduch, 2004). As the argument goes, adverse selection is mitigated under the group-lending methodology for two reasons. One, in an economy where all borrowers know each other's types, the group lending with joint liability contract will induce assortative matching. In theory, members of the risky groups will default on their loans more often than members of the safe groups. Hence, members of the risky groups end up paying higher effective interest rates compared to the safe types even though all borrowers have exactly the same contracts and interest rates. The lower effective interest rates induce safe borrowers to enter the credit market, resulting in improved efficiency as a whole.

Two, the group lending contract with joint liability in effect allows the lender to transfer some of the cost of administering credit to risky borrowers back to the risky borrowers themselves. By retaining safe borrowers, the average default incidence becomes even lower, thereby further reducing costs for the lender. The lender can now in turn reduce interest rates even further given its lower costs in administering loans to both ‘risky’ and ‘safe borrowers’. The lender would most likely reduce its interest rates if it faces stiff competition from other lenders in the market or if its aim is to simply recover its costs as part of its social mission. Therefore, group lending in theory can eliminate adverse selection problems and inefficiencies (Armendáriz de Aghion & Morduch, 2004).

2.5.2.2 Ex Ante Moral Hazard

The ex ante moral hazard refers to the borrower’s unobservable actions – including levels of labour and other inputs – once the borrower has taken out a loan but prior to the realisation of project returns. The borrower’s unobservable actions can be such that it can affect the outcome of the project. If it impacts in a negative way, it will increase the probability of default. This is a serious problem of credit markets because the lender cannot stipulate how a borrower should run the project and cannot exert control in the receipt of repayments. Further, since the borrower is protected by limited liability, as the borrower has no collateral, the borrower does not fully internalise the cost of project failure and may be tempted to undertake riskier projects (Ghatak & Guinnane, 1999; Armendáriz de Aghion & Morduch, 2004).

Stiglitz (1990) and Varian (1990) set out the important early work on the ex ante moral hazard approach to group lending. They argue that the group lending with joint liability contract circumvents the ex ante moral hazard because it induces borrowers to monitor the choice of projects and risks taken by other borrowers and to impose penalties upon those who have chosen excessively risky projects (Armendáriz &

Morduch, 2010). The joint liability contract likewise relies on the ability of the group to impose sanctions on individuals who try to avoid loan repayments.

2.4.2.3 Ex Post Moral Hazard

The ex post moral hazard refers to the actions of the borrower after the realisation of project returns. The ex post moral hazard problem arises not from asymmetrical information but from the limited ability by the lender to enforce sanctions against a voluntarily defaulting borrower even if the project succeeded. This problem likewise occurs when the borrower can falsely claim a loss because the lender does not fully observe the borrower's profits.

Under group lending with joint liability however, the lender may still be able to reinforce payment. According to Besley and Coate (1995), there is a positive net effect on repayment rates between highly successful borrowers paying off the loans of not so fortunate borrowers and moderately successful borrowers defaulting on their own because of the burden of paying off the loans of those whose projects have failed. Hence, with sufficient social capital, enforcement of loan repayments is better in a borrowing group than under an individual liability contract (Ghatak & Guinnane, 1999).

Conversely, despite the many celebrated features of joint liability lending – particularly how it is able to circumvent informational asymmetries – there has been a shift in recent years among microfinance institutions from joint-liability loans towards individual-liability loans (Giné & Karlan, 2010). The move away from joint-liability loans has even included well-known MFIs including Grameen Bank and BancoSol of Bolivia.

2.5.3 Gender and Microfinance

2.5.3.1 Unitary Approach or 'Pure Investment' Model

The theoretical framework for how household decisions are made goes back to the influential work by Gary Becker in the 1960s on the so-called unitary approach. The approach is sometimes called the 'pure investment' model because it leaves no scope for intra-household conflict given its focus on efficiency. In his *A Treatise on the*

Family, Becker (1981) examines the principles of the efficient allocation of labour on households. He aims to understand how households allocate members to activities, with individuals looking to gain from their comparative advantages. Becker likewise assumes that in order to analyse decisions about expenditures and 'noneconomic' investments such as the number, education and health of children, male and female preferences can be aggregated into a common household objective function. Applying Becker's prediction in agricultural economies in developing countries, it suggests that men have a comparative advantage over women in strength-intensive marketable activities. As a result, women are left to devote their time and resources in marketable activities that require relatively less physical strength, or in unpaid household work (Armendáriz & Morduch, 2010).

Based on the pure investment model, Rosenzweig and Schultz (1982) find that parents 'tragically' allocate nutrients in a pure investment manner. In their study in rural India, they found that the survival probabilities for female infants are higher in places where women have greater employment opportunities. They argue that parents are forced to 'invest' in children with the greatest earning potential, resulting in the uneven mortality patterns. Based on a simple approach by Behrman et al. (1982), they show that allocation of resources (e.g., food) shift with incomes. At very low-income levels, male children represent a higher earning potential for the household, thus, resources may be biased against female children as they represent a lower earning potential. As the general level of income increases, however, the allocation of resources within households becomes more equal.

2.5.3.2 Financial Impact of Lending to Women

The bias in favour of women borrowers by MFIs is because women are perceived to be better clients such that targeting them creates financially sustainable institutions. Evidence indicating that women are, in fact, better clients supports this perception. Khandker et al. (1995) find that 15.3 per cent of male borrowers were having difficulties in loan repayments compared to only 1.3 per cent of women borrowers. Further, Kevane and Wydick (2001) in their study of a group lending institution in Guatemala find that female borrowing groups outperformed their male borrowing counterparts. Along this line, Hossain (1988) likewise finds that in Bangladesh, 81 per cent of women borrowers did not encounter repayment problems compared to only 74 per cent of men borrowers.

Further, there is also evidence that suggest that women likewise make better employees. In Albania, Beck et al. (2009) find that loans handled by female loan officers have lower default rates on average compared to loans handled by male borrowers. In addition, in low-income countries, wages of women are relatively lower than those of men (Armendáriz & Morduch, 2010). An argument can thus be made that it makes good financial sense for MFIs to prefer and deal more with women clients as against men clients.

2.5.3.3 Development Impact of Lending to Women

Based on a publication by the UN (2012), *The World's Women 2010,* female-headed households are more likely to be poor, women likewise account for two-thirds of the world's 774 million adult illiterates, and have lower labour participation rates (52 per cent for women vis-à-vis 77 per cent for men). Gender disparities in adult literacy rates, labour participation (i.e., especially in jobs with status, power and authority) and decision-making positions remains wide in most regions of the world. From a development impact standpoint, therefore, targeting women may lead to a greater impact on socioeconomic empowerment.

In a study by Chattopadhyay and Duflo (2004) on whether the provision of public goods can be attributed to the *Pradhan*, the local village council chiefs in India, they found that women *Pradhan* tend to be biased in favour of the provision of public goods beneficial for women, families, and communities compared to their male counterparts. On the other hand, in terms of children's health, Pitt et al. (2003) find that credit provided to women clients in Bangladesh improves measures of nutrition and health for both boys and girls. Credit to men, however, has no significant effect. Against these arguments and ethical considerations aside, microfinance institutions – especially those pursuing social objectives – might therefore prefer to work with women as the resources that will be allocated to them may lead to stronger developmental impacts.

2.6 Measuring Microfinance Impact

Since the birth of the 'new wave' microfinance in the late 1980s, microfinance has come to be seen as the new way of providing the poor access to finance (Hulme & Mosley, 1996) and an important development policy and poverty reduction tool. Like any other poverty reduction tool, however, its impact and effectiveness is not without any criticism. Given various anecdotal evidence of microfinance success stories from female borrowers and other micro entrepreneurs notwithstanding, many argue that the impact and effectiveness of microfinance as a poverty reduction tool is still questionable (Copestake, 2002; Midgley, 2008; Westover 2008) and no clear evidence yet exists that microfinance have positive impacts (Armendáriz & Murdoch, 2005).

One of the earliest and most-cited evidence of the impacts of microfinance on poverty is the set of studies by David Hulme and Paul Mosley (1996). Hulme and Mosley employed a control group approach and looked at the changes in household income in villages with microfinance programs as well as in non-program areas. They found that only non-poor borrowers (with income levels above the poverty line) enjoy sizable positive impacts with microfinance. However, the more provocative finding is that not only do the poor household not benefit from microfinance but that a huge majority of those in the control group with incomes below the poverty line prior to getting loans actually ended up with less incremental income.

Another important finding by Hulme and Mosley, albeit impliedly, is that aside from access to credit, other complementary factors are crucial in the generation of income or output. One of this is the microfinance borrowers' entrepreneurial skill. This is similar to the findings by Banerjee et al. (2009) in their study in Hyderabad, India where they made the following findings. Firstly, households with an existing business at the time of the program invest in durable goods, and their profits increase. Secondly, households with high propensities to become business owners see a decrease in non-durable consumption, consistent with the need to pay a fixed cost to enter entrepreneurship. Thirdly, households with low propensities to become business owners see nondurable spending increase.

Another widely quoted study that suggests a positive social and economic impact of microcredit on Bangladesh is the highly influential Pitt and Khandker (1998) study. The study remains the most influential study of the long-term impacts of microcredit and is still a leading basis for the microfinance narrative – that it reduces poverty and more particularly so when given to women borrowers (Roodman & Morduch, 2009). In their study, Pitt and Khandker find strong evidence that microfinance programs help the poor through consumption smoothing and asset building. It likewise found that some five per cent of borrowers might lift themselves out of poverty each year by borrowing from the microfinance program provided that the estimated impacts on consumption continue over time (Khandker, 1998:56). The Pitt and Khandker (1998) and Khandker (1998) studies are the commonly cited evidence by Yunus of his belief that five per cent of Grameen Bank's clients exit poverty in a typical year (see for example Yunus, 1999, 2007).

Roodman and Morduch (2009) however, in their review of the impact of microcredit on the poor in Bangladesh, specifically the Pitt and Khandker study, conclude that there is little solid evidence that microfinance improves the lives of the poor. Roodman and Morduch showed in their replication of the Pitt and Khandker study that it does not convincingly rule out reverse causation. Citing an example, Roodman and Morduch (1998) state that a positive correlation between access to microcredit and household spending may merely suggest that richer households borrow more. As a result of the challenge to the Pitt and Khandker study posed by Roodman and Morduch, the already scarce academic evidence of the proposition that microcredit reduces poverty was further depleted (Armendáriz & Murdoch, 2005; Duvendack et al., 2011).

Nonetheless, assessing the true relationship between microfinance and poverty reduction is not simple. Accurate assessment of the impact of microfinance on poverty reduction, if any, requires a rigorous test of the counterfactual – what would have happened to a person who borrowed from an MFI is she had not done so. As Kurmanalieva et al. (2003) point out studies based on a rigorous counterfactual find much smaller gains attributed to microfinance than older, non-randomised studies. These kinds of studies, while much needed, are sorely lacking (Kurmanalieva et al., 2003). Further, the views of Kurmanalieva et al. (2003) is in conformity with the proposition under the 'Stainless Steel Law of Evaluation' by sociologist Peter Rossi (1987), which states that "the better designed the impact assessment of a social program, the more likely is the resulting estimate of net impact to be zero". The Stainless Steel Law – if it holds up – implies that randomised studies, the acknowledged best approach to estimating net impacts will most likely show smaller or zero effects than older non-randomised studies (Roodman, 2012).

The scientific testing of the impact of microcredit through randomised experiments is unfortunately surprisingly difficult (Rosenberg, 2010). There may be several plausible explanations if we find people who have access to microcredit are doing better than those who do not. For example, a person who applies for a microcredit may be more driven, ambitious and entrepreneurial, in which case she would probably be better off than others whether or not they can get access to microcredit. Until recently, just a few researchers have used randomised controlled trials (RCTs) to assess microfinance impact by way of testing the counterfactual. Well-designed RCTs are seen by many as the gold standard for assessing an intervention's impact and is arguably the best way to assess the impact of microfinance interventions (Stewart et al., 2010). The Banerjee et al. (2009) study together with the Karlan and Zinman (2011) study represent two very crucial RCTs. The said studies found no strong causal link between access to microfinance and poverty reduction. They likewise found no evidence of improvement in household income or consumption.

In the Banerjee et al. (2009) study, half of the 104 slums in Hyderabad, India were randomly chosen for the opening of an MFI branch by Spandana. In 2006-2007, Spandana started lending in the 52 randomly chosen slums. The study results showed that 15 to 18 months after lending began in treated areas, there was no effect of access to microcredit on average monthly expenditure per capita but expenditures on durable goods increased in treated areas and the number of new businesses increased by one third. It likewise found no impact of microcredit, at least in the short term (within 15-18 months) on measures of health, education or women's decision-making.

In the Karlan and Zinman study, First Macro Bank, an MFI based in Manila, the Philippines was persuaded to adopt a credit scoring system that randomly awarded or denied loans to marginal borrowers. The results of the study were disappointing. As far as the evidence goes, the loans did not result in improvement in income levels or type of diet about 18 months after the provision of credit. The study results also ran counter to the women orientation of microfinance as it found that male-owned enterprises tended to become more profitable after loan provision vis-à-vis women-owned enterprises.

The mildly positive results of the first RCTs done in the field of microfinance have spawned heated debates between researchers and practitioners (Banerjee, Duflo & Karlan, 2009; Easterly 2010) and some of the biggest network organisations in microfinance (e.g., Grameen Foundation, Accion International, FINCA, Opportunity International and Women's World Banking). The proponents of microfinance are reluctant to accept the RCT findings and continued to point out anecdotal evidence of strong positive impact of microfinance through various individual success stories.

There is however an indication that some proponents of microfinance do not wholly disagree with the mildly positive findings, arguing that like other factors, microfinance alone cannot do the job (Daley-Harris, 2007). Daley-Harris argues that there is no one single solution to global poverty and as such microfinance should be combined with a broad array of empowering interventions in order for it to become a powerful poverty reduction tool. Even Yunus (2003:171) readily acknowledges the reality of the need for complementary factors for microfinance to have some positive impact on poverty and admits "microcredit is not a miracle cure that can eliminate poverty in one fell swoop" and "…combined with other innovative programs that unleash people's potential, microcredit is an essential tool in our search for a poverty-free world".

To understand whether microfinance works, more rigorous research needs to be done. What the recent RCTs and debates on microfinance have significantly contributed to the microfinance literature is that it is becoming apparent – if it is not already – that microfinance may not be the silver bullet that it was claimed to be by its staunchest proponents and that the microfinance narrative may have been overhyped. Nevertheless, the gap between the rosy microfinance narrative of the past and the gloomy rigorous evidence of present studies should not be used as an indictment of microfinance. If indeed it does not on the average reduce poverty, it must have some beneficial use for the poor for it to withstand the market test. This is what this study aims to understand and explore.

2.7 Chapter Summary

This chapter can be summarised into three major discussions: political economy of microfinance, theoretical and empirical bases of the research, and the review of microfinance impact studies. The review on the political economy of microfinance has concluded that the global microfinance industry has evolved in line with the changing political, philosophical and economic ideologies of the time. It can be argued that the changing dynamics of microfinance is one that took a positive turn at least when measured in terms of growth and sustainability. From its early beginnings as largely failed highly subsidised credit programs in the 1950s and 1960s, the global microfinance industry can now be described as more dynamic, inclusive (e.g., with higher outreach) and sustainable. These developments, however, have also come under recent scrutiny with some arguing that the growing commercialisation of microfinance is actually hurting the poor.

Further, the review of literature on the theoretical and empirical bases of the study has concluded that there are at least three major theoretical bases as grounds for this research. These theories – supply-leading finance, group lending with joint liability and women empowerment – attempts to explain the major underpinnings of microfinance. These theories alone, however, cannot explain all aspects of microfinance. What these major theoretical bases represent are the most widely researched theories that made the most impact on the development and advancement of microfinance as a development tool.

Finally, the last part of the chapter reviewed and discussed a number of microfinance impact studies. It concluded that there is now almost universal acceptance of the idea that microfinance is not a panacea for poverty. This was primarily due to the results of recent microfinance studies using randomised experiments that found no positive impact on the average of access to microcredit and poverty reduction. Given that this notion was still very prevalent as recent as 2006 during the peak of the microfinance revolution, the study results shifted the microfinance narrative to a more deliberate one. These recent developments should, however, not be used as an indictment of microfinance but as opportunity to explore and study how it can still possibly be improved in order to be a more effective development tool.

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CHAPTER THREE
POLITICAL ECONOMY AND MICROFINANCE IN THE PHILIPPINES

3.1 Introduction

Chapter 3 provides an overview of the political economy and microfinance in the Philippines. The main objective of this chapter is to determine and establish the interrelationships between the different actors that make up the Philippine political economy and how it directly and indirectly affects the microfinance landscape in the Philippines. This chapter will also present and discuss how the present microfinance policy infrastructure evolved and was shaped into what it is today. This determination is central to the research as the thorough understanding of the political and microfinance landscape is a crucial input in analysing study results.

This chapter starts by describing Philippine geography, people and government in Section 3.2. It then discusses the Philippine political economy from 1899 to 2014 in Section 3.3. The next part, Section 3.4, presents the socioeconomic profile of the Philippines. It is followed by a discussion of the microfinance industry in the Philippines in Section 3.5.

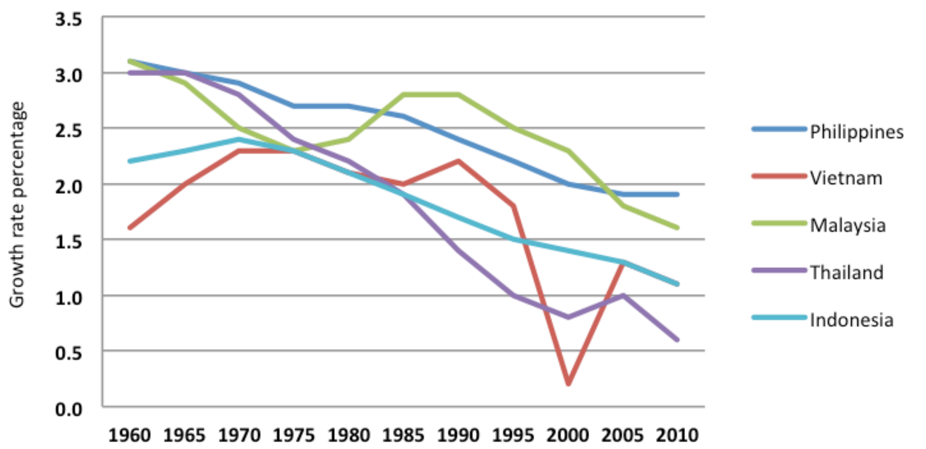
3.2 Geography, People, and Government

The Philippines, officially known as the Republic of the Philippines, is an archipelagic state comprising of 7,107 islands located in Southeast Asia. The Luzon Straight across which lies Taiwan bound it on the north. It is bounded on the east by the Philippine Sea. To the south, the Celebes Sea separates it from another archipelagic state, Indonesia. The Sulu Sea to the southwest separates it from Malaysia. Finally to its west, across the West Philippine Sea lies Vietnam. The Philippines is categorised broadly into three main island groups: Luzon, in the north; the Visayas in the centre; and Mindanao in the south. The capital city, Manila, is located in Luzon and is the seat of government and the centre of education, trade and economic activities.

The Philippines has a land area of about 300,000 square kilometres. The Philippines has a tropical climate and roughly has two distinct seasons, a dry season (November to April) and a wet or rainy season (May to October). Based on official government estimates, the Philippine population as of the 2010 Census of Population and Housing stood at 92.34 million with an estimated population growth rate of 1.89 per cent (National Statistics Office, 2012). Projecting this data forward, the country recently celebrated a population milestone, breaching the 100 million mark in July 2014 and becoming the 12th most populous country in the world Commission on Population, 2014).

The current population growth rate is moderately lower than the population growth rates experienced by the country during the 1980s (2.35 per cent); the 1990s (2.34 per cent); and 2000s (2.04 per cent). It is still, however, significantly higher (see Figure 1) vis-à-vis its neighbouring countries and relatively comparable economies such as Malaysia (1.58 per cent), Indonesia (1.07 per cent), Vietnam (1.08 per cent) and Thailand (0.57 per cent).

Figure 1. Population growth rate, selected Southeast Asian Countries



The official languages in the Philippines are Filipino, which is based mainly on Tagalog, and English. According to the 2000 Census of Population and Housing of the National Statistics Office (NSO), 63.71 per cent of the household population five years old and over can speak English (National Statistics Office, 2005). Further, the figure is significantly higher in the National Capital Region, where 81.75 per cent of the household population five years old and over able to speak English.

The modern Philippine republic gained independence from Spain during the declaration of independence by General Emilio Aguinaldo on June 12, 1898. The declaration of independence was however not recognised by both Spain and the United States of America (USA). On December 10, 1898, the Treaty of Paris was signed and the Philippines was ceded to the USA by Spain for US$20 million. After the Philippine-American War (1899-1902), World War I (1914-1919) and World War II (1939-1945), the USA finally recognised Philippine independence through the signing of the Treaty of Manila on July 4, 1946. The date of Philippine independence was officially observed on July 4, 1946 until it was amended by Republic Act (RA) No. 4166 on August 4, 1964. The act changed the official date of Philippine independence from July 4, 1946 back to the original declaration of independence of the Philippines from Spain on June 12, 1898.

The Philippines is a democratic republic with a presidential system of government. It has three separate and co-equal branches of government, namely: i) executive (law-enforcing body); ii) legislative (law-making body); and, iii) judiciary (law-interpreting body). The President who functions as the head of state, head of government and commander-in-chief of the armed forces heads the executive branch. The President is elected by popular vote to a fixed term of six years and is not eligible for any re-election. On the other hand, the legislative branch consists of the Senate or the Upper House and the House of Representatives or the Lower House. The members of the Senate are elected at large to a six-year term while the members of the House of Representatives are elected from both legislative districts and through sectoral representations to a three-year term. Finally, the judiciary branch consists of a system of courts with the Supreme Court as the highest judicial court as well as the court of last resort. The Chief Justice leads the Supreme Court together with 14 Associate Justices. The justices are appointed by the President of the Philippines upon the recommendation of the Judicial and Bar Council and serve life terms until the mandatory retirement age of 70. The 1987 Philippine Constitution sets up a system of checks and balances to ensure that no one branch of government becomes too powerful over the other two as each branch has powers that it can use to check and balance the power of the other.

3.3 Political Economy

3.3.1 Laying the Foundation – The Rise of the 'National Oligarchy' (1899-1960s)

The modern Philippine political economy can be traced back to the rise of the land-owning elite predominantly consisting of Filipino-Chinese mestizos at the onset of the 20th century. According to Tan (1986), the Filipino-Chinese mestizos are an important element of Philippine society and played a significant role in the formation of the Filipino middle class. Their role in nation building continues even in contemporary times. This land-owning class had been formed as a result of agricultural commercialisation during the 19th century (Crouch, 1985). When the Americans' colonial rule began in 1899 following its victory in the 1898 Spanish-American War, they sought to win over these autonomous land-owning elites and powerful local forces as part of their basic 'policy of attraction'[2]. The policy, as espoused by Governor-General William H. Taft, centred on three key themes. First, is to encourage Filipino participation in government initially at lower provincial levels and eventually – albeit with some controversies – at the American-controlled commission. Second, is to see to it that short-term sedition laws are set in place to legally hamper the struggle for independence of the Aguinaldo-led revolutionary forces (De Dios & Hutchcroft, 2003; Burns, 2008). Third, is to show significant bias in political support and patronage to the land-owning class including the Federal Party *(Partido Federal)*[3], the dominant political party at the time. The 'policy of attraction' induced the land-owning elites to cooperate with the Americans and would leave a deep and lasting imprint on the Philippine political economy that remains to this day.

Under increasingly light state supervision during the American colonial period (1899-1946), the elite essentially governed themselves under the colonial regime and used its privileged position to further its economic interests. This period ushered in the rise of a 'national oligarchy' of landed elites (Anderson, 1988). Unlike in Thailand and Indonesia where the 'bureaucratic-aristocratic' elites were strengthened by the

[2] During the time of William H. Taft as head of the Second U.S. Commission to the Philippines, he followed a number of what he believed to be pragmatic short-term policies – often termed as the "policy of attraction" – to bring about Filipino support for U.S. rule and end the ongoing resistance from Filipino independence activists

[3] Formed on 23 December 1900, the Partido Federal dominated Manila politics from 1900-1905. The party pushed for the statehood of the Philippines as one of its original platforms.

agricultural commercialisation in the 19th and 20th century, the same process in the Philippines led to the rise of the land-owning elite whose economic base were separate from the bureaucracy (Crouch, 1985). The favourable arrangements and patronage directly provided by the Americans to this favoured segment of Philippine society continued until the declaration of Philippine independence on July 4, 1946 following the signing of the Treaty of Manila.

The emergence of the Philippines as a truly sovereign state in 1946 was however difficult in part because the grantor of independence, the Americans, are a rising power unlike elsewhere in Southeast Asia where the grantor of independence are fading European powers (De Dios & Hutchcroft, 2003). In order to gain access to post-war reconstruction assistance, the Philippines under the leadership of President Manuel Roxas (1946-1948), the fifth president of the republic, had little choice but to agree to the terms of independence as legislated by the United States Congress. Post-colonial economic and foreign policies were thus overwhelmingly weighted to favour American trade and investment interests. Military agreements after the war likewise gave the Americans both powerful military bases as well as command over the armed forces of the Philippines. This arrangement clearly benefitted the elite as the unjust and graft-ridden political and economic structures during the colonial years were sustained with support of Washington.

As complete as the neocolonial system seemed, the situation quickly turned unstable for the Philippines. From 1946 to 1949, the country plunged into a deep crisis so much so that the government and the economy were in a state of collapse. This was in large part to the corrupt Filipino collaborators (i.e., land-owning elite) who readily acceded to American wishes as well as plundered the post-war reconstruction fund (Golay, 1961). To the contrary, Pomeroy (1992) argue that this was due to the neocolonial economic relations imposed by the Americans that were designed to favour their economic interests over Filipino interests.

The inflow of dollar payments (e.g., war damage payments, post-war reconstruction assistance and payment to war veterans and their families) was not enough to offset the negative balance of trade with the government incapable of stemming the outside flow of foreign exchange. In 1949, USA accounts for 77 per cent of Philippine foreign trade and 80 per cent of imports. Thus, inflow of dollar payments that were supposedly designed to spur economic development after the war flowed out of the Philippines as quickly as they poured in (Pomeroy, 1992).

The government, now led by President Elpidio Quirino (1948-1953) – after the sudden death of Roxas in 1948 – responded to the balance of payment crisis by instituting a system of import and currency exchange controls. As an unintended consequence of this policy response to the crisis, the Philippines entered an import substitution industrialisation (ISI) stage as the manufacturing sector grew rapidly, averaging 12 per cent growth per year during the first half of the 1950s.

The ISI stage was however short-lived as the growth rate of manufacturing fell by about a third during the second half of the 1950s and declined even further during the early 1960s. The latter half of the 1960s saw the slight recovery of the manufacturing sector. It was apparent, however, at the time that the manufacturing sector was no longer the engine of development that it was perceived to be in the early 1950s. As short-lived as it may be, the early years of the ISI stage in the early 1950s brought about important changes in the economic interest of the ruling class. The elite expanded their interest from agriculture and diversified into a mix of agriculture, industry, real estate, commerce and finance. Thus, the ISI stage also ushered in the period when the diversified family conglomerates became the leading segment of the economy (Hutchcroft, 1998).

In the early 1960s, with the aim of stimulating the economy, President Diosdado Macapagal (1961-1965) devalued the peso and abolished import controls. The peso devaluation boosted agricultural exports and increased production of mineral products. This was accompanied however by substantial tariffs for emerging industries. These contradictions showed the lack of a clear economic development policy direction. The diversified family conglomerates took advantage of this lack of policy direction. They further amassed wealth through agricultural and mineral exports that were propelled by the peso devaluation. The manufacturing firms also took advantage of tariff controls – similar to what happened in the early 1950s – when they greatly benefited from exchange controls.

3.3.2 Massive Corruption and Debt-Driven Growth – Ferdinand Marcos Administration (1965-1986)

The two decades of the Ferdinand Marcos administration were very tumultuous and was marked by social and political unrest. During the mid up to the late 1960s, the Philippines faced various economic problems and experienced a highly unstable political environment. Bureaucrat capitalism worsened and the manufacturing sector, which has been the engine of economic growth during the previous decade, began to slow down. Overall, real GDP growth slowed down as agriculture production declined as well. In the late 1960s, exports became sluggish and the country experienced another balance of payment (BOP) crisis.

The crisis was hastened in 1969 as Marcos raided the public treasury to secure votes through political patronage, organised violence and fraud to ensure victory in his re-election bid (Steinberg, 1994). After Marcos won in 1969 with what had been the most dishonest elections in Philippine history at the time, the BOP crisis was followed by the devaluation of the peso that fuelled another round of inflation. At the time, the atmosphere of optimism that marked Marcos' first few years in office has largely dissipated.

The economic slowdown in the early 1970s further exacerbated civil unrest, both from the right wing and left wing elements. Communist insurgency was re-established along Maoist lines and violence between Muslims and Christians in Mindanao and the Sulu archipelago was on the rise (International Business Publications USA, 2007). The quality of life deteriorated even in urban areas resulting in heightened demand for a change in leadership. Marcos resorted to propaganda and massive government spending to prop up the popularity of his regime. The political machinations were largely funded by foreign borrowings that further plunged the country in debt. The foreign loans, however, came at a steep price. Economic policies, even long after the loans were granted, were greatly influenced by the dictates of the International Monetary Fund (IMF).

In September 1972, Marcos declared martial law. He cited the need for authoritarian rule to spur economic growth and put an end to the communist insurgency (Kushida, 2003). He then subsequently proclaimed a new constitution that ensured his term as president up to the next decade. He likewise suppressed the media and used violence against the political opposition. Massive corruption, crony capitalism and profligate spending meanwhile continued.

During the martial law years, the United States and international organisations such as the World Bank (WB) and IMF largely supported the authoritarian regime. Marcos was seen by the Americans as a key ally in maintaining their strategic military presence in the Asia Pacific region due to the Cold War. In view of this alliance, Marcos got more aids and loans from the WB and IMF.

In the meantime, freedom remained largely curtailed as those opposed to Marcos were swiftly arrested and thrown into jail on the strength of trump-up charges. This did not however stop Marcos' foremost critic, Senator Benigno Aquino, from returning from exile in the United States. Upon his return to Manila in 1983, Aquino was assassinated in the airport tarmac. This brazen act further catapulted the country into deeper economic and political turmoil, which surprisingly culminated in a bloodless revolution in February 1986.

By the time Marcos fled to Hawaii in February 1986 – ending his 21-year rule as president – the economy was severely crippled and was left in ruins. The '*Bagong Lipunan'* (New Society) envisioned by Marcos has turned into a nightmare as the country's democratic institutions were severely weakened, foreign debts ballooned, investor confidence at its lowest and the economy plummeted. The Philippines was then called as the 'Sick Man of Asia'. It is important to note that the development of the Philippines during the 1960s and 1980s has not been particularly bad compared to other poor countries from the rest of the world. However, viewed against its neighbouring Asian tiger economies, the 'sick man' tag seemed justified.

3.3.3 Erratic Recovery from Deep Crisis – Corazon Aquino Administration (1986-1992)

The administration of President Corazon Aquino was propelled into power through the triumph of the 1986 People Power Revolution. It marked the end of an authoritarian regime and ushered in the restoration of democracy in the Philippines.

The relatively peaceful manner by which Aquino was catapulted into power drew international acclaim and admiration. It also became the blueprint as well as an inspiration for other non-violent revolutions in other parts of the world.

Upon assuming the presidency, Aquino immediately formed a revolutionary government and provided for a transitional constitution that restored civil liberties and dismantled the predominantly Marcos-ingrained bureaucracy. She appointed a commission that submitted a new constitution that was ratified and enacted in February 1987, almost a year into her term. The 1987 Philippine Constitution limited the powers of the presidency and fixed its term to six years with no re-election. It also established a bicameral legislature. Aquino focused her economic policies on creating a market-orientated and socially responsible economy, with the private sector playing a central role.

Early on, it became apparent that Aquino had to decide on the issue of foreign debt. On the international front, the country and the Aquino administration were faced with a massive US$28.0 billion in external debt due to the huge borrowings made during the Marcos administration. At the time, government economic planners argued that economic recovery might not be achieved in the short to medium-term if huge resource outflows associated with external debt servicing will not be reduced. Meanwhile, some government policy advisers likewise recommended that Aquino adopt a unilateral two-year moratorium on debt servicing and a selective repudiation of loans that will be found tainted with fraud or corruption. They added that there might simply be not enough money left for public spending in infrastructure, education and social services to spur any type of economic recovery from the deep recession in 1984-1985.

On the other hand, business-oriented groups, the private sector and their representatives in the Aquino cabinet objected to the recommendation that the country take unilateral action on its debt. They argued that it is essential that the Philippines not break with its major creditors in the international community and honour all its debt. Ultimately, President Aquino rejected the idea of debt moratorium and selective loan repudiation. On September 18, 1986, during President Aquino's historic speech[4] before the joint session of the United States Congress, she clearly stated that the Philippines would honour all its debts:

> *"...Finally may I turn to that other slavery: our $26 billion foreign debt. I have said that we shall honor it. Yet, the means by which we shall be able to do so are kept from us. Many of the conditions imposed on the previous government that stole this debt, continue to be imposed on us who never benefited from it.*
>
> *And no assistance or liberality commensurate with the calamity that was vested on us has been extended. Yet ours must have been the cheapest revolution ever. With little help from others, we Filipinos fulfilled the first and most difficult condition of the debt negotiation, the full restoration of democracy and responsible government..."*

Aquino likewise faced the highly contentious issue of land reform early in her administration. Given Aquino's campaign promise of rural and equitable development and the moral imperative of reaching out to the poor, there were high expectations that a meaningful and true land reform program will be implemented. Government economic planners likewise advanced the idea that a redistribution of wealth is required in order to achieve the objective of increasing the purchasing power of the poor and spur broad-based spending. However, Aquino failed to urge Congress to craft a substantive land reform program. Thus, while the First Congress under the 1987 Constitution was able to pass the Comprehensive Agrarian Reform Law on June 10, 1988, the law was said to be weak and full of loopholes. After all, land-owning interests still heavily represented Congress at the time. The high expectations of rural development and wealth redistribution through land reform were not met and a meaningful and true land reform never happened.

The passage of a weak agrarian reform law meanwhile once again showed that the land-owning elites, from which the Aquino clan also belonged, had already been deeply entrenched and wielded great influence over state and economic affairs. The heavy influence of the ruling elite and the United States in the Aquino government

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[4] Five hours after the eloquent address, the House of Representatives voted 203 to 197 in favour of providing US$200 million in emergency aid to the Philippines.

was also viewed by many as one of the reason for the privatization of government-owned utilities during her term. It also became apparent meanwhile that the economic perspective prevalent during the Marcos administration is still embedded in the bureaucracy. Government policies are still being shaped, influenced and redirected to favour the interests of the business community and international creditors to the detriment of the poor.

Modest growth was registered during Aquino's six-year term particularly from 1986-89 when the economy grew at an annual average of 5.2 per cent. She proved that moderate growth could be achieved even with huge resource outflows in the form of debt-service payments. The modest growth, however, was derailed by a series of unfortunate natural and man-made events. In 1989, a failed coup attempt by right-wing rebels slowed down the economy. This was exacerbated in July 1990 by a powerful 7.8 magnitude earthquake followed by the eruption of Mt. Pinatubo in June 1991, the second largest volcanic eruption of the 20^{th} century. The large aerosol cloud from the intense volcanic eruption lowered average global temperature by about 0.60C over the next 15 months.

The issue of the presence of American military bases was also a test faced by Aquino. She declared that it was an affront to Philippine sovereignty. The negotiations on the renewal of lease for the military bases threatened to sour relations between the two countries. In September 1991, the Philippine Senate rejected the renewal of the lease of the American military bases by the slimmest of margin, voting 12-11. Nonetheless, in the aftermath of the Mt. Pinatubo eruption that severely damaged the American military bases in the Philippines, American forces subsequently abandoned them and left the country. It marked the pull-out of the strategic military presence of the United States in Southeast Asia.

Overall, the economy grew by 3.4 per cent from 1986-1992. The slow growth was however not enough for the Philippines to recover from the deep crisis in 1984-1985. As the country entered the 1990s, the crucial question for the political economy was whether the ruling class – which holds majority of the nation's wealth and wields enormous influence in policy-making – would limit its political activities to seeking economic advantage or would forge its economic and political interests in such a way that would foster a dynamic economy. As the issues of land reform and privatisation of government-controlled utilities have however shown, the elites have already created a relatively strong economic base independent of the state and showed that they will not be easily pushed aside by the government.

3.3.4 Building Reform Momentum – Fidel Ramos Administration (1992-1998)

In the presidential elections in May 1992, then Defence Secretary Fidel Ramos, who had the support of outgoing President Aquino, won the presidency with just 23.6% of the total votes in a seven-way race. Nevertheless, despite an underwhelming mandate, Ramos immediately launched an economic revitalisation plan premised on the following policies: i) increased private sector participation and investments; ii) further government deregulation; and, iii) political solutions to the insurgency problem.

As a result of the government's policies and programs designed to foster national reconciliation and unity, the Philippines experienced a period of political stability and rapid economic growth and expansion under Ramos. Major peace agreements with Muslim separatists, communist insurgents and military rebels were secured. These initiatives resulted in renewed investor confidence in the economy. Major industries were also deregulated and non-performing government assets were privatised. Consequently, the telecommunications industry and other protected sectors were opened up to domestic and foreign competition. The severe electricity shortage that threatened the Ramos administration early on was likewise addressed.

Expanding and deepening the reforms undertaken by Aquino, the economy recovered dramatically under Ramos. From 1993-1997, the economy grew by 5.0 per cent while per capita GDP increased by 2.8 per cent per year, the highest in more than two decades. Ramos likewise vigorously implemented a comprehensive social reform agenda that addressed the long-standing problem of poverty, jobs and livelihood, health, education and skills training, housing, environmental protection, children and the youth, the elderly and the handicapped, agrarian reform, and access to equal opportunity.

The stability in both the political and economic front under Ramos have left many to believe that the Philippines might now be ready to finally take off and join its more progressive neighbours. From the 'Sick Man of Asia', the Philippines was now dubbed as Asia's 'Next Tiger Economy'. The momentum in the economic gains during the first five years (1992-1997) was however briefly interrupted during the outset of the 1997 Asian Financial Crisis (AFC). This was eerily similar to the experience under Aquino where the promising economic gains from 1986-1989 were not sustained in 1990-1991 due to various internal and external factors.

Nevertheless, during the last year of Ramos' term in 1998, even if the Philippine economy took a down turn, it still fared better than most of its Asian neighbours. Many credit this economic resilience to the sound political, fiscal and economic policies under Ramos that drew praise from the international community. Overall, including the sharp decline in 1998, the economy grew by an annual average of 3.1 per cent under Ramos.

3.3.5 'Failed Experiment' – Joseph Estrada Administration (1998-2000)

In May 1998, unlike his predecessor, Joseph Estrada was elected to the presidency with a landslide victory. He leveraged his popularity as an actor to make gains in politics, first serving as a local executive for 17 years, as senator for one term, then as vice president until finally rising to the highest position of the land as president. His campaign promise to help the poor and to develop the rural and agricultural communities has also made him very popular among the masses. Nonetheless, despite his populist rhetoric, Estrada's policy pronouncements were surprisingly conservative. His approach to poverty alleviation did not involve direct cash transfers. He rather emphasized the need for job creation and greater rural infrastructure spending.

In terms of general policy direction, Estrada announced early in his term that he would form a strong economic team composed of technocrats, academics and respected business leaders. This helped calm down investors and middle-class fears who were concerned about his populist image and connections with unscrupulous personalities.

Under the cloud of the 1997 AFC and agricultural problems due to severe drought

Nevertheless while Estrada assumed the presidency under the cloud of the 1997

AFC and agricultural problems due to severe drought, the economy contracted by only negative 0.6 per cent in 1998. At the time, many consider the country to have escaped the contagion effects of the crisis that severely affected much of East and Southeast Asia. As a comparison, in 1998, the economies of its neighbouring countries fell significantly – Thailand by negative 10.5 per cent; Malaysia by negative 7.4 per cent; and Indonesia by negative 13.1 per cent. The economic resiliency was however largely attributed to the sound macroeconomic fundamentals left behind by his predecessor.

Still, even with a strong economic team behind him, Estrada failed to capitalise and build on the gains of the previous administration. His administration was marred by allegations of incompetence, corruption and cronyism. Meanwhile, in a complete policy reversal from Ramos, he likewise declared an all-out war against the Muslim separatist group Moro Islamic Liberation Front (MILF) that caused further instability in parts of Mindanao, southern Philippines.

In his second year in office, investor confidence started to wane. Estrada's weak leadership style and fresh allegations that he exerted influence in the investigation of his aide in the manipulation of the stock market manipulation has began to take its toll on the economy. Nonetheless, while the economy recovered and grew by 3.4 per cent in 1999, the country was again left behind by its neighbouring countries, which recorded significant gains despite experiencing severe recessions during the previous year.

In early 2000, Estrada's finance minister resigned in protest at a growing culture of corruption. Estrada's popularity also began to plummet. To stem the negative tide of public opinion, he sought to initiate delayed reforms that would have build upon the progress made by Ramos. It however proved to be too late. In October 2000, Estrada was embroiled in another controversy involving pay-offs from illegal gambling. In December 2000, the Senate initiated impeachment proceedings on Estrada due to the corruption charges. On January 16, 2001 however, the impeachment trial broke down when the Senate majority composed of a faction identified with Estrada voted to block the examination of evidence deemed crucial to the case. Nonetheless, this political manoeuvre backfired and hastened Estrada's departure from office as this led to massive street demonstrations and the loss of political support from his cabinet, military and the police. In January 20, 2001, the Philippine Supreme Court declared the seat of the presidency vacant as it deemed Estrada to have had constructively resigned from his position as President of the Republic of the Philippines.

On September 12, 2007 or after almost six years of trial by the government anti-graft court, the *Sandiganbayan*, the deposed former president was found guilty of plunder and was sentenced to life imprisonment. He was however subsequently granted pardon on October 25, 2007, just more than a month after his sentence by his successor, Gloria Macapagal-Arroyo. Estrada's tumultuous two and a half years in office have effectively undone the significant progress made by Ramos and pushed the country back into uncertainty.

3.3.6 'Strong Republic: Economic Recovery Amidst Political Instability' – Gloria Macapagal-Arroyo Administration (2001-2010)

When the Philippine Supreme Court declared the position of president vacant, it subsequently declared then Vice President Gloria Macapagal-Arroyo as president in January 2001. However, days after leaving office Estrada questioned the legitimacy of Arroyo's succession claiming that he did not resign. The Supreme Court, however, voted unanimously to uphold the legitimacy of Arroyo's succession. Arroyo was also able to gain the support of civil society groups and the victory of her allies in the national elections in May 2001 meant that Congress would support her priority measures.

Upon assumption in office, Arroyo immediately began the difficult task of putting the economy that was derailed by the failed Estrada government back on track. Arroyo, who holds a doctorate in economics, made the economy the focus of her presidency. Her policy thrusts were focused on the following: i) implementing an economic philosophy of free enterprises; ii) modern agriculture sector founded on social equity; iii) social bias toward the disadvantaged in the society; and, iv) good governance to build confidence in the country and channel resources to the poor.

Early in her administration and amid the backdrop of an unstable economy and political situation, Arroyo was able to restore investor confidence and won back many of the investments lost under Estrada. She placed high premium on reforming and strengthening the bureaucracy. Her first three years in office were however still marred by legitimacy issues. In October 2003, Arroyo survived an attempt to bring down her administration when junior military officers mounted a short-lived mutiny. Her husband, Jose Miguel Arroyo was likewise implicated in allegations of corruption and accepting bribes. At the time however, the people were still not open to the idea that the person they replaced Estrada with may also be embroiled in corruption, whether personally or through her family.

In May 2004, after initially announcing[5] that she would not seek the presidency, Arroyo ran and won the presidential elections. She defeated Fernando Poe, Jr., the presidential frontrunner and Estrada associate in a closely and bitterly fought election. The congressional canvass that followed was very contentious amid alleged discrepancies in the election returns and insinuations of widespread cheating by the Arroyo camp.

Amid this backdrop of continuing political instability, Arroyo was able to steer the economy into unchartered territory. In 2007, the Philippine economy grew at its fastest rate during the past three decades, with real GDP growing at seven per cent. During the global financial crisis in 2008, the Philippines was once again not severely affected unlike some of its regional neighbours. This was attributed to the following factors, namely: i) a vibrant domestic economy; ii) lower dependence on exports; iii) strong business process outsourcing industry; iv) inflow of remittances; and, v) minimal exposure in complex international securities.

The picture in the political front was however entirely different. Arroyo faced protests from Estrada supporters, right-wing forces and towards the end of her term even from her previous cabinet members and the civil society. This is due to mounting allegations of corruption and electoral fraud. When Arroyo finished her term in June 2010, she has the distinction of being the most unpopular president since Marcos. In a

[5] In a speech delivered on December 30, 2002, Arroyo stated that she would no longer seek the presidency in the May 2004 elections. The 1987 Constitution explicitly states that the President of the Philippines can only serve for one term. However, it also implicitly states that a president's successor who has not served for more than four years can still seek a full term. In October 2003, Arroyo announced that she would seek a full term.

2010 survey conducted by the Social Weather Stations, Arroyo registered a net public satisfaction rating of negative 53 per cent (i.e., 16 per cent approve her performance and 69 per cent who said otherwise), the lowest for a Philippine president since 1986. In it curious to note that none of her predecessors even had a negative public satisfaction rating during their term.

After Arroyo stepped down in 2010, corruption and electoral fraud allegations continue to hound her. Various cases have been filed in court as Arroyo has now lost her immunity from suits even though she ran and won for a lower office during the 2010 and 2013 elections. During the said elections, Arroyo was elected as congressional representative of Pampanga, her home province. On November 18, 2011, Arroyo was arrested following the filing of criminal charges against her for electoral sabotage. She is presently under hospital arrest while undergoing trial for both plunder and electoral sabotage charges.

Overall, the economic growth during her 10-year reign as president averaged a moderate 4.5 per cent per year. This was the highest vis-à-vis her three immediate predecessors, namely: i) Estrada: 2.3 per cent; 2) Ramos: 3.7 per cent; and 3) Corazon Aquino: 3.8 per cent. Many economists however argue that the economic growth during her administration only benefited the elite, big businesses and closely allied politicians and has largely excluded the poor. According the 2009 Human Development Report, the Philippines recorded a *Gini* coefficient or income inequality of 0.448. This is, at the time, the highest income inequality among ASEAN member countries with the exception of Myanmar and Brunei Darussalam.

3.3.7 'Straight Path: Good Governance as Key to Economic Development and Poverty Reduction' – Benigno Simeon Aquino III Administration (2010-Present)

In the May 2010 elections, Senator Benigno Simeon Aquino III, the son of former president Corazon Aquino and a reluctant presidential candidate was elected president. He won by a comfortable margin over former president Estrada during the first computerized national elections in the Philippines. Aquino campaigned on a promise to crack down on corruption, government transparency and good governance. This he claimed would be the key in reducing poverty in the Philippines.

After Aquino III won the elections, he promised a commitment to transformational leadership. His platform of government is contained under his ‘A Social Contract with the Filipino People’, which is the guiding framework and commitment to transformational leadership. More than halfway through his six-year term, Aquino has steadily embarked on a mission to steer the Philippines into a straight path to economic development anchored primarily on a *‘Daang Matuwid’* or ‘Straight Path’ rhetoric of good governance and leadership by example. Early in his term, Aquino’s efforts to institute reforms were however hampered by a bureaucracy that is still full of well-placed Arroyo political appointees. This was perceived as Arroyo’s attempt to use key government bodies (e.g., Office of the Ombudsman, Supreme Court, etc.) to block attempts to investigate her and her family for alleged corruption and other crimes even after her presidency ended in 2010.

Then, many Arroyo political appointees were asked to tender their courtesy resignation by Aquino. Some heeded the call while others did not. As expected, two key Arroyo appointees and known to be partial to Arroyo – Ombudsman Merceditas Gutirrez and Supreme Court Chief Justice Renato Corona – did not resign from their posts. However, facing the threat of imminent impeachment, Ombudsman Gutierrez resigned from her post on April 29, 2011. On the other hand, Corona decided to fight it out. On December 12, 2011, the House of Representatives impeached Corona[6]. The Senate was then immediately convened into an impeachment court with the trial commencing on January 16, 2012. Then on May 29, 2012, Corona was convicted by the impeachment court and was immediately removed from office.

In addition, given the high level of distrust with the Arroyo administration, Aquino ordered a review of all government contracts entered into by the previous

[6] Associate Justice Renato Corona was appointed by Arroyo as Chief Justice of the Supreme Court (SC) in May 2010, less than two months before she is constitutionally mandated to leave office on June 30, 2010. This is in violation of Section 15, Article VII of the 1987 Constitution which states that: “Two months immediately before the next presidential elections and up to the end of his term, a President or Acting President shall not make appointments to executive positions when continued vacancies therein will prejudice public service or endanger public safety.” However, the SC – packed with Arroyo appointees – ruled that the Constitutional ban on Presidential appointments does not apply to the Supreme Court. As the court of last resort, the SC is responsible for interpreting the meaning of the Constitution and its most recent decision is the law on the matter.

administration. This effectively halted spending in public construction and government services in the name of fiscal restraint. Many attribute government underspending as a major cause of the sluggish economic growth experienced by the country at the beginning of the Aquino administration. The domestic economy grew by a meagre 3.7 per cent in 2011. This is way below the growth target of 7.0 per cent under the 'Philippine Development Plan 2011-2016'. The economic slowdown in 2011 was also attributed to a myriad of external and internal shocks such as the Middle East and North Africa (MENA) crisis, high oil prices, fragile global economic recovery, the Japan and Thailand tragedies as well as typhoons and flooding which affected agriculture production and damaged infrastructure.

Learning from these early challenges while also remaining steadfast with his platform of good governance and a clean and transparent government, the economy dramatically recovered in 2012 and expanded by 6.8 per cent. This was followed by a better than expected GDP growth of 7.2 per cent in 2013. This is despite the various natural (i.e., 7.2-magnitude earthquake, super typhoon 'Yolanda', etc.) and man-made (i.e., Zamboanga City siege by the Moro National Liberation Front) disasters that affected the country in 2013. In fact, during the last quarter of 2013, the Philippines recorded the second best economic performance in the Asian region, next only to China.

The robust economic growth during the last few years were however without its fair share of critics. Some argue that economic growth remains 'exclusive' of the poor as evidenced by the growing number of poor families and an insignificant decline in poverty incidence. According to the latest data from the NSCB (2014), in 2012, 19.7 per cent of Filipino families are poor, a slight decline from the 2009 figure of 20.5 per cent of families. The slight reduction in poverty incidence among families translates to an increase in the number of poor families at 4.21 million in 2012, up from the 4.04 million in 2009.

Taking cognizance of the fact that the most recent robust economic growth did not seem to redound to a significant overall reduction in poverty, Aquino rolled out an updated 'Philippine Development Plan 2014-2016' in February 2014. Under the updated development plan, the Aquino government aims to meet its economic targets while at the same time make significant inroads in reducing poverty. In the next two years, Aquino intends to make a sharper connection between economic growth and poverty reduction by targeting specific regions and provinces where the poor lives for specialised interventions. The government however admits that substantially reducing poverty takes time especially given recurring geo-climatic shocks. Nonetheless, the government targets an overall economic growth of 6.5 to 7.5 per cent in 2014 and seven to eight per cent in 2015. Should these growth targets be achieved in the future, the Aquino administration hopes that this would subsequently lead to a significant reduction in poverty.

3.4 Socioeconomic Profile

3.4.1 Macroeconomic Overview (1965-2014)

The Philippine economy has experienced repeated boom-and-bust cycles in the more than six decades since the country achieved independence from the United States in 1946. During the 1950s and until the early 1960s, the Philippine economy ranked as one of the most progressive in Asia. In fact, during the 1950s, Philippine per capita GDP is one of the highest in East and Southeast Asia, behind only Japan, the city-states of Singapore and Hong Kong and Malaysia (then Malaya) and significantly higher than that of Thailand, Indonesia, Vietnam and China (Balisacan & Hill, 2003).

During the second half of the 1960s up to the 1970s, the economy grew steadily (see Table 3.1). From 1965 to 1970, the aggregate real GNP grew at an annual average rate of 5.0 per cent. This was followed by a decade of further growth and continuous expansion as GNP grew at an average of 5.8 per cent throughout the 1970s.

Table 3.1 GNP and GDP growth rate in the Philippines (1965-2013)

Years	Average annual GNP growth rate	Average annual per capita GNP growth rate	Average annual GDP growth rate	Average annual per capita GDP growth rate
1965-70	5.0	2.0	4.7	1.7
1971-75	5.5	2.6	5.8	2.9
1976-80	6.2	3.3	6.1	3.2
1981-85	-0.6	-3.2	-1.1	-3.8
1986-90	4.2	1.6	4.7	2.1
1991-95	1.2	-1.0	2.2	-0.1
1996-00	4.4	2.2	3.6	1.4
2001-05	4.6	2.7	4.6	2.6
2006-10	4.9	3.0	5.0	3.1
2011-13	6.6	3.7	5.9	4.2

Source: World Development Indicators, World Bank; National Statistical Coordination Board

The moderate aggregate growth rates that the Philippines experienced during the 1960s and 1970s – while slightly lower – were approximately comparable to that of its Southeast Asian (SEA) neighbours (see Table 3.2). During the said 15-year period, the average GDP growth rate was at 5.5 per cent. On the other hand, Thailand grew by 7.6 per cent; Malaysia by 7.4 per cent; and Indonesia by 7.0 per cent. Thus, it appeared at the time that economic development in the Philippines was trending similarly upwards, albeit at a slightly slower pace, like its SEA neighbours.

Table 3.2 Average GDP growth, selected SEA countries (1965-1980)

Country	1965-70	1970-75	1976-80
Philippines	4.7	5.8	6.1
Thailand	9.0	5.8	8.0
Malaysia	6.4	7.2	8.6
Indonesia	5.4	7.8	7.9

Source: World Development Indicators, World Bank

Further, owing perhaps to its favourable initial position in the 1960s vis-à-vis its neighbours – with the exception of Malaysia – the Philippine per capita GDP at the end of the 1970s (using the constant 2000 US$) was still significantly higher than that of Thailand and is more than twice that of Indonesia (see Table 3.3). This is despite a slightly slower growth trend for the Philippines during the said 15-year period. In 1965, Philippine GDP per capita was just slightly behind Malaysia and was almost twice that of Thailand and more than thrice that of Indonesia. By 1980, however it appeared that both Thailand and Indonesia have significantly closed the gap. Meanwhile, Malaysia has started to pull away.

Table 3.3 GDP per capita (constant 2000 US$), selected SEA countries

Country	1965	1970	1975	1980	1985	1990	1995	2000	2005	2010
Philippines	735	796	916	1074	881	979	972	1043	1186	1378
Thailand	385	516	601	789	925	1400	1995	1968	2387	2751
Malaysia	973	1145	1431	1919	2161	2608	3604	4030	4612	5264
Indonesia	196	236	306	401	476	615	832	804	948	1180

Source: World Development Indicators, World Bank

At the outset of the high growth years of the 1980s that saw the beginning of the remarkable economic transformations in East Asia and the emergence of Southeast Asia, both Malaysia and Thailand grew rapidly while Indonesia grew more steadily. Meanwhile, the city-states of Singapore and Hong Kong together with South Korea and Taiwan were well on their way to attaining newly industrialised country (NIC) status.

On the other hand, the Philippines lagged behind its neighbours as its economy failed to take off. The 1980s for the Philippines was characterised by failed economic policies and a heightened political crisis. While average annual GDP grew by 1.8 per cent from 1981-90 (See Table 3.4), it was marred by a massive economic contraction of more than 7.0 per cent in 1984 and 1985. It marked the country's first recession in the post-war era (Asian Development Bank, 2007). The contraction proved to be too deep for the Philippines to fully recover from in the short-term. In fact, the mild recovery that the country experienced in 1986-1989 was not enough to offset the dismal performance of the economy in the first half of the 1980s.

Further, taking into account the high population growth rate of around 2.35 per cent during the same period, Philippine per capita GDP actually contracted by 0.8 per cent. The minimal GDP growth coupled with a high population growth rate is in stark contrast with the experience of both Thailand and Indonesia where economic growth and the decline in population growth happened simultaneously during the 1980s (see Table 3.4). As earlier mentioned and as can be seen in Figure 1, the reduction in Philippine population growth rates have been both gradual and minimal.

Table 3.4 GDP, per capita GDP and population growth, selected SEA countries (1981-1990)

Country	Average annual GDP growth	Average annual per capita GDP growth	Average annual population growth
Philippines	1.8	-0.8	2.4
Thailand	7.9	6.0	1.6
Indonesia	6.4	4.4	1.8

Sources: World Development Indicators, World Bank; National Statistics Office

The 1990s can be summarised as a series of unfortunate events for the Philippines – both natural and man-made. The economy experienced two mild contractions and two moderate recoveries. In 1990, a major earthquake hit central and northern Luzon. This was followed by the eruption of Mt. Pinatubo in 1991. The twin natural disasters caused billions of pesos in damages to property and infrastructure. The destruction brought about by the eruption of Mt. Pinatubo was so severe it caused the economy to contract in 1991. The economy however quickly recovered from the slight recession and registered moderate economic growth from 1993-96. At the end of 1996, the Philippine economy was slowly gaining momentum and strength and was showing signs that it may finally be ready to join the ranks of its more progressive neighbours.

Typical of its boom-and-bust cycle of economic development, however, the moderate economic growth in the mid-1990s was short-lived. In 1997, just as the economy appeared set for long-term growth, the Asian Financial Crisis (AFC) set in. In addition, and to a lesser extent, the economy was further held back in 1998 by the severe drought brought about by the *El Nino* phenomenon. Nevertheless, owing to the strong regulatory and supervisory framework of the financial sector, the Philippines was one of the first countries to emerge from the AFC. The economy recovered in

1999 up until another political shock hit the country. In December 2000, then President Estrada – under increasing pressure of removal from office through impeachment and other extra-constitutional means – was forced to step down from office and placed the country in a political turmoil.

At the end of the 20th century, it was clear that the severe recession in 1984-85 and mild contractions in 1991-92 and 1998 have taken its toll on the Philippines. As pointed out earlier in Table 3.3, from 1980-2000 the Philippine economy remained stagnant. Per capita GDP in 2000 of US$1,043 was even lower than that of the per capita GDP of US$1,074 in 1980. The slight reduction in per capita GDP during the period was due to the fact that the average annual population grew at a slightly higher rate of 2.4 per cent vis-à-vis annual GDP which increased by 2.35 per cent (see Table 3.5). The Philippines it seemed was caught in a time warp and remained in the 1980s while its neighbouring countries enjoyed steady growth from the 1960s and at least until the outset of the 1997 AFC.

Table 3.5. Average GDP growth, selected SEA countries (1981-2013)

Country	1981-1990	1991-2000	2001-2010	2011-2013
Philippines	1.8	2.9	4.8	5.9
Thailand	7.9	4.6	4.4	3.2
Malaysia	6.0	7.2	4.6	5.2
Indonesia	6.4	4.4	5.2	6.2

Source: World Development Indicators, World Bank; National Statistics Office

From 2001-2010, the Philippines registered solid economic growth. Average annual GDP growth during the decade was a robust 4.8 per cent (see Table 3.5). This was approximately comparable to the growth experienced by the Philippines in the 1960s and 1970s and briefly in 1993-1997. It is also important to note that after 20 years, the growth figures of the Philippines are again roughly comparable to that of Thailand and Indonesia (see Tables 3.6 and 3.7). It can be argued that it may be a case of the said two countries slowing down after almost two decades of steady growth from the late 1970s until the mid-1990s rather than the Philippines again on the verge of long-term economic growth.

Table 3.6 GDP, per capita GDP and population growth, Philippines (1961-2010)

Ten-Year Period	Average annual GDP growth	Average annual per capita GDP growth	Average annual population growth
1961-1970	4.9	1.8	3.0
1971-1980	5.9	3.1	2.7
1981-1990	1.8	-0.8	2.6
1991-2000	2.9	0.7	2.2
2001-2010	4.8	2.8	1.9

Sources: World Development Indicators, World Bank; National Statistics Office, the Philippines

Nevertheless, it is also hard to discount the possibility that the moderate economic growth from 2001-2010 may be due to good economic management and a presence of a stable and predictable policy and business environment. In addition, the fact that the population growth rate has slowed down from 3.0 per cent in the 1960s to 1.9 per cent during the last 10 years may also be not just a minor coincidence in the 2.8 per cent rise in per capita GDP. As pointed out earlier, the same thing happened to both Thailand and Indonesia during their decade of high growth in the 1980s. This study, however, will not go into that area.

Table 3.7 GDP, per capita GDP and population growth, selected SEA countries (2001-2010)

Country	Average annual GDP growth	Average annual per capita GDP growth	Average annual population growth
Philippines	4.8	2.8	1.9
Thailand	4.4	3.4	0.9
Indonesia	5.2	2.9	1.2

Sources: World Development Indicators, World Bank; National Statistics Office

Looking at the Philippine aggregate macroeconomic performance from 1965-2010 (see Table 3.8), the following can be observed:

Table 3.8 Philippine aggregate macroeconomic performance (1965-2010 [a/])

Indicator	1968[b/]	1978	1988	1998	2008
Per capita GNP (constant 2000 US$)	774	1031	965	989	1303
Per capita GNP growth rate (%)	2.0	3.3	1.6	2.2	3.0
Annual GNP growth rate	5.0	6.2	4.2	4.4	4.9
Annual GDP growth rate	4.7	6.1	4.7	3.6	5.0
Inflation (GDP deflator)	6.5	11.0	8.4	9.7	4.5
Value added, Industry (% of GDP)	31.0	37.2	34.7	31.7	32.7
Value added, Agriculture (% of GDP)	28.4	27.8	23.1	17.9	12.7
Value added, Services (% of GDP)	40.6	35.0	42.2	50.4	54.6
Employment, Industry (% of total)	n.a.	15.4	14.9	16.4	15.0
Employment, Agriculture (% of total)	n.a.	51.8	46.8	39.2	34.9
Employment, Services (% of total)	n.a.	32.8	38.3	44.4	50.1

a/ Five-year averages with year indicated as middle year

b/ Six-year averages, 1965-70

Source: World Development Indicators, World Bank

First, it was apparent and at the same time quite puzzling as to why the Philippines almost completely missed out on the Asian boom and to a certain extent even regressed during the high growth years of the late 1970s until the mid-1990s. Per capita GNP in the late 1990s is even lower than that of the late 1970s. In addition, as can be seen in Table 3.9, per capita GDP even shrank by around 3.0 per cent in 2000 compared to that of 1980.

In contrast, during the same period (1980-2000), the per capita GNP of Thailand grew by 149 per cent, Malaysia by 110 per cent and Indonesia by around 100 per cent. Even though the Philippines posted moderate growths during the last 10 years, the gap created when the Philippines essentially stagnated for two decades may be hard to overcome. To illustrate how far back the Philippines has lagged behind its neighbours, if the per capita GDP of the Philippines will continue to grow at the rate of 2.8 per cent (the highest growth since the 1970s) with population growth remaining constant, it will still take more than 20 years before it can achieve the 2010 per capita GDP of Thailand.

Table 3.9 GDP per capita (constant 2000 US$), selected SEA countries (1970-2010)

Country	1970	1980	1990	2000	2010
Philippines	796	1074	979	1043	1378
Thailand	516	789	1400	1968	2751
Malaysia	1145	1919	2608	4030	5264
Indonesia	236	401	615	804	1180

Source: World Development Indicators, World Bank

Second, in terms of structural transformation, despite the high aggregate economic growth rates that the Philippines posted during the 1960s and 1970s, there was very little change in the sectoral composition of the economy. The share of industry in GDP increased from 31.0 per cent during the late 1960s to 37.2 per cent in the late 1970s (see Table 3.10). Industrialisation however, seemingly ended there for the Philippines as the share of industry in GDP started its decline in the early 1980s. In contrast, Thailand, Malaysia and Indonesia continued their march toward industrialisation as the share of industry in their respective GDP grew steadily. In 2009, the share of industry in GDP in the Philippines was at 30.2 per cent. This is significantly lower than that of Thailand (43.3 per cent), Malaysia (44.3 per cent) and Indonesia (49.1 per cent).

Table 3.10 Industry, value added (% of GDP), selected SEA countries (1965-2009)

Country	1965	1970	1975	1980	1985	1990	1995	2000	2005	2009
Philippines	31.1	31.9	35.0	38.8	35.1	34.5	32.1	32.3	31.9	30.2
Thailand	22.9	25.3	25.8	28.7	31.8	37.2	40.7	42.0	44.0	43.3
Malaysia	27.5	27.4	34.0	41.0	38.5	42.2	41.4	48.3	49.7	44.3
Indonesia	12.6	18.7	33.5	41.7	35.8	39.1	41.8	45.9	47.5	49.1

Source: World Development Indicators, World Bank

In terms of agriculture, the situation is similar to that of industry. In 1965, the Philippines had the smallest share in agriculture value added in GDP among its neighbours at 27.2 per cent (see Table 3.11). At the time, Indonesia is still relatively agriculture-dependent as its share of agriculture value added in GDP is a high 56 per cent. However, beginning 1980, the Philippines had the largest share of agriculture at 25.1 per cent among the four countries. Nevertheless, while it was not significantly different from the 1965 figures, it showed the early beginnings of the dynamic and sharp structural transformation happening in the economies of Thailand, Malaysia and Indonesia given their rapid economic development.

Further, the share of agriculture value added in GDP of the Philippines eventually declined starting the 1990s and is now just at 14.8 per cent in 2009 from 27.2 per cent in 1965. However, the reduction in Thailand, Malaysia and Indonesia were markedly significant. From 1965-2009, the gross value added of agriculture in GDP in the said countries showed the following structural transformations: Thailand (31.9 to 11.6 per cent); Malaysia (28.8 to 9.5 per cent); and Indonesia (56.0 to 15.8 per cent).

Table 3.11. Agriculture, value added (% of GDP), selected SEA countries (1965-2009)

Country	1965	1970	1975	1980	1985	1990	1995	2000	2005	2009
Philippines	27.2	29.5	30.3	25.1	24.6	21.9	21.6	15.8	14.3	14.8
Thailand	31.9	25.9	26.9	23.2	15.8	12.5	9.5	9.0	10.3	11.6
Malaysia	28.8	29.4	28.9	22.6	19.9	15.2	12.9	8.6	8.4	9.5
Indonesia	56.0	44.9	30.2	24.0	23.2	19.4	17.1	15.6	13.4	15.8

Source: World Development Indicators, World Bank

Meanwhile, given the fact that there was very little change in the sectoral contribution of industry in terms of gross value added in GDP from 1965-2009 (31.1 to 30.2 per cent) similar to what was observed by Balisacan and Hill (2003), it can be deduced that the decline in the agriculture value added (27.2 to 14.8 per cent) was thus absorbed by the services sector (see Table 3.12). This was again in contrast to the more general pattern observed in the industrialisation of the East and Southeast Asian economies wherein much of the decline in the share of the agriculture sector in GDP was absorbed by the industrial sector. This is consistent with Lewis' Dual Sector model wherein economic growth of a developing economy can be explained by the transition between two sectors – a traditional agricultural sector and a modern industrial sector. However, a parallel can be drawn from the Philippine experience from that of India where much of the decline in the share of agriculture in GDP is absorbed by the services sector (Cagliarini & Baker, 2010).

Table 3.12. Services, value added (% of GDP), selected SEA countries

Country	1965	1970	1975	1980	1985	1990	1995	2000	2005	2009
Philippines	41.7	38.6	34.7	36.1	40.4	43.6	46.3	52.0	53.8	55.0
Thailand	45.2	48.8	47.3	48.1	52.3	50.3	49.7	49.0	45.8	45.1
Malaysia	43.8	43.2	37.2	36.3	41.6	42.6	45.6	43.1	41.9	46.2
Indonesia	31.4	36.4	36.3	34.3	40.9	41.5	41.1	38.5	39.2	35.2

Source: World Development Indicators, World Bank

3.4.2 Historical Poverty Profile (1985-2000)

In 1985, the poverty incidence of families was pegged at 44.2 per cent. Since then, poverty has declined to 31.8 per cent in 1997 (see Table 3.13). The modest downward trend in poverty incidence was however halted by the outset of the 1997 AFC that caused poverty incidence to increase by 1.9 percentage points to 33.7 per cent in 2000. From 1985-2000, poverty declined by 10.5 per cent or an average poverty reduction rate of only 0.7 per cent per annum.

Table 3.13 Selected poverty-related statistics, the Philippines (1985-2000)

Year	Poverty incidence (%)	Magnitude of poor population	Gini coefficient	Average GDP growth rate[a/]
1985	44.2	26,674,645	0.4466	-4.3%
1988	40.2	25,385,200	0.4466	4.7%
1991	39.9	28,554,247	0.4680	3.0%
1994	35.5	27,372,971	0.4507	2.0%
1997	31.8	26,768,596	0.4872	5.3%
2000	33.7	30,850,262	0.4822	2.7%

a/ Three-year averages including the two previous years

Sources: National Statistical Coordination Board, various years

World Development Indicators, World Bank

Further, during the above period, great strides were made in government efforts to reduce poverty in the relatively high growth years from 1986-1988 and 1995-1997. The biggest decline in poverty was however recorded from 1992-1994 during a relatively low annual GDP growth of 2.0 per cent. During the said period, poverty declined by an average of 1.4 per cent per year. This may be explained by the reduction in inequality at the time as evidenced by the reduction in the Gini coefficient by 0.0173 points. It reinforced the link between economic growth and human development as mutually reinforcing pillars of sustainable development and progress in poverty reduction (Bolnick, 2004; United Nations Development Programme, 1996). Overall, while the percentage of poverty declined, the magnitude of poor population increased significantly from 26.67 million people in 1985 to 30.85 million in 2000. This may be attributed to the combination of the following, namely: i) slow economic growth; ii) rising inequality; and, iii) rapid population growth.

In terms of poverty incidence in urban and rural areas, the gap has widened significantly from 1985-2000 (see Table 3.14). During the said period, poverty incidence declined by 13.7 per cent in urban areas while rural areas only saw a reduction of 3.8 per cent. Thus, at the end of the 15-year period, rural poverty is now more than twice of urban poverty. The magnitude of poverty in rural areas is even more daunting considering that more than half (52 per cent) of the population live in rural areas. Based on the census conducted by the NSO in 2000, 48.0 percent of the population (36.7 million) live in 9,950 urban barangays. This illustrates that poverty in the Philippines is still predominantly a rural phenomenon.

Table 3.14 Poverty Incidence of Poor Families, Urban-Rural Areas (1985-2000)

Urban-Rural Area	1985	1988	1991	1994	1997	2000
Philippines	44.2	40.2	39.9	35.5	31.8	33.7
Urban	33.6	30.1	31.1	24.0	17.9	19.9
Rural	50.7	46.3	48.6	47.0	44.4	46.9

Source: National Statistics Office

3.4.3 Current Poverty Profile (2001-2013)

From 2000 to 2012, poverty was reduced by a measly 2.3 per cent despite an average GDP growth of around 5.1 per cent during roughly the same period from 2001 to 2013 (see Table 3.15). The poverty incidence actually trended slightly higher from 2003-2009 after initially declining by 2.6 per cent from 2000-2003. From 2009 to 2012, when the economy grew by around 4.8 per cent on average, poverty conditions across the country declined by only 1.1 per cent.

Among the 17 regions of the country, the National Capital Region, Region IV-A (CALABARZON) and Region III (Central Luzon) consistently posted the lowest poverty incidence from 2003 to 2012. For instance, the National Capital Region posted a poverty incidence of 3.9 per cent in 2012, well below the national average of 25.2 per cent. Region IV-A and Region III likewise registered poverty rates that are significantly lower than the national average, posting 10.9 per cent and 12.9 per cent, respectively. It is probably no coincidence that both Region IV-A and Region III are the two closest regions to NCR. This means that economic development, investments, and infrastructure are still heavily concentrated in NCR as well as in nearby highly-urbanised regions.

On the other hand, the ARMM, Region VIII (Eastern Visayas), and Region XII (Southwestern Mindanao) consist the bottom cluster of the poorest regions in the country, posting poverty rates that are around double the national average. What is of significant cause for concern though is the alarming trend of poverty increase in the ARMM, from 30.5 per cent in 1991 to 55.8 per cent in 2012. The Autonomous Region in Muslim Mindanao is commonly identified as a conflict-affected area and is arguably the least stable region in the country. Conflict-affected areas in the country are usually the poorest areas as well due to the inducing effect of conflicts, which go beyond the initial impact of the fighting and the associated destruction it brings. The poverty compounding effects include the disruption of services including access to them, disruption of economic activity, displacement of populations and investments, and the collapse of local markets, (GRM International BV, 2007). Overall, these factors have likely contributed to the poor state of affairs in the ARMM.

It is worth noting that while it might appear that there are no significant improvements in poverty conditions at the national level from 2009-2012, the data from the NSCB shows that the Caraga Region improved its poverty incidence significantly from 54.4 per cent in 2009 to 40.3 per cent in 2012, or a net poverty incidence reduction of 14.1 per cent. From having the highest poverty incidence in the country in 2009, the Caraga Region is no longer part of the bottom cluster of the poorest regions in 2012. Other regions that registered significant poverty reductions from 2009-2012 include Region IX (5.7 per cent), Region IV-B (3.5 per cent), and Region V (3.1 per cent).

Table 3.15. Poverty incidence rate among population (1991-2012)

Region	1991	2000	2003	2006	2009	2012
Philippines	34.4	27.5	24.9	26.6	26.3	25.2
National Capital Region	7.1	5.8	3.2	4.7	3.6	3.9
CAR	42.7	25.8	21.7	26.0	25.1	22.8
Region I	36.6	29.5	22.8	25.9	22.0	18.5
Region II	42.8	25.3	19.6	26.8	25.5	22.1
Region III	21.1	17.3	12.4	13.1	13.7	12.9
Region IV-A	22.7	15.2	12.1	10.3	11.9	10.9
Region IV-B	44.4	36.4	37.5	40.6	34.5	31.0
Region V	54.5	45.3	45.8	44.2	44.2	41.1
Region VI	39.6	36.7	30.6	29.1	30.8	29.1
Region VII	43.6	31.5	37.2	35.9	31.0	30.2
Region VIII	50.0	37.6	37.6	41.5	42.6	45.2
Region IX	40.3	38.6	45.7	45.0	45.8	40.1
Region X	46.6	38.0	38.8	39.0	40.1	39.5
Region XI	39.6	27.9	31.0	30.6	31.4	30.7
Region XII	53.3	40.7	33.1	37.9	38.3	44.7
CARAGA	54.3	53.8	44.7	49.2	54.4	40.3
ARMM	30.5	43.8	31.4	47.1	47.4	55.8

Source: National Statistical Coordination Board (2013)

In terms of the major island groups, Luzon has consistently posted poverty incidence levels that are significantly lower than the national average while both Visayas and Mindanao recorded poverty incidence rates higher than the national level (see Table 3.16). However, with the highest number of the population living in Luzon, it continues to have the largest percentage share of the total poor population.

Table 3.16 Poverty incidence and share to total poor population by major island group

Major island group	Poverty incidence among population (%)			Share to total poor population (%)		
	2003	2006	2009	2003	2006	2009
Philippines	24.9	26.4	26.5	100.0	100.0	100.0
Luzon	16.7	18.6	17.9	38.2	39.9	38.2
Visayas	34.8	34.9	35.2	27.5	26.3	26.8
Mindanao	36.8	37.8	39.6	34.3	33.7	34.9

Source: National Statistical Coordination Board

3.5 Overview of Microfinance in the Philippines

3.5.1 Background

In the Philippines, with a projected population of more than 100 million (Commission on Population, 2014), poverty remains as one of its biggest problems. In 2009, the proportion of families with per capita incomes below the poverty threshold is 20.9 per cent. Meanwhile, the poverty incidence of the population as a whole is 26.5 per cent. In absolute figures, around 3.86 million families or 23.1 million Filipinos fall below the poverty threshold and are considered poor. A little more than half of the population (52 per cent) live in areas of which 46.9 per cent are considered poor. The rate of poverty reduction has been slow and the country is unlikely to meet its poverty reduction target[7] of halving poverty by 2015 set under the Millennium Development Goals (MDGs).

[7] Based on the Philippines fourth progress report on the MDGs delivered before the United Nations General Assembly in 2010, the country only has a medium probability of halving the proportion of th population living below the poverty threshold.

The Philippine government faces a huge challenge in reducing poverty. Specific interventions are needed especially given that there are wide disparities in poverty across regions and between urban and rural areas. In addition to the specific interventions, the government has during the last decade recognised the importance of microfinance in poverty reduction. Past and present medium-term development plans have consistently included microfinance as a major policy tool in poverty reduction efforts. Consequently, the provision of microfinance by the formal and informal financial sector has increased significantly during the last decade.

In the Philippines, microfinance[8] is defined as the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance products to the poor and low-income households and their microenterprises. In addition, the National Credit Council (NCC) further defines microfinance as the viable and sustainable provision of a broad range of financial services (savings and credit) generally, by the private sector to poor and low-income households[9] engaged in livelihood and microenterprise activities using non-traditional and innovative methodologies and approaches (e.g., non-collateralised cash-flow based lending). The maximum individual loan amount provided for microfinance loans is PhP150,000.[10]

Microfinance has shown through various studies that it is an effective and powerful tool for poverty reduction. Meanwhile, some argue that the methodologies and empirical evidence supporting the poverty reduction effect of microfinance in these studies are either flawed – or at best weak. However, others point out that there is already an overwhelming amount of evidence in the literature showing a beneficial effect on the reduction of vulnerability and increases in income of the poor among microfinance clients (Khandker, 2001; Wright, 2000; Zaman, 2000).

The beneficial effect of microfinance bears significance for the Philippines where microenterprises make up 91.6 per cent of all business establishments and employ 30

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[8] As defined by the *Bangko Sentral ng Pilipinas* (2010)

[9] According to the National Statistical Coordination Board, the annual per capita poverty threshold for the Philippines is 2009 is PhP16,841. Below this threshold or minimum income, that individual will be considered as ‘poor’.

[10] This definition is consistent with the provisions of Republic Act No. 8425 or the Social Reform and Poverty Alleviation Act.

per cent of the total workforce (see Table 3.17). However, many of these micro enterprises have no access to credit from the formal financial institutions due to lack of collateral. Consequently, they are forced to rely on informal moneylenders that normally charge exorbitant rates. This in effect severely inhibits the poor borrowers from investing in productive income-increasing activities. Further, studies show that microfinance services were delivered to only one third of the total poor households thereby indicating that there is a huge potential market for microfinance in the Philippines.

Table 3.17 Enterprise profile in terms of employment and value added

	Micro enterprises	**Small enterprises**	**Medium enterprises**	**Large enterprises**
Number of enterprises (%)	91.6	7.7	0.3	0.4
Employment (%)	30.0	23.7	7.5	38.8
Value Added (%)	4.9	20.5	10.3	64.3

Source: Department of Trade and Industry, 2011

One of the challenges for the government is to address the gap in the formal financial system in order to make credit more accessible to the poor, particularly the micro enterprises. The provision of micro credit, together with other financial and non-financial services to the micro enterprises will empower them to engage in more productive economic activities. Thus, it is essential to put emphasis on the sound development of both the demand and supply side of microfinance – the microfinance institutions on one side and the microenterprises on the other.

3.5.2 Microfinance Policy Development

The improvement in the quality of life of the Filipino people has always been the overarching goal of the development efforts of the government. The Philippines has been working towards this end – particularly the eradication of poverty – for many decades now. Poverty reduction has in fact been regularly embodied in its medium development plans. Nevertheless, poverty remains pervasive in the Philippines. Such a poor record in reducing poverty however is not due to lack of trying but may instead be partly due to the country's boom-and-bust cycle of economic development. It may also be partly due to failed poverty reduction policies, programs and strategies undertaken in the past. In this section, we will look at the evolution of rural finance and microfinance policies in the Philippines from the 1960s to the present given the emergence of microfinance as a poverty reduction tool.

3.5.2.1 Era of Directed Credit Programs (1960s – Early 1980s)

In the three decades following World War II, the use of directed credit programs[11] (DCPs) has been widespread and generally accepted as an effective way to address poverty, boost production and speed investments, among others (Vogel & Adams, 1997). In an attempt to resolve supposed market failure, subsidised and directed agricultural credit programs dominated government and donor policies and programs at the time (Meyer, 2011). This 'old paradigm' crowded global development efforts until the 1980s.

In the Philippines, from 1960s up to the 1980s, government initiatives to address a range of problems such as rural insurgency and rural poverty were likewise focused on the provision of directed credit programs. In the 1960s, DCPs played a crucial role in stimulating food production programs (Micu, 2010; Vogel & Llanto, 2005). The government followed a supply-led approach to credit delivery directed mostly towards the agriculture sector. The approach was characterised by massive infusions of institutional credit using cheap funds from the government (Corpuz and Kraft, 2005). These were used to fund various commodity-specific agricultural credit programs for rice, corn and livestock with rural banks as conduits. The proliferation and popularity of DCPs continued in the 1970s as the government adopted it as a major poverty reduction tool. Loanable funds were earmarked for direct availment by targeted borrowers at highly concessional rates. The massive credit subsidies were intended to bring down the cost of borrowing for the targeted sectors (Micu, 2010).

Specialized banks such as rural banks, development banks, and government financial institutions extended the loans for the DCPs. However, government line agencies that do not have the mandate as well as the capability to implement DCPs – they are not trained to handle financial matters – were likewise used as channel institutions. The

[11] Directed credit programs refer to the channelling of financial resources by administrative decisions to a select sector of the population for a specific purpose and at subsidised rates. Examples of directed credit are loans targeted to small farmers, women, micro entrepreneurs, etc.

proliferation of highly subsidised credit programs displaced commercial lending and impeded the emergence of new private financial institutions (Brooks & Nash, 2002). Deposit mobilisation by banks was also neglected due to the availability of cheap loanable funds from the government (Llanto et al. 2005). The DCPs were likewise met with massive repayment problems and fund capture by large-scale borrowers that contributed in huge fiscal losses for the government (Almario et al. 2006).

Finally, in the mid-1980s, under the weight of poor repayment rates, low private sector participation and mounting loans of small farmers and other rural borrowers, the DCPs of the government collapsed. Unfortunately, attempts to resolve market failure and gaps in the credit market have only led to government failure. The DCPs likewise failed in the promotion of an effective and sustainable rural financial market and the reduction of poverty (Badiola, 2007). These disappointing results prompted the government to shift towards market-based policies. Thus, the transition from the old-paradigm of directed rural and agricultural credit approach has given way to the new market-based paradigm of credit.

3.5.2.2 Transition to a Market-Based Paradigm (Early 1980s – Late 1990s)

Learning from its experience in the 1960s up to the early 1980s, the government emphasized the need to develop market-based policies beginning the early 1980s. The government acknowledged that the low interest rate policy implemented through subsidised credit have only resulted in mounting arrearages and bankruptcy of many rural banks. Consequently, the government shifted its basic policy framework to a reliance on market principles in terms of interest rates and fund allocation. In the late 1980s, the central bank liberalised the banking sector through the deregulation of interest rates. It also abandoned its restrictive bank entry and branching policies and encouraged the entry of new players in the banking sector (Quinones & Seibel, 2000). This led to the increase in the number of commercial banks and their branches (Lim & Esguerra, 1996). The liberalisation of the banking sector was meant to spur rural and agricultural credit by allowing banks to recover their lending costs through market-based interest rates.

Unfortunately, in the early 1990s, it became apparent that the financial liberalisation efforts have not resulted into increased lending to the agricultural sector. In fact, the transition into a market-based paradigm from the previous directed credit approach has even led to a decline in agricultural lending (Castillo & Casuga, 1999). In 1993, amid growing concerns that the poor have not been able to access credit from the formal banking sector and the banks being risk averse to providing agricultural credit using their own funds, a broad alliance of government, banks, cooperatives and farmer groups established the landmark Social Pact on Credit[12]. The pact acknowledged the weakness of the financial system and called for the rationalisation of credit programs and policies to make them more accessible to the poor. The main driving force behind the group's campaign is its concern over the low outreach of government DCPs. The pact also led to the creation of the National Credit Council later that year. The creation of the NCC provides the government an instrument in coordinating and managing the credit policy reform process.

In 1995, the government launched the Social Reform Agenda (SRA), the government's main blueprint to address poverty. The SRA incorporated the government's five major strategies to address poverty: i) promoting and sustaining economic growth to create employment and livelihood opportunities; ii) sustaining growth based on people-friendly strategies; iii) expanding social services to provide minimum basic needs; iv) fostering sustainable income-generating community projects; and v) building the capacity of poor people to help themselves.

However, due to the highly politicized nature of agricultural lending, the forward-backward policies on credit resulted in the resurgence of subsidised DCPs in the mid-1990s. This heavily undermined the government's own financial policy reform efforts. As a result, in the late 1990s, there were actually more DCPs than there were in the 1980s. Nevertheless, the government was determined to pursue its financial policy reforms.

[12] According to Munoz (2009), the story behind the existence and formation of the group called Social Pact on Credit (SPC) has been limited to the resolution it submitted to then President Ramos in 1993 that led to the formation of the National Credit Council. Administrative Order No. 86, series of 1993 – the law creating the NCC – acknowledged that the SPC recommended the rationalisation of different government-based credit and guarantee programs as these cater to small farmers and other rural workers, fisher folk, urban poor and small entrepreneurs via a rationalisation mechanism.

Table 3.18 Laws/Measures Adopted to Implement the National Strategy for Microfinance

Laws/Measures	Key Provisions
Social Reform and Poverty Alleviation Act (RA No. 8425)	▪ Market-based interest rate policy for microfinance ▪ Government funds used only for capacity building purposes ▪ Emphasis on savings mobilisation ▪ Established the People's Credit and Finance Corporation, the forerunner of microfinance services through wholesale lending ▪ Defined capacity-building to exclude any and all forms of seed funding, equity infusion, and partnership funds from government to microfinance institutions
Agriculture and Fisheries Modernisation Act of 1997 (RA No. 8435)	▪ Phase-out of DCPs in the agriculture sector ▪ Rationalization of loan guarantee programs ▪ Adoption of market-based interest rates ▪ Non-provision of credit subsidies ▪ Government financial institutions as wholesalers of funds
Executive Order 138, series of 1999	▪ Directs government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines ▪ Non-participation of government non-financial agencies in the implementation of credit programs ▪ GFIs to be the main vehicle in the implementation of government credit programs ▪ Adoption of market-based financial and credit policies ▪ Increased participation of the private sector in the delivery of financial services
General Banking Law of 2000 (RA No. 8791)	▪ Recognition of peculiarities of microfinance (e.g. allows cash-flow based lending and collateral free loans ▪ Lifting of the moratorium on branching, specifically for microfinance banks ▪ Issuance of BSP Circular 272 in 30 January 2001 implementing the microfinance provisions of the GBA
Barangay Micro Business Enterprises Act of 2002 (RA No. 9178)	▪ Requires market-based interest rates for loans to barangay or village-based microenterprises ▪ GFIs acting as wholesalers of funds ▪ Setting up of a special credit window within a GFI that will provide credit to barangay micro business enterprises at market-based interest rates
Magna Carta for Micro, Small and Medium Enterprises (RA No. 9501)	▪ Facilitating access to sources of funds ▪ Complementing and supplementing financing programs and doing away with stringent and burdensome collateral requirements ▪ Provision of effective guarantee systems
Credit Information Systems Act (RA No. 9510)	▪ Establishes a comprehensive and centralised credit information system for the collection and dissemination of fair and accurate information ▪ Directly addresses the need for reliable credit information concerning the credit standing and track record of borrowers
Philippine Cooperative Code of 2008 (RA No. 9520)	▪ Start-up capital from PhP2,000 to PhP15,000 ▪ CDA is authorised to increase the required capital after every five years whenever necessary ▪ Credit cooperatives now include multi-purpose cooperatives that provide savings and credit to their members ▪ Existing credit and multi-purpose cooperatives shall inform the CDA of its intention to continue performing its present functions ▪ Should the said cooperatives decide to exercise enhance functions, it shall notify CDA and satisfy the requirements for conversion to a financial service cooperative (FSC) ▪ FSCs authorized to provide savings and credit to its members and other financial services are subject to regulation by the BSP

Sources: Draws largely from Lamberte (2006); Micu 2010; and Geron

3.5.2.3 Institutionalisation of Microfinance as a Development Tool (Late 1990s – Present)

In an effort to finally put an end subsidised DCPs that have proven to be too costly for the government, the Philippines implemented various policy reforms to finally institutionalise a market-based credit policy environment. Among the initial policy reform was the creation of the National Strategy for Microfinance (see Box 3.1). The National Strategy for Microfinance (NSM) was drafted and issued by the NCC in consultation with various stakeholders. It envisions a viable and sustainable micro financial market that will provide majority of poor households and microenterprises access to financial services. It calls for greater private sector role under a liberalised and market-oriented economy with government providing the enabling environment. It embodies a new neoliberal paradigm of a private sector-driven market.

After the issuance of the NSM, the NCC advocated for the enactment of new laws and the amendment of contradictory ones in order to institutionalise the market-based financial and credit policies as embodied in the strategy within the broader spectrum of a law (Micu, 2010). The Philippine Congress supported the market-based credit delivery paradigm of the government and enacted several laws that incorporated this policy thrust and implemented the NSM. Some of the major enabling laws and measures that were enacted in support of the strategy are shown in Table 3.18. The table likewise enumerates the key provisions of the various laws and measures which reflects how the government has finally embraced and provided for a market-oriented paradigm in its credit and financial policies.

3.5.2.4 Regulatory Framework for Microfinance

The growth of microfinance in the Philippines can be traced, to a great extent, to the approval, acceptance and functioning of a very clear national strategy as well as the setting up of enabling laws and regulations after the NSM was approved. This led to the entry of different types of institutions wanting to engage in microfinance. Recognising the different nature and strengths of these institutions in delivering microfinance services to the poor, the government issued the Regulatory Framework for Microfinance Institutions to ensure sound, transparent and sustainable development of the microfinance industry. The objectives of the regulatory framework and the scope of microfinance regulation are shown in Box 3.1.

Box 3.1 Regulatory Framework for Microfinance Institutions

Objectives of the Regulatory Framework

1. To protect the financial system from unsound (i.e. excessively risky) practices by deposit-taking institutions (either from the public or its members) and thereby, protect the country's payments system;
2. To protect small clients; and,
3. To promote the establishment of an accurate, reliable and transparent set of financial information for all types of MFIs.

Scope of Microfinance Regulation

Only institutions taking deposits from the general public and/or from its members are subject to prudential regulation and supervision. Since microfinance NGOs are not supposed to take deposits from their clients, they will not be subjected to prudential regulations. However, those microfinance NGOs that collect savings beyond the compensating balance will be subject to the appropriate regulatory agency.

Source: National Credit Council

The regulatory framework builds on the institutional strengths of the different institutions that are engaged in microfinance. It also clarifies the government agency responsible for supervising and regulating the said institutions. The framework likewise utilises existing regulatory structures. Under the framework banks with microfinance operation will remain under the supervisory and regulatory ambit of the BSP. On the other hand, credit cooperatives will continue to be under the regulatory domain of the Cooperative Development Authority (CDA). Meanwhile, microfinance NGOs that collect savings beyond the compensating balance will be required transform into a formal financial institution. These microfinance NGOs can either choose to be a bank or a credit cooperative. In either case, they will continue to be regulated and supervised either by the BSP or CDA. Finally, microinsurance will be under the jurisdiction of the Insurance Commission (IC).

However, the regulatory framework also left out one possible source of regulatory arbitrage. Microfinance NGOs – the biggest provider of microfinance in the Philippines – are generally not covered by prudential regulations by the central bank because they are considered as non-deposit taking entities. Nevertheless, almost all microfinance NGOs collect "compulsory savings"[13] usually referred to as capital build-up from their clients. This practice by the microfinance NGOs is being tolerated by the BSP as long as the compulsory savings does not exceed the amount of loans per client.

Some argue that in a sense microfinance NGOs are under some form of self-regulation as they are subject to increasing market discipline. Microfinance NGOs periodically reports an established set of financial standards to the Microfinance Council of the Philippines, Inc. (MCPI) supposedly to ensure that they are operating in accordance with sound business practices. The MCPI is an association of microfinance practitioners and service providers and is the largest network of microfinance institutions in the Philippines. However, it is clear that there appears to be a conflict of interest on the part of MCPI as its governing body also comes from its membership. As the MCPI is tasked to inform the concerned regulatory authorities when a microfinance NGO collects savings from their clients beyond the compensatory balance, this authority may be subject to abuse of discretion or even bad faith.

3.5.3 Microfinance Industry Stakeholders

As defined under the National Strategy for Microfinance and the Regulatory Framework for Microfinance, the major stakeholders in the Philippine microfinance industry are the following: i) policy makers and regulators; ii) wholesalers of microfinance funds to retailers; iii) retailers of funds to microfinance clients; iv) capacity building and social preparation institutions (see Table 3.19).

[13] Compulsory savings may be in the form of a percentage of the loan amount that is required as mandatory savings and is meant to guarantee loan repayment. It was seen as conducive to encouraging saving habits in poorer households.

Table 3.19. Philippine Microfinance Industry Stakeholders

Policy and regulation	Wholesalers of funds to retailers	Retailers of funds to end users	Capacity building/ social preparation
▪National Credit Council ▪*Bangko Sentral ng Pilipinas* ▪Cooperative Development Authority ▪Securities and Exchange Commission ▪Insurance Commission ▪Agricultural Credit and Policy Council ▪Microfinance Council of the Philippines, Inc.	▪Government financial institutions ▪Private commercial banks	▪Rural banks ▪Thrift banks ▪Cooperative banks ▪Microfinance NGOs ▪Savings and Credit Cooperatives	▪Government Financial Institutions ▪Government agencies involved in MSME development ▪Local Government Units ▪Academe ▪NGOs ▪Private sector

3.5.3.1 Policy and Regulation

- **National Credit Council**

The NCC was created under Administrative Order (AO) No. 86 issued by President Ramos in 8 October 1993. The creation of the NCC was a government policy response to the need for an institutional champion to lead and monitor the implementation of a comprehensive policy framework on credit programs (Lamberte, 2006). It is mandated to provide the following: i) rationalise and optimise government directed credit programs (DCPs); ii) develop alternative credit delivery mechanisms for greater private sector participation; iii) create an environment conducive to credit policy; and iv) define and rationalise the role of guarantee programs and guarantee agencies. The NCC aims to help MFIs broaden and deepen their microfinance services by setting in place a market-oriented financial and credit policy environment.

The council was initially chaired by the head of the Department of Finance (DOF) and co-chaired by the head of the Land Bank of the Philippines. The LBP was likewise designated as the secretariat of the council. The NCC is composed of government regulatory bodies, financial institutions and line agencies involved in credit delivery as well as representatives from private sector associations from banks, cooperatives and NGOs.

In 1995, based on a study conducted by the Philippine Institute for Development Studies (PIDS), it found that LBP was not the most appropriate agency to act as secretariat to the council due to its direct involvement in delivery of credit programs. The study likewise recommended the transfer of the secretariat functions of the NCC from the LBP to the DOF given the latter's mandate as the government's steward of sound fiscal policy. Consequently, on 06 February 1996, President Ramos issued AO 250 transferring the secretariat functions of the NCC to the DOF.

In 1997, after the conduct of the following: i) complete inventory of all government DCPs; ii) series of credit policy-related studies; and iii) policy dialogues and consultations with key stakeholders – the National Strategy for Microfinance (see Box 3.2) was formulated. The strategy envisions a viable and sustainable micro financial market that will provide majority of poor households and microenterprises access to financial services. It calls for greater private sector role under a liberalized and market-oriented economy with government providing the enabling environment.

- ***Bangko Sentral ng Pilipinas***

The BSP is the central bank of the Philippines. The BSP is the regulatory authority over all banks in the Philippines. The BSP also regulates non-bank financial institutions (NBFIs) either with, or without, quasi-banking functions. It is mandated under Republic Act No. 8791 or The General Banking Law of 2000 to recognise microfinance as a legitimate banking activity and to establish rules and regulations for its practise within the banking sector. During the same year, the BSP declared microfinance as its flagship program for poverty alleviation. Since then, it has been proactive in the development of microfinance using a three-pronged approach, to wit: i) to provide the enabling policy and regulatory environment for microfinance; ii) to increase the capacity of the BSP and the banking sector on microfinance operations; and iii) to promote and advocate for the development of sound and sustainable microfinance operations (*Bangko Sentral ng Pilipinas,* 2010a). If this approach is properly sustained, the BSP sees it as an effective intervention in alleviating poverty especially in the countryside.

As both regulator and supervisor of the banking system, the BSP ensures that its policies and regulations are receptive to the needs of the microfinance industry. As such, it has issued various circulars for banks engaged in microfinance to adhere to international best practices and performance standards to become more sensitive to the peculiarities of microfinance operations (Roman, 2004). Moreover, it institutionalised microfinance in its structure by establishing a top-level Microfinance Committee,[14] a Microfinance Unit, and a Microfinance Core Group of Examiners making the BSP one of the first central banks in the Asia-Pacific Region with a permanent office dedicated to microfinance (*Bangko Sentral ng Pilipinas,* 2010b).

[14] The Microfinance Committee was established on 06 June 2002 through Monetary Board Resolution No. 829.

Box 3.2 National Strategy for Microfinance in the Philippines

Vision. To have a viable and sustainable private micro (financial) market, with the government providing a supportive and appropriate policy environment and institutional framework to that market.

Objective. To provide access to financial services to the majority of poor households and microenterprises by the year 2005. This will be achieved in a liberalized and market-oriented economy where the private sector plays a major role and the government provides the enabling environment for the efficient functioning of markets and the participation of the private sector.

Policy Framework. The government's microfinance policy is built on the following principles:

1. Greater role of the private sector/MFIs in the provision of financial services;
2. An enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
3. Market-oriented financial and credit policies, e.g. market-oriented interest rates on loan and deposits; and
4. Non-participation of government line agencies in implementation of credit/guarantee programs.

Institutional Framework. The policy framework and their relative comparative advantages in providing financial services to the poor determine the respective roles of the various players in microfinance. Thus, their respective roles are as follows:

- **Microfinance Institutions:** to engage in sound, sustainable and viable microfinance intermediation;
- **National Government through the National Credit Council:** to provide a market-oriented financial and credit policy environment which will promote efficient financial markets, and help private microfinance institutions broaden and deepen their micro financial services;
- **National Credit Council:** as microfinance policy making body, to ensure such policy environment;
- **People's Credit and Finance Corporation:** as the government credit corporation focused on poor households and microenterprises, to provide wholesale (loanable funds) and technical assistance to the MFIs and support the development of innovative financial products/services for poor households/microenterprises;
- **Government financial institutions:** to provide wholesale funds (including those sourced from foreign borrowings) to MFIs which do not have access to wholesale loans from private commercial banks;
- **Commercial and other private banks:** to provide wholesale funds and financial services to MFIs;
- **NGOs:** to provide technical assistance in facilitating the linkage between the poor households/microenterprises and microfinance institutions, community organizations and capacity building of the target clientele;
- **Donors:** to provide assistance to social preparation activities, and those that will lead to the broadening and deepening of micro financial services such as: development of microfinance products, training in microfinance technologies, and upgrading of performance standards, operating systems and procedures.

Strategy. To realise the objective of providing poor households/microenterprises greater access to micro financial services, the following strategies will be pursued:

1. Provision of a policy environment that is conducive to the effective and efficient functioning of the financial market.
2. Establishment of a market-oriented financial and credit policy environment that is conducive for the broadening and deepening of micro financial services. Broadening and deepening mean the development of new product lines and services, the design and implementation of new microfinance technologies and practices that will result to increased microfinance intermediation between the target clientele and MFIs.
3. Implementation of a capacity-building program for MFIs.

Source: National Credit Council

- **Securities and Exchange Commission**

The Securities and Exchange Commission (SEC) is the government-registering agency for all non-government organizations (NGOs). Microfinance NGOs – while not regulated by the BSP – are required to register with the SEC as non-stock, non-profit organisations. However, they are not under any form of regulation. Thus, in order to monitor the number of NGOs with microfinance operations, the SEC has required all NGOs providing micro-credit to categorically state in their respective charters and by-laws that microfinance is part of the services that they are providing.

- **Cooperative Development Authority**

The Cooperative Development Authority (CDA) performs oversight functions and is mandated to register, monitor, develop, promote and supervise all cooperatives in the Philippines. However, the supervisory capacity of the CDA has been hampered by a lack of specialised financial expertise as well as its mixed mandate that includes contrasting regulatory and promotional functions (Gardiol et al., 2005). In response to the policy gap, the Congress of the Philippines amended the Cooperative Code of the Philippines[15] in 2009. The amendments empowered and strengthened the regulatory and supervisory authority of the CDA over cooperatives, particularly multi-purpose cooperatives that provide savings and credit services.

- **Insurance Commission**

The Insurance Commission (IC) regulates and supervises all insurance activities in the Philippines in accordance with the provisions of the Insurance Code. Under the Regulatory Framework for Microfinance in the Philippines, the IC regulates and supervises insurance companies including mutual benefit associations (MBAs) offering insurance products and services. This includes the provision of microinsurance products, a key component of microfinance. In 2010, the NCC in collaboration with other government agencies and the private sector launched the

[15] In 17 February 2009, President Arroyo signed Republic Act No. 9520 otherwise known as the Philippine Cooperative Code of 2008. It amended Republic Act No. 6938 or the Cooperative Code of the Philippines.

National Strategy for Microinsurance and the Policy Framework for Microinsurance. These twin pillars of microinsurance development provide the blueprint in regulating the microinsurance industry with the aim of protecting consumers and improving access to microfinance.

The National Strategy for Microinsurance (see Box 3.3) defines the vision, objective, roles of the various stakeholders as well as the key strategies to be pursued in enhancing access to insurance products and services of the poor. On the other hand, the Regulatory Framework for Microinsurance establishes the policy and regulatory environment that will encourage, enhance and facilitate the safe and sound provision of microinsurance products and services by the private sector. The framework defines the terms microinsurance[16] and microinsurance products[17] and identifies the entities that can provide microinsurance products.

[16] Microinsurance refers to the insurance, insurance-like and other similar business activity of providing specific products and services that meet the needs of the poor.
[17] Microinsurance product is a financial product or service that meets the risk protection needs of the poor where: the amount of premiums, contributions, fees or charges, computed on a daily basis, does not exceed five (5) percent of the current daily minimum wage rate for non-agricultural workers in Metro Manila; and the maximum sum of guaranteed benefits is not more than 500 times the daily minimum wage rate for non-agricultural workers in Metro Manila.

Box 3.3 National Strategy for Microinsurance in the Philippines

Objective. To provide the poor increased access to microinsurance products and services through the adoption and implementation of the following key policy strategies:

1. Increased participation of the private sector in the provision of microinsurance services;
2. Establishment of an appropriate policy and regulatory environment for the safe and sound provision of microinsurance by the private sector;
3. Mainstreaming of informal insurance, insurance-like, and other similar activities/schemes; and
4. Institutionalization of financial literacy (learning/education) that will highlight the importance of microinsurance, the applicable rules and regulations, the duties and responsibilities of the providers, and the rights of the insured.

Key Stakeholders. The development of an insurance market for the poor requires the participation of all key stakeholders from both the government and the private sector. To ensure that the objective of increased access of the poor for risk protection is attained, it is imperative for key stakeholders to focus on roles where they have distinct and comparative advantage.
Their respective roles are as follows:

- **Government:** shall support and encourage the participation of private insurance providers in offering appropriate risk protection to the poor.
- **Insurance and insurance-like providers:** shall take the lead role in directly providing microinsurance products and services to the poor.
- **Intermediaries:** refer to entities or individuals such as brokers and agents that shall facilitate the provision of insurance products and services by licensed insurance providers.
- **Support institutions:** shall provide the necessary support services and assistance to build the capacity of key stakeholders in microinsurance.
- **Development partners:** refer to international organizations, be it publicly or privately owned, and individuals of good reputation that support the development thrusts of the government.

Strategy. To realise the objective of providing poor households and microenterprises greater access to microinsurance products and services, the following specific strategies shall be pursued:

1. Provision of an appropriate policy and regulatory environment that is conducive to the effective and efficient functioning of the private microinsurance market.
2. Mainstreaming informal insurance.
3. Institutionalisation of financial literacy.

Source: Department of Finance

- **Agricultural Credit and Policy Council**

The Agricultural Credit and Policy Council (ACPC) is an attached agency of the Department of Agriculture. The ACPC is a pioneer in pushing for reforms and innovations in rural and agricultural finance. In 1986, President Aquino signed Executive Order No. 113 which mandated ACPC to provide policy directions on agricultural credit towards a healthy and sustainable rural financial system. To address the need for access to sustainable credit of small farmers and fisher folks, the ACPC has fostered a robust market orientation and holistic approach to the rural credit system (Agricultural Credit Policy Council, 2011). Likewise, the ACPC is the lead government agency that developed and implemented policies and innovative financing programs whereby government credit resources were used when all DCPs were terminated [18] by virtue of the Agro-industry Modernization Credit and Financing Program under Republic Act No. 8435 or the Agriculture and Fisheries Modernization Act (Jimenez, 2009).

- **Microfinance Council of the Philippines, Inc.**

The Microfinance Council of the Philippines, Inc. (MCPI), a duly registered non-government organisation, is a network of 45 institutions working towards the rapid development of the microfinance industry in the Philippines. It is composed of 36 microfinance practitioners and 9 allied service institutions. The membership among the practitioners is dominated by microfinance NGOs. Nonetheless, it also has some microfinance-oriented banks and a thrift bank as members. The MCPI is committed to providing equitable access to financial and non-financial services to its clients to reduce poverty in the Philippines (MCPI, 2011).

Under the Regulatory Framework for Microfinance in the Philippines, the MCP is viewed as the repository of reports and information of NGO MFIs. However, it

[18] Sec. 21, RA 8435. Phase-out of the Directed Credit Programs and Provision for the Agro-Industry Modernization Credit and Financing Program. - The Department shall implement existing DCPs; however, the Department shall, within a period of four (4) years from the effectivity of this Act, phase-out all DCPs and deposit all its loanable funds including those under the Comprehensive Agricultural Loan Fund (CALF) including new funds provided by this Act for the AMCFP and transfer the management thereof to cooperative banks, rural banks, government financial institutions and viable NGOs for the Agro-Industry Modernization Credit Financing Program (AMCFP). Interest earnings of the said deposited loan funds shall be reverted to the AMCFP.

does not have the power and authority to impose sanctions on member organisations. Microfinance NGOs are not subject to prudential regulation and supervision by any government regulatory body. To ensure that they are operating in accordance with sound practices, the MCPI has established a set of financial standards and performance indicators that are periodically collected from microfinance NGOs. The performance indicators are focused on portfolio quality, efficiency, sustainability, outreach and savings generation (Valdemar et al. 2007). These indicators in some instances form the basis of evaluation by donor agencies and other interested parties in determining the necessary technical assistance appropriate for certain MFIs. It is envisioned that MCP, over time, shall act as a self-regulatory organisation for microfinance NGOs in the Philippines.

3.5.3.2 Wholesale Financial Institutions

Government financial institutions (GFIs) and private commercial banks, as wholesalers of funds, generally provide the loanable funds for microfinance. However, there is no prohibition for commercial banks to also engage in retail lending to microfinance clients. To this end, some commercial banks have established their own subsidiaries like rural banks, thrift banks as well as microfinance-oriented branches to meet the requirements of their clients for retail microfinance services.

Commercial banks provide wholesale funds to private financial institutions (PFIs) using their own funds and adopting their own lending criteria. Meanwhile, government-owned and controlled corporations (GOCCs) and GFIs are directed by current government policies to provide wholesale funds (including those sourced from borrowings) to microfinance institutions that do not have access to funds from commercial banks. These funds are being provided at market rates.

The People's Credit and Finance Corporation (PCFC) leads government institutions engaged in wholesale lending to MFIs. The PCFC is the lead agency for microfinance services delivery in the country. It is a GOCC and is an attached agency of the Land Bank of the Philippines (LBP). The head of the PCFC is also the chair of the Microfinance Program Committee (MFPC), an association of GFIs and GOCCs that are engaged in wholesale lending to retail MFIs. The MFPC is composed of the following government agencies: i) LBP; ii) Development Bank of the Philippines

(DBP); iii) Small Business Guarantee and Finance Corporation; and iv) National Livelihood Development Corporation.

3.5.3.3 Retail Microfinance Institutions

The retail microfinance institutions are the financial institutions that provide direct microfinancial services (e.g. microcredit and micro savings) to microfinance clients. These institutions include the following, namely: i) microfinance NGOs; ii) rural banks; iii) thrift banks; iv) cooperative banks; and v) savings and credit cooperatives.

- **Microfinance NGOs**

  Under the National Strategy for Microfinance, microfinance NGOs are expected to engage in sound, sustainable and viable microfinance intermediation. However, at present, there is no single government agency that has supervision over microfinance NGOs. They likewise do not report to any oversight agency (whether private and public). Consequently, no single institution has a complete set of relevant information on the financial performance of microfinance NGOs. While many microfinance NGOs belongs to the Microfinance Council of the Philippines, not all members actually submit the established set of financial standards to the council.

- **Rural Banks**

  Rural banks are banks that operate in rural communities. Rural banks are privately owned and managed and they provide people in the rural communities with basic financial services. As of June 30, 2011, there are 154 microfinance-oriented and microfinance-engaged rural banks in the Philippines with a total microfinance-lending portfolio of about PhP5.3 billion to 844,714 borrowers (*Bangko Sentral ng Pilipinas,* 2011a).

- **Thrift Banks**

  Under Republic Act No. 7906 or the Thrift Banks Act of 1996 thrift banks shall include savings and mortgage banks, private development banks, and stock savings and loans associations organized under existing laws, and any banking corporation that may be organized for the following purposes: i) accumulating the savings of depositors and investing them; ii) providing short-term working capital and medium- and long-term financing to businesses engaged in agriculture, services, industry and housing; and iii) providing diversified financial and allied services for its chosen market and constituencies specially for small and medium enterprises and individuals. According to data from the BSP (2011a), as of June 30, 2011, there are 23 microfinance-oriented and microfinance-engaged thrift banks in the Philippines with a total microfinance-lending portfolio of about PhP697.0 million to 40,881 borrowers.

- **Cooperative Banks**

Like rural banks, cooperative banks are the more popular type of banks in the rural communities. Unlike rural banks however, which are privately owned and managed, cooperative banks are organised and owned by cooperatives or federation of cooperatives. They are organised for the primary purpose of providing a wide range of financial services to cooperatives and their members in order to promote and expand the rural economy. According to data from the BSP (2011), as of June 30, 2011, there are 21 microfinance-engaged cooperative banks in the Philippines with a total microfinance-lending portfolio of about PhP810.3 million to 78,110 borrowers.

- **Savings and Credit Cooperatives**

The Savings and Credit Cooperatives is the type of cooperative that promotes and undertakes savings and lending services among its members. It generates a common pool of funds in order to provide financial assistance and other related financial services to its members for productive and provident purposes (Cooperative Development Authority, 2009)

3.5.3.4 Social Preparation/Capacity Building Entities

- **Donors**

Under the National Strategy for Microfinance, donors are expected to provide assistance to social preparation activities and those that will lead to the broadening and deepening of microfinance services such as the development of microfinance products, training in microfinance technologies, and upgrading of performance standards, operating systems and procedures. Donors will also be encouraged to provide assistance in those areas that have been clearly identified from a consultation process with the DOF-NCC and microfinance institutions.

Donor agencies have regularly provided social preparation and capacity building activities not only to MFIs and their clients but also to other key microfinance stakeholders like rural banks and government agency personnel. Some of these donor agencies are the following: 1) World Bank; 2) Asian Development Bank; 3) Canadian International Development Agency; and 4) German Technical Cooperation.

- **Non Government Organisations**

Under the National Strategy for Microfinance, NGOs are expected to provide technical assistance in facilitating the linkages between the poor households/microenterprises and microfinance institutions as well as to assist in the capacity building of the target clientele.

3.5.4 Current State of Microfinance

From 2009 to 2013, the Economist Intelligence Unit (EIU) through its Global Microscope on Microfinance Business Environment has consistently ranked the Philippines as one of the best in the world in terms of the regulatory framework for microfinance. The year 2010, in particular has been good for microfinance in the Philippines. The Economist Intelligence Unit (EIU) in its 2010 Global Microscope on Microfinance Business Environment ranked the Philippines as second in terms of overall microfinance business environment among 54 countries around the world. The Philippines moved one spot in the rankings as it placed third overall – behind Peru and Bolivia – during the First Annual Microfinance Index and Study in 2009.

In terms of overall regulatory environment, the EIU ranked the Philippines as having the best overall regulatory environment for microfinance. In terms of institutional development, the Philippines ranked fourth. However, underlying the need to further improve the business climate in the Philippines, it only ranked 18th in terms of overall investment climate. The EIU used 13 indicators in its microfinance index. These are subdivided into three broad categories: i) Regulatory Framework; ii) Investment Climate; and iii) Institutional Development (see Box 3.4).

Box 3.4 Microscope indicators, Global Microscope on the microfinance business environment 2010

Regulatory framework
1. Regulation of microcredit operations
2. Formation and operations of regulated/supervised specialised MFIs
3. Formation and operation of non-regulated MFIs
4. Regulatory and examination capacity

Investment climate
1. Political stability
2. Capital market stability
3. Judicial system
4. Accounting standards for microfinance
5. Governance standards for microfinance
6. MFI transparency

Institutional development
1. Range of services offered by MFIs
2. Credit bureaus for microfinance
3. Level of competition in the microfinance sector

Source: Economist Intelligence Unit, 2010

In terms of microfinance exposure of the banking sector, in 2010 microfinance-oriented and microfinance-engaged banks have lent around PhP6.53 billion to 932,622 microfinance borrowers. This is higher than the 2009 figures of PhP6.42 billion and 894,855 microfinance borrowers (see Table 3.20).

Table 3.20 Microfinance in the Philippine banking sector[a/]

	Number of banks	**Amount (billion pesos)**	**Number of borrowers**
Microfinance oriented banks:			
Rural banks	5	1.28	249,730
Thrift banks	3	0.20	9,092
Sub-total	8	1.49	278,822
Microfinance-engaged banks:			
Rural banks	149	3.85	556,427
Cooperative banks	23	0.71	80,609
Thrift banks	22	0.49	16,764
Sub-total	194	5.05	653,800
Grand total	202	6.53	932,622

a/ Data as of 31 September 2010

Source: Bangko Sentral ng Pilipinas, 2011

On the other hand, based on the report from the Microfinance Program Committee[19] from July 2004 to April 2010 a total of PhP169.24 was released to 6.07 million microfinance clients throughout the country. These loans likewise generated some 2.99 million new jobs.

The highest amount of loan releases amounting to PhP33.85 billion were channelled to Region III (Central Luzon). These loans benefited 763,406 microfinance clients. This was almost 20% of the total loan releases during the period. Region II (Cagayan Valley) ranked second with 18.24 billion to 431,866 microfinance clients. Region IV-A (CALABARZON) placed third with PhP16.41 billion to 631,938 microfinance clients. Rounding out the top six regions are Region VII (Central Visayas), Region X (Northern Mindanao) and Region VI (Western Visayas) (see Table 3.21). The microfinance loans released to the top six regions likewise generated a total of 1.63 million new jobs. This significantly improved and diversified the income of the micro enterprises as well as contributed to regional development. While the top three recipients of microfinance loans were all from Luzon, the next three were from Visayas and Mindanao.

Table 3.21 Top Regional Microfinance Accomplishments

Region	Loans released (billion pesos)	Number of beneficiaries
III	33.849	763,406
II	18.235	431,866
IV-A	16.408	631,938
VII	14.495	734,511
X	13.631	409,511
VI	13.241	619,840

Source: Microfinance Program Committee, 2010

Overall, more than half (51.76%) of all micro enterprises are engaged in wholesale and retail trade. The manufacturing (14.43%) and hotels and restaurant industries (12.30%) were a far second and third respectively (see Table 3.22). The same picture

[19] The Microfinance Program Committee is composed of government financial institutions engaged in wholesale lending to microfinance institutions. It is led by the People's Credit and Finance Corporation and is composed of other GFIs namely: Land Bank of Philippines, Development Bank of the Philippines, Small Business Guarantee and Finance Corporation and the National Livelihood Development Corporation.

emerges in terms of employment structure. Wholesale and retail trade accounts for 47.48% of total employment and again followed by the manufacturing and hotels and restaurants industry with 15.33 per cent and 13.20 per cent, respectively.

Table 3.22 Percentage distribution of microenterprises in terms of industry, number of establishments, employment and value added

Industry	Number of establishments	Employment structure	Value added
Agriculture, Hunting and Forestry	0.36	0.56	0.01
Fishing	0.13	0.20	0.00
Mining and Quarrying	0.03	0.05	0.92
Manufacturing	14.43	15.33	0.28
Electricity, Gas and Water	0.07	0.15	0.02
Construction	0.17	0.29	0.02
Wholesale and Retail Trade	51.76	47.48	1.73
Hotels and Restaurants	12.30	13.20	0.16
Transport, Storage and Communications	0.91	1.43	0.11
Financial Intermediation	2.97	4.69	0.80
Real Estate, Renting and Business Activities	5.75	5.99	0.62
Education	1.04	1.79	0.08
Health and Social Work	4.25	2.95	0.08
Other Community, Social and Personal Service Activities	5.81	5.69	0.09

Source: National Statistics Office, 2008

Meanwhile, in spite of its sheer numbers – comprising 91.6 per cent of all business establishments – micro enterprises adds very little to the overall economy, with a value added of only 4.9 per cent. If we disaggregate the value added across industries, wholesale and retail trade adds just 1.73 per cent followed by mining and quarrying at 0.92 per cent and financial intermediation at 0.80 per cent. The manufacturing and hotels and restaurants industries, despite accounting for 29 per cent of employment have a combined value added of only 0.42 per cent.

In terms of employment distribution of microenterprises across regions, the National Capital Region (NCR) accounts for 27.83 per cent (see Table 3.23). Region IV-A is second at 13.85 per cent with Region III coming in at third at 9.86 per cent. The Autonomous Region in Muslim Mindanao and CARAGA regions account for the least employment at only 1.05 per cent and 1.69 per cent, respectively. It is important to note that in 2009, the two regions also have the highest poverty incidence in the country.

Table 3.23 Employment distribution of microenterprises

Region	Percent
National Capital Region	27.83
Cordillera Administrative Region	1.73
Region I	5.33
Region II	2.90
Region III	9.86
Region IV-A	13.85
Region IV-B	2.59
Region V	3.86
Region VI	5.76
Region VII	6.13
Region VIII	2.51
Region IX	2.86
Region X	3.86
Region XI	4.94
Region XII	3.25
CARAGA	1.69
Autonomous Region in Muslim Mindanao	1.05

Source: National Statistics Office, 2008

3.6 Chapter Summary

This chapter on the political economy and microfinance in the Philippines can be summarised into three major discussions, namely: political economy of the Philippines from 1899 to the present, socioeconomic profile of the Philippines from the 1960s to the present, and an overview of microfinance in the Philippines. The review on the political economy of the Philippines has concluded that various political and economic forces helped shaped government policies through the years. It likewise showed that the political, philosophical and economic ideologies of the Philippines mirrored that of global trends as dictated by western nations.

In terms of the development of the Philippine microfinance industry, the country did not escape the early failure of the heavily subsidised directed credit programs that were used to finance rural agricultural development in the 1950s up to the 1970s. What is encouraging, however, is that the Philippines likewise rode the move towards building more sustainable financial institutions as key to expanding outreach of microfinance. As proof of this positive development, the Philippine microfinance policy infrastructure was recently hailed as one of the best in the world. Setting aside these achievements, it is apparent that a lot still needs to be done given that poverty is still prevalent in the country. The provision of microfinance still holds the key to the needs of poor households for formal microfinancial services such as credit, savings, insurance, remittances, etc.

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CHAPTER FOUR
METHODOLOGICAL FRAMEWORK

4.1 Introduction

The literature review in Chapters 2 and 3 underscored the need to analyse the impact of microfinance on poverty reduction in the Philippines. The Philippine government has recognised microfinance as an important policy tool in its efforts to reduce poverty. Some important findings, however, show that many of the poor lack access to formal financial services (Milgram, 2001; Ahmad, 2003; Coleman, 2006; Ruben, 2007) with microfinance reaching only one-third of poor households in the Philippines (Carroll, 2014). Given the steady growth of global microfinance portfolio and outreach during the last few years (MicroRate, 2011; Microfinance Information Exchange, 2012), it is imperative for the Philippines to capitalise on this trend in order to help improve its poverty situation.

This chapter serves as the methodological chapter where a mixed method approach combining the use of both quantitative and qualitative analysis on the impact of access to microcredit on poverty reduction is conceptualised and operationalised. The structure of this chapter is as follows. Section 4.2 discusses the hypotheses of the study. Section 4.3 provides an overview of the research design. Section 4.4 discusses the impact assessment framework. Section 4.5 provides the sampling design, selection and procedure. Section 4.6 provides the estimation model. Finally, Section 4.7 provides the chapter summary.

4.2 Hypotheses of the Study

The empirical findings on the impact of microfinance on the poor is mixed. On the one hand, proponents of microfinance argue that microfinance is reaching the poorest of society (Grameen Foundation, 2011; Maes & Reed, 2012). On the other hand, emerging empirical evidence suggest that microfinance is less successful in targeting and reaching the poorest (Amin et al., 2003; Coleman, 2006; Kondo et al. 2008; Adjei & Arun, 2009). The question that arises is to what extent does the socioeconomic and demographic characteristics impact on the ability of households to access microfinance particularly within the context of the GFC. Considering the foregoing, this research hypothesises that:

H1: The socioeconomic and demographic characteristics of households will have a direct impact on their ability to access microfinance.

The joint liability condition in group-lending contracts is often credited as the key innovation that led to the expansion of credit to the poor (Morduch, 1999; Armendariz & Morduch, 2010). In addition, group lending has been proven successful in solving failures in credit markets by mitigating problems created by information asymmetries, such as adverse selection and moral hazard (Stiglitz, 1990; Varian 1990 Van Tassel, 1999; Armendariz de Aghion & Morduch, 2004). Based on these findings, this research proposes to test the hypotheses related to group lending. The hypothesis is stated as follows:

H2: Group-based lending contract enhances the livelihood of households.

According to Goldberg (2005), the quality and rigor of microfinance impact evaluations vary and their results should be interpreted with caution. For example, Hossain (1988), Chen and Snodgrass (2001), Dunn and Arbuckle (2001), and Khandker (2005) found that microfinance program participants, on average, earned more per year than non-participants across villages in India, Peru and Bangladesh. In addition, the studies by Khandker (1998) and Pitt and Khandker (1998) found that access to credit has led to substantial increases in the income of borrowers. Given the above findings, the question that arises is to what extent does household participation in microfinance programs improve their livelihood. To test the hypothesis related to microfinance program participation, it is hypothesised that:

H3: Participation of poor households in microfinance programs increases household income.

Many studies argue that increased income and access to formal financial services due to microfinance has enabled the poor to invest in education and health thereby improving their wellbeing (DeLoach & Lamanna, 2011; Littlefield et al., 2003). In addition, Pitt et al. (2003) argue that credit provided to women clients improves measures of nutrition and health of households. In a later study, Pitt et al. (2006) find that participation in credit programs led to a greater role for women borrowers in terms of household decision-making and access to financial resources. Based on these findings, this research hypothesises that:

- H4: Participation of poor households in microfinance programs will have a positive impact towards the education of their children/dependents.
- H5: Access to microfinance programs enables poor households to invest in the health of their children/dependents.
- H6: Participation of poor households in microfinance programs enhances their ability to make decisions at home.

Government policymakers are faced with many challenges. Early policy intervention involving heavily subsidised directed credit programs by government in a number of developing countries have failed (Von Pischke et al. 1983; Morduch, 1999; Robinson, 2001; Sonne, 2010). However, the shift to a market-based paradigm has spurred the growth of self-sustainable MFIs (Otero & Rhyne, 1994; Hulme & Mosley, 1996). The changing global market conditions imply that policymakers need to continually adopt an active stance towards evaluating the impact of government policy on the performance of the microfinance industry by remaining attuned to global developments as well as to the nuances of local markets. To this end, this research proposes to test the following hypothesis:

- H7: An enabling policy and regulatory environment for microfinance under a market-based paradigm is perceived to have positive effects on the performance of the microfinance industry.

4.3 Overview of the Research Design

To address the objectives and to test the hypothesis outlined above, the study will use a mixed method approach. For the quantitative analysis, the study will undertake a survey of eligible households comprising of both microfinance clients and non-clients. On the other hand, for the qualitative analysis, the study will use participatory focus group discussions of microfinance clients and will survey key microfinance stakeholders via in-depth interviews.

4.3.1 Household Survey

To test the following hypotheses, H1 to H5, a one-time survey of 211 eligible households involving microfinance clients and non-clients will be undertaken. The 211 eligible households will be broken down into the following: 105 old client and new client households in the treatment and control areas, and 106 non-clients but qualified households in the treatment and control areas. This quasi-experimental design was originally used by Coleman (1999) to measure the impact of group lending in Thailand.

Following the Asian Development Bank (2007), Banerjee et al. (2010) and Augsburg et al. (2012) studies on microfinance, a structured questionnaire will be used and shall consist of a series of questions relating to households' perceptions about microfinance, as well as their socioeconomic characteristics, including some social wellbeing measures on health, education and women empowerment. The structured questionnaire will be pre-tested for clarity and ease of response before the execution of the full-scale survey. The empirical investigation for testing H1 to H5 will entail descriptive analysis, correlation analysis and regression analysis. The household survey will employ a pipeline design. Pipeline designs are widely used in impact evaluations (see Coleman 1999; Khandker et al. 2010) because they provide a convincing control group (Duvendack et al. 2011). The survey area will be where the MFI chosen for the study is operating.

4.3.2 Focus Group Discussion

To investigate the impact of microfinance on women empowerment as well as some other social wellbeing measures such as health and education, a series of participatory focus group discussions will be conducted with a random sample of clients who also took part in the household survey. Focus group discussions will be conducted in the same area where the household survey questionnaire was administered. There will be a total of eight focus groups involving 5-8 participants per focus group. The focus groups will be used to probe and tease out to what extent does access to microfinance under group lending:

1. Empower women;
2. Impact on the savings behaviour of the borrower;

3. Impact on the health of household members; and
4. Impact on the education of household members.

Women empowerment will be measured in terms of changes in household dynamics (e.g., decision-making as it relates to household expenditure, savings, investments, etc.) before and after joining a microfinance program. Impact of microfinance on the savings behaviour of the borrower will be analysed from the responses provided by the focus group participants. Impact of microfinance on the health and education of household members will be measured in terms of changes in household expenditures, savings and investments that relates to measures of health and education prior and after getting access to microfinance. The data collected will be analysed using qualitative software. The results are expected to provide a deeper insight into the impact of microfinance on abovementioned household outcomes and complement the empirical findings based on the household surveys.

4.3.3 Survey of Key Stakeholders/Informants

The survey of key stakeholders through semi-structured interviews will be used to elicit information on the challenges and opportunities facing the Philippine microfinance industry. This survey will attempt to specifically elicit information that will assist in answering the following questions:

1. To what extent has government policies (e.g., enabling policy and regulatory environment) impacted on the performance of the microfinance industry;
2. What criteria is used by microfinance institutions in selecting and targeting clients;
3. What are the perceptions of MFIs as to their role in poverty reduction; and
4. What is government policymakers' expectation on the role of MFIs in poverty reduction efforts?

Respondents will include representatives from microfinance industry stakeholders, namely, government policymakers and officials, government and private financial institutions, donors and NGOs. To gather key insights, the respondents will be top-level officials, policymakers and experts in the field.

4.3.4 Data Sources and Description

The primary data that will be used in the quantitative and qualitative analysis will be obtained from the household survey, focus groups and survey of key stakeholders/informants. Primary quantitative data on biographical information, household characteristics, income, expenditures and health information will be gathered through the household survey. Further, primary qualitative data such as focus groups and interview transcripts will be gathered through the focus group discussions and the survey of key stakeholders through semi-structured interviews.

On the other hand, the secondary data to be used in the analysis will be obtained from official statistics as compiled by various Philippine government offices. For income-based poverty statistics, secondary data will be obtained from the National Statistical Coordination Board, Department of the Interior and Local Government and the Department of Social Welfare and Development. For non-income based poverty statistics, secondary data will be obtained from the National Statistics Office, Department of Social Welfare and Development, Department of Education, Department of Labor and Employment and Food and Nutrition Research Institute. Other sources secondary data will be from the Department of Trade and Industry, *Bangko Sentral ng Pilipinas*, People's Credit and Finance Corporation and the Microfinance Council of the Philippines, Inc.

4.4 Impact Assessment Framework

The quasi-experimental design that will be used to measure the impact of microfinance includes the creation of a treatment group and a control group. The treatment group is composed of existing clients while the control group is composed of new clients that are all randomly selected from the list of the clients of the MFI. The existing clients are those who have availed of microfinance loans from the MFI for at least three years prior to the conduct of the survey. On the other hand, the new clients are those who have availed of microfinance loans from the MFI for less than one year. An equal number of non-client households will be asked to participate in a household survey.

Further, non-client households from the same village as the existing and new clients will also be asked to participate in the said survey. The ratio of client households to non-client households that will be surveyed is 1:1. Should there be problems in getting non-client households to participate in the study, a smaller ratio of non-client households will be utilised. The smaller number of non-client households is due to the difficulties relating to the recruitment of non-clients (for example, see Dunn, 2007)

Table 4.1 Type of household respondent

Type of HH	Treatment area	Control area
Client households	(A) Existing/old clients	(C) New clients
Non-client households	(B) Qualified non-clients	(D) Qualified non-clients

Source: Adopted from Coleman (2006)

Based on the table above, the impact of microfinance on households is given by the expression:

(1) Microfinance Impact = (A-B)-(C-D)

This expression is called the difference-in-difference (DID) method. To see how the DID method generates a clean measure of the average impact of access to microfinance, the above table can be filled by the factors determining outcomes for the different households (see Table 4.2). The factors determining outcomes are adopted from Armendariz and Morduch (2010) who suggest that it is possible to rule out potential selection biases by comparing all qualified households between the treatment and control areas. Simply comparing the incomes and other outcome variables of microfinance clients and non-clients using data from the treatment area would not rule out potential selection biases. This is also the case if the data from the control area composed of only the new clients will be compared to the data from the treatment area using only the existing clients since the participants are still a select group, leading to potential selection bias.

Table 4.2 Factors determining outcomes

Type of HH	Treatment area	Control area
Client household	(A) Existing clients • Observable characteristics • Unobservable characteristics affecting access • Area attributes • Microfinance program	(C) New clients • Observable characteristics • Unobservable characteristics affecting access • Area attributes
Non-client household	(B) Qualified non-clients • Observable characteristics • Area attributes	(D) Qualified non-clients • Observable characteristics • Area attributes

Source: Adopted from Coleman (2006)

From the above table, it can be inferred that the new clients in the control area will not have the impact of the microfinance program compared to the existing clients in the treatment area because even if they have be identified as potential or new clients, they have yet to receive microfinance loans from the MFI. On the other hand, qualified non-client households will neither have the effect of the unobservable characteristics affecting access to microfinance nor the impact of the microfinance program itself since they have not been part of the microfinance program.

Going back to the expression Microfinance Impact = (A-B)-(C-D) and using the data from Table 4.2, the expression (A-B) will therefore provide the net effects of the unobservable characteristics affecting access as well as the microfinance impact. On the other hand, the expression (C-D) will yield the net effect of the unobservable characteristics affecting access. Thus, the process of elimination given the expression (A-B)-(C-D) will yield the net effect of the microfinance program. The importance of the impact evaluation strategy using eligibility rules as proposed by Armendariz and Morduch (2010) is that by including qualified non-client households (B and D), the potential of placement bias was avoided. Simply comparing existing and new clients as can be given by the expression (A-C) will give us the net effects of both the microfinance impact and the difference in area attributes. Given that microfinance program placements are not decided randomly, it is expected that area attribute effects in most cases will not be identical.

4.5 Sampling Design, Selection and Procedure

4.5.1 Survey Area

The impact survey requires two types of areas, the treatment area and the control area. The treatment area is defined as areas where the MFI has been providing microfinance for a considerable period of time in order to have a sizable pool of qualified existing clients. The longer time period is expected to allow for a better measure of microfinance impact, if any. On the other hand, the control area is defined as areas where prospective new clients have been identified but no loans have yet been released. Similar to Coleman (2006) and Kondo et al. (2008), a suitable control area should be different village and not just a new centre in the same village as the treatment area.

4.5.2 Respondents and Sampling Size

The three groups of household survey respondents are:

- *Existing/old clients.* Micro entrepreneurs who have been with the program for at least three years in the treatment area and is on the active client list prior to the conduct of the household survey.
- *New clients.* Micro entrepreneurs who have been with the program for less than one year or for less than two loan cycles in the control area and is on the active client list prior to the conduct of the household survey.
- *Qualified non-clients*. Micro entrepreneurs who have not availed of any microfinance loans but who have otherwise qualified. The qualified non-clients will come from the treatment and control areas.

The sampling size will consist of 90 existing/old clients, 15 new clients and 106 qualified non-clients, for a total of 211 household survey respondents.

For the focus groups, the participants will come from the pool of existing/old clients of which at 40 least existing/old clients will be randomly chosen and asked to participate in the focus group discussion. Finally for the survey of key stakeholders, no more than 20 key informants of the Philippine microfinance industry will be interviewed.

4.5.3 Sampling Selection

The selection of the household survey respondents will be conducted in the following manner:

- *Existing/old clients*. These will be drawn randomly from the deidentified coded database prepared by the MFI of qualified existing clients in the treatment area. The deidentified coded databases supplied by the MFI will be subjected to Microsoft Random Sampling software by the researchers to identify the required number of existing/old clients needed for the study.
- *New clients*. These will be drawn randomly from the list from the deidentified coded database prepared by the MFI of new clients in the control area. The deidentified coded databases supplied by the MFI will be subjected to Microsoft Random Sampling software by the researchers to identify the required number of existing/old clients needed for the study.
- *Qualified non*-clients. These will be randomly drawn from the list prepared by the MFI of qualified non-clients in both the treatment and control areas. Non-client households will be randomly selected via systematic sampling method from the villages where the MFIs operate. The sample universe of households will come from the 2010 Census of Population and Housing conducted by the National Statistics Office out of which the random sample of non-client households will be selected.

Focus group participants will likewise be drawn randomly from the list of existing/old clients who took part in the household survey. Finally, prospective interview participants will be selected from the publicly available list of key Philippine microfinance industry stakeholders consisting of top-level officials, policymakers and experts in the field.

4.5.4 Research Instrument

The types of data collection instrument to be used for the study are the following: a) structured interviews via a household survey/questionnaire; b) participatory discussions via focus groups; and, c) semi-structured interviews of key informants. The survey/questionnaire will be administered to a randomised sampling of qualified households. The questionnaire contains a series of questions that were compiled following the determination of information needed for the study and the review of previous randomised evaluations on microfinance and its impact on poverty (see for example Banerjee, et al. 2010; Augsburg, et al. 2010).

The major sections of the questionnaire include questions on biographical information of the individual borrower (i.e., sex, age, literacy, education, etc.) household characteristics (i.e., income, expenditures, debts, savings, etc.) and household enterprise.

The structured questionnaire will be pre-tested for clarity of understanding and ease of response before the execution of the full-scale study. The pilot survey will be administered to 20 households from the chosen research area. The results of the pilot test will be used to revise the questionnaire and will be subsequently personally administered with assistance from trained enumerators to the 260 survey respondents from the chosen research area.

The focus group guide questions will be used to probe the extent to which microfinance under group lending have empowered women clients and improved the health and education of household members. Finally, the semi-structured interview guide questions will be used gather information from key microfinance industry informants on the challenges and opportunities facing the Philippine microfinance industry.

4.6 Estimation Model

The empirical investigation in the study will entail descriptive analysis, correlation analysis and regression analysis. The DID strategy described in the impact assessment framework will be implemented in a regression framework. The regression framework is specified as follows:

(2) $$Y_{ij} = \beta_1 X_{ij} + \beta_2 V_j + \beta_3 M_{ij} + \beta_4 T_{ij} + \varepsilon_{ij}$$

where:

Y_{ij} = household outcome of interest

X_{ij} = household characteristics

V_j = village characteristics

M_{ij} = membership dummy; 1 if client in treatment or control areas, 0 otherwise

T_{ij} = treatment variable; 1 (or >0) if client in treatment area, 0 otherwise

The above expression is similar to the formulation in Coleman (1999) and Montgomery (2005). The expression likewise covers the three known sources of bias in evaluating the impact of microfinance using new clients as a control group. The use of the membership dummy variable M provides control for non-random program participation or sample selection (Coleman, 1999). Not controlling for sample selection results in biased estimates of the impact of microfinance [for example, see Coleman (1999) and Armendariz & Morduch (2010)]. Finally, non-random program placement is controlled by village characteristics V_j or fixed effects estimation (Khandker, 1998)

4.6.1 Treatment Variables

The treatment variable can be expressed in different measures of program participation. For example, (i) have availed of microfinance services (1 = yes, 0 = otherwise); (ii) number of months since first loan release for the village, (iii) total amount of loans, and (iv) number of loans cycles the household has borrowed. Coleman (1999) used (ii). He argues that (ii) is a more precise measure of program availability than say (i). This is because length of exposure to the program is expected to have an impact.

4.6.2 Outcome Variables

The outcome variables that will be used in the study are the following: (i) basic household welfare measures such as per capita income, per capita expenditures, per capita savings, and food expenditures; (ii) other financial transactions such as other loans and personal savings stocks;[2] (iii) household enterprises and employment; (iv) household assets such as land, farm equipment, livestock and poultry, and household appliances; and (v) human capital investments such as education and health.

4.6.3 Independent Variables

The outcome variables that will be used in the study include household characteristics such as age of the reference person (household head) or respondent; education of the reference person; number of years in the village, and house size. Age is expected to be a factor because it is well known that age earning profile is not flat. Education, of course, is a known determinant of both earning capacity and productivity in non-market (home) production. The number of years in the village is a proxy for social capital. House size is a proxy for household wealth.

4.7 Chapter Summary

In this chapter, an overview of the research design and methodology of the study was discussed. In particular, the chapter outlines the details of the research design that will employ the following: 1) Household Survey; 2) Focus Group Discussion; and, 3) Survey of Key Stakeholders/Informants. The chapter also present the framework to assess impact of microfinance as well as the sampling design, selection and procedure.

The chapter likewise presented the estimation model of the study that will employ descriptive analysis, correlation analysis and regression analysis. The difference-in-difference strategy presented in the impact assessment framework will be implemented in the specified regression framework.

A mixed method approach was used for the study to collect both quantitative and qualitative data. To collect the quantitative data needed for the study, a household survey of eligible households consisting of both microfinance-client and non-client households was randomly administered in the chosen survey area in Northeastern Mindanao. On the other hand, to collect the qualitative data required for the study, both a participatory focus group discussion of microfinance clients and in-depth interviews of key microfinance stakeholders were conducted. The succeeding chapters will report the analysis of the data gathered.

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CHAPTER FIVE

EMPIRICAL ANALYSIS OF THE SOCIOECONOMIC AND DEMOGRAPHIC CHARACTERISTICS OF MICROFINANCE-RECIPIENT AND NON-RECIPIENT HOUSEHOLDS IN NORTHEASTERN MINDANAO

5.1 Introduction

This chapter presents and discusses the examination of socioeconomic and demographic characteristics of microfinance recipient and non-recipient households in Northeastern Mindanao, the Philippines. If the goal of microfinance institutions include social inclusion, as many proclaim to be, it is therefore crucial for MFIs to determine if they are reaching their target clients. This is even before MFIs can begin to deliberate on the possible 'direct link' between MFI activity and the evolution of the socioeconomic situation of their clients and their families. Similarly, it is important to find out to what extent does the socioeconomic and demographic characteristics impact on the ability of households to access microfinance. It is therefore crucial to determine if there may be bias or not in the MFI selection process in favour of 'less risky' clients. This chapter likewise investigates the differences and/or similarities between microfinance recipient households and non-client households.

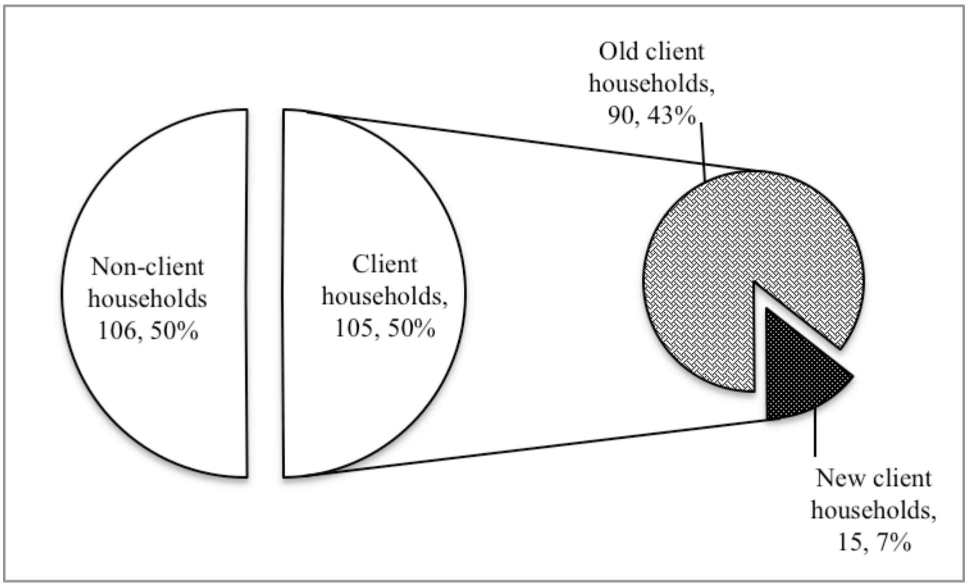
The rest of the chapter is organised as follows. Section 5.2 discusses the demographic characteristics of microfinance recipient households and non-recipient households in Northeast Mindanao. On the other hand, Section 5.3 discusses the socioeconomic characteristics of microfinance recipient households and non-recipient households. Section 4 discusses the poverty status of the surveyed households using three different poverty measures, namely: 1) self-rated poverty approach; 2) national and regional poverty line approach; and, 3) multidimensional poverty approach. Section 5.5 summarises the chapter.

5.2 Demographic Characteristics of Microfinance-Client Households and Non-Client Households in Northeastern Mindanao

5.2.1 Distribution of Household Survey Respondents

Figure 5.1 depicts the distribution of all surveyed households in Northeastern Mindanao, the Philippines in 2013. The 211 households surveyed are roughly equally divided between microfinance client households and non-client households, with 105 and 106 survey respondents, respectively. Microfinance client households are further subdivided into two sub-groups, namely: i) old microfinance client households or those who have an active group loan for at least three years; and, ii) new microfinance client households or those who have an active group loan for less than one year. On the other hand, non-client households are those households that have no existing group loan but are qualified to avail of one per CBI standards. Further, Figure 5.1 likewise shows the distribution of the microfinance client households, with 90 households or 43 per cent, classified as old microfinance client households with the rest, comprising of 15 households or seven per cent, classified as new microfinance client households.

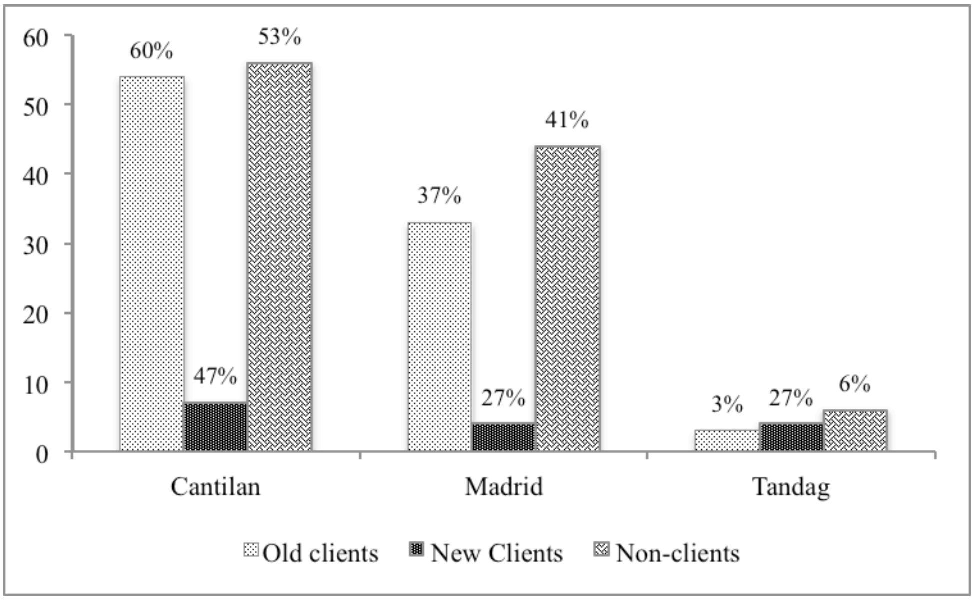
Figure 5.1 Household survey respondents distribution in Northeastern Mindanao



Source: Derived from survey data.

Figure 5.2 shows the distribution of all surveyed households according to branch coverage of CBI. It shows that 56 per cent or 117 households belong to Cantilan branch-covered areas, 38 per cent or 81 households belong to Madrid branch and six per cent or 13 households belong to Tandag City branch. Moreover, in terms of the distribution of client and non-client households, 58 per cent of client households and 53 per cent of non-client households are from Cantilan branch with Madrid branch having a distribution of 35 per cent and 42 per cent and Tandag City branch at seven per cent and five per cent, respectively.

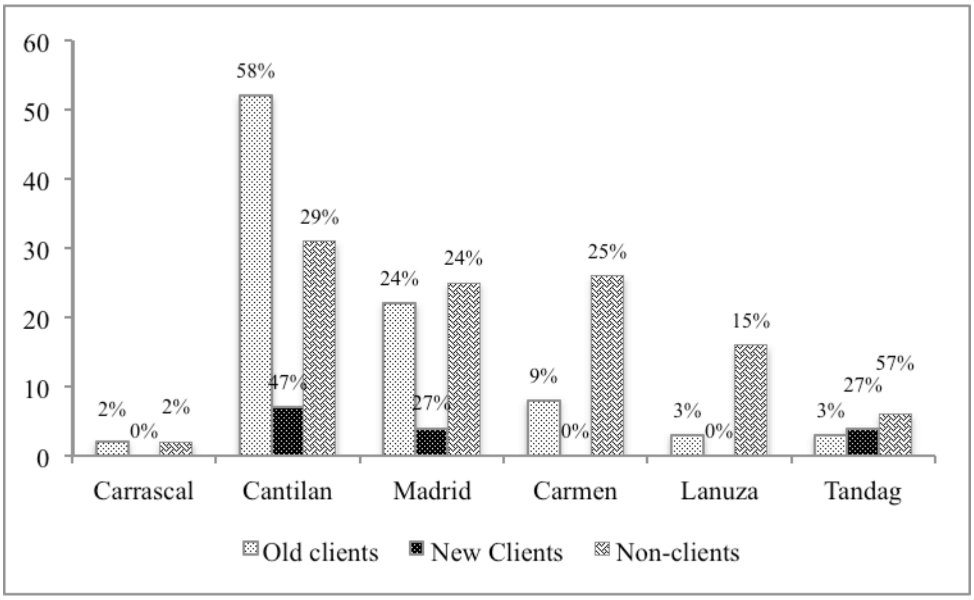
Figure 5.2 Household survey respondents distribution per CBI branch coverage



Source: Derived from survey data.

Figure 5.3 depicts the distribution of the surveyed households according to municipality or city. The figure shows that the biggest number of respondents – both client and non-client households – come from the municipality of Cantilan with 56 per cent of client households and 29 per cent of non-client households. The municipality of Madrid comes next with a 25 per cent and 24 per cent client to non-client household distribution followed by the municipalities of Carmen (seven per cent and 25 per cent), Lanuza (three per cent and 15 per cent), Tandag City (seven per cent and five per cent) and the Municipality of Carrascal at two per cent for both client and non-client households.

Figure 5.3 Household survey respondents distribution per municipality/city



Source: Derived from survey data.

5.2.2 Demographic Characteristics of Household Survey Respondents

Table 5.1 provides the demographic characteristics of all household survey respondents. According to the NSCB (2003), a household "refers to an aggregate of persons, generally but not necessarily bound by ties of kinship, who live together under the same roof or eat together or share in common the household food. A person who lives alone is also considered a separate household." The majority of respondents are female (91.0 per cent); however, only 12.3 per cent belong to female-headed households. In terms of measuring household decision-making, this data may be crucial given the steady increase[20] in the number of female-headed households in the Philippines during the past decades. On the other hand, in terms of microfinance program clients, 93.3 per cent are female. This is consistent with previous studies and reports showing that many microfinance institutions and most microfinance programs target female borrowers (ILO, 2008; Reed, 2011).

Further, there may be a number of good reasons for targeting female borrowers as prospective microfinance clients from both business and public policy standpoints.

[20] According to the Philippine Commission on Women (2014), the number of female-headed households in the Philippines has been steadily increasing from only 10.0 per cent in 1970 to 21.2 per cent in 2009.

The recent study by D'Espallier, Guerin, and Mersland (2011), utilising a global data set of 350 MFIs in 70 countries confirms the commonly held belief that women microfinance clients in general carry lower credit risks for lenders than men. This is consistent with previous studies arguing that women microfinance borrowers have higher repayment rates compared to men (Armendariz & Murdoch, 2005; Hossain, 1988; Hulme, 1991; Khandker et al., 1995; Sharma & Zeller, 1997).

Table 5.1 Demographic characteristics of household survey respondents

Variable	Old client [A]	New client [B]	Non-client [C]	Total	Differences [A-B]	[A-C]	[B-C]
Female, respondent	0.944	0.867	0.887	0.910			
Age, respondent	48	40	40	44			
Age, household head (hh)	49	42	43	46			
Female, hh	0.133	0.067	0.123	0.123			
No schooling, hh	0.000	0.000	0.009	0.005			
Primary (<5 yrs), hh	0.000	0.000	0.019	0.009			
Primary (at least 5 yrs), hh	0.422	0.267	0.377	0.389			
Secondary, hh	0.444	0.600	0.434	0.450			
Tertiary, hh	0.133	0.133	0.170	0.152			
Household size	4.83	5.80	4.90	4.93			
Distance, town centre	5.37	4.13	4.72	4.95			

Note: *, **, *** signifies significance at 10%, 5% and 1% level respectively.

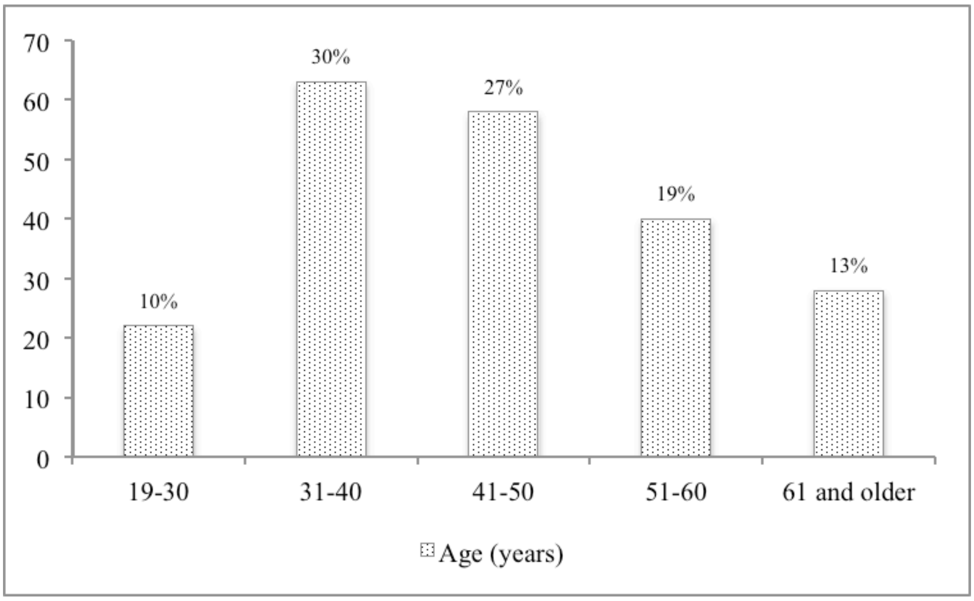
Source: Derived from survey data.

In terms of age, on average, the respondents are 44 years old while the household heads are slightly older at 46 years old on average. Client household respondents are likewise older than non-client household respondents on average, at 47 years old and 40 years old, respectively. Fifty-seven per cent of household heads were aged 31-50 years, 32 per cent were aged 51 years and older and ten per cent were below 30 years old. Figure 5.4 shows the age distribution of the household heads.

The education level of the household heads ranged from no education to tertiary level education. Less than one per cent either had no education or have not completed at least five years of schooling, 38.9 per cent had finished primary education or completed at least five years of schooling, 45.0 per cent have some secondary education and 15.2 per cent have some tertiary or vocational education. This is consistent with the national figures on literacy where the Philippines have achieved an almost universal basic literacy[21] rate of 95.6 per cent and a functional literacy[22] rate of 86.5 per cent (National Statistics Office, 2011).

Overall, the average household size of all survey respondents is 4.9 persons per household. This is consistent with the regional household size of 4.8 persons per household in the Caraga Administrative Region (Caraga) where the survey area is located and is slightly higher than the average national household size[23] of 4.6 individuals per household (National Statistics Office, 2012). In terms of the distance of the dwelling of the survey respondents to the nearest town/city centre, the survey respondents live approximately five kilometres from the nearest town on average.

Figure 5.4 Age distribution of household head



Source: Derived from survey data.

[21] Basic literacy or simple literacy "refers to the ability of a person to read and write with understanding a simple message in language or dialect" (National Statistics Office, 2011).

[22] A functionally literate individual "refers to a person who can read, write and compute or one who can read, write, compute and comprehend" (National Statistics Office, 2011).

[23] The average household size in the Philippines has been slowly shrinking, from 5.3 persons per household in 1990 to 5.0 persons per household in 2000 and to only 4.6 individuals per household in 2010 (National Statistics Office, 2012).

5.3 Socioeconomic Characteristics of Microfinance Client Households and Non-Client Households in Northeastern Mindanao

5.3.1 Living Standards

Table 5.2 depicts the housing condition of the survey respondents' households. Around three out of four households (71.6 per cent) have lived in their place of residence for more than 10 years, with an average of 31.3 years. Those who live in their current place of residence for less than five years account for 14.7 per cent of respondents with the rest (13.7 per cent) having stayed in their residence from five years to ten years. Further, the majority of respondents own their residential land and dwelling, accounting for 67.8 per cent and 83.4 per cent, respectively. In terms of house roofing and walling, most are made of light materials with 67.3 per cent of roofs made from thatch materials and 64.9 per cent of walls made of bamboo or wood. Finally, almost half (45.0 per cent) of all flooring materials[24] are made of bamboo or wood followed by concrete/cement at 37.4 per cent and natural floor[25] (dirt/sand) at 10.0 per cent.

Table 5.3 presents the basic housing amenities of survey respondents. It shows that 89.5 per cent of households have access to safe drinking water[26], either through improved drinking water sources[27] (43.1 per cent) or other improved drinking water sources[28] (46.4 per cent). Only 2.8 per cent of the surveyed households are still using

[24] Flooring is one of the standard of living indicator used by the United Nations in its Multidimensional Poverty Index in order to determine if a household is multidimensionally poor.

[25] A household if classified as deprived under the Multidimensional Poverty Index if their flooring has dirt, sand or dung floor.

[26] According to the UNICEF and World Health Organization (2012), access to safe drinking water is defined as the proportion of the population using 'improved drinking water sources', which "includes sources that, by nature of their construction or through active intervention, are protected from outside contamination, particularly faecal matter".

[27] Improved drinking water sources include "piped household water connection located inside the user's dwelling, plot or yard" (UNICEF and World Health Organization, 2012).

[28] Other improved drinking water sources include "public taps or standpipes, tube wells or boreholes, protected dug wells, protected springs and rainwater collection" (UNICEF and World Health Organization, 2012).

unimproved drinking water sources[29]. In terms of cooking fuel, almost all (99.1 per cent) of the respondents use either wood or charcoal to cook their food with less than one per cent (0.9 per cent) using liquefied petroleum gas (LPG). This means that almost all of the surveyed households are classified as multidimensionally poor in terms of the cooking fuel indicator under the Multidimensional Poverty Index

Table 5.2 Dwelling condition of survey respondents

Variable	Measure	Frequency		Percentage
		Client	Non-client	
Number of years living in residence	<5 years	7	24	14.7
	5 - 10 years	11	18	13.7
	>10 years	87	64	71.6
Residential land	Owned	74	69	67.8
	Rented	9	9	8.5
	Informal use	22	28	23.7
Dwelling status	Owned	96	80	83.4
	Rented	1	7	3.8
	Informal use	8	19	12.8
Roofing material	Iron sheet	29	30	28.0
	Cogon (thatch)	72	70	67.3
	Makeshift	0	2	1.0
Walling material	Concrete	25	32	27.0
	Bamboo/wood	70	67	64.9
Flooring material	Dirt/sand	10	11	10.0
	Bamboo/wood	45	50	45.0
	Ceramic tiles	0	2	1.0
	Concrete/cement	43	36	37.4

Source: Derived from survey data.

[29] According to the UNICEF and World Health Organization (2012), unimproved drinking water sources include the following: unprotected dug well, unprotected spring, cart with small tank/drum, tanker truck, and surface water (river, dam, lake, pond, stream, canal, irrigation channels), bottled water. Further, the Joint Monitoring Programme for Water Supply and Sanitation (JMP) by the WHO/UNICEF "considers bottled water a source of improved drinking water *only* when another improved source is also used for cooking and personal hygiene".

being used by the United Nations Development Programme in its Human Development Report. In terms of sanitation as measured by the type of toilet facility, nine out of ten households (90.5 per cent) have their own improved or sanitary toilet facilities, with 7.6 per cent sharing their toilet with other households and the remaining households (1.8 per cent) using open pit which are both considered unsanitary toilet facilities (NSO, 2010). Finally, 93.4 per cent of the surveyed households have electricity in their homes. This can be considered as a good electrification level given that based on the findings of the 2008 Annual Poverty Indicators Survey (APIS) conducted by the National Statistics Office (2010), 36 per cent of households in the bottom 30 per cent of the income stratum do not have access to electricity[30] compared to only eight per cent of households in the upper 70 per cent of the income stratum.

Table 5.3 Basic housing amenities of survey respondents

Variable	Measure	Frequency		Percentage
		Client	Non-client	
Drinking water	Improved	40	51	43.1
	Other improved	47	51	46.4
	Unimproved	2	3	2.4
Cooking fuel	LPG (gas)	1	1	0.9
	Charcoal/wood	104	105	99.1
Toilet facility	Water-sealed, owned	97	94	90.5
	Water-sealed, shared	7	9	7.6
	Open pit	1	3	1.8
Electricity	With electricity	98	99	93.4
	No electricity	7	7	6.6

Source: Derived from survey data.

[30] The Philippine Department of Energy is targeting full electrification of all *barangays* (villages) by 2015 and 90 per cent of all households by 2017 (Cacho, 2012).

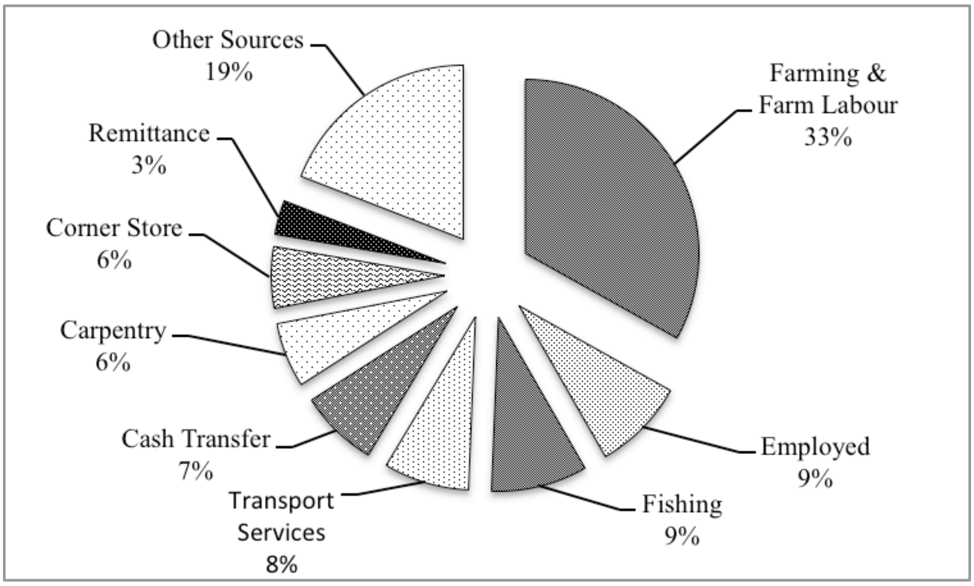
5.3.2 Income and Expenditure

Figure 5.5 shows the regular sources of income of all surveyed households. One-third (33 per cent) of households derive their income from farming and farm labour. This is followed by fishing and paid employment (both professional and non-professional), with both registering nine per cent. Transport services come in at fourth with eight per cent. A further seven per cent of households rely on conditional cash transfers[31] (CCT) from the Department of Social Welfare and Development (DSWD). Rounding out the regular sources of income are carpentry and *sari-sari stores* (corner stores) with six per cent apiece; remittances with three per cent; with the rest (19 per cent) coming from other sources.

Based on the 2009 official poverty statistics for the basic sectors from the NSCB (2012), the fishing and farming sectors posted the highest poverty incidence among the nine basic sectors in the Philippines at 41.4 per cent and 36.7 per cent, respectively. Interestingly, the NSCB likewise noted that the employed population registered a high poverty incidence of 22.4 per cent in 2009, which is the same as that of the unemployed population (NSCB, 2012).

[31] Otherwise known as the *'Pantawid Pamilyang Pilipino Program'* or 4Ps. This is the Philippine government's human development program that is patterned after similar conditional cash transfer schemes implemented in other developing countries. The 4Ps provides cash grants to program beneficiaries in exchange for families keeping their children in school and ensuring regular visits to health centres. Its dual objectives are to provide social assistance for short-term poverty alleviation and social development through investment in human capital in order to break the intergenerational poverty cycle.

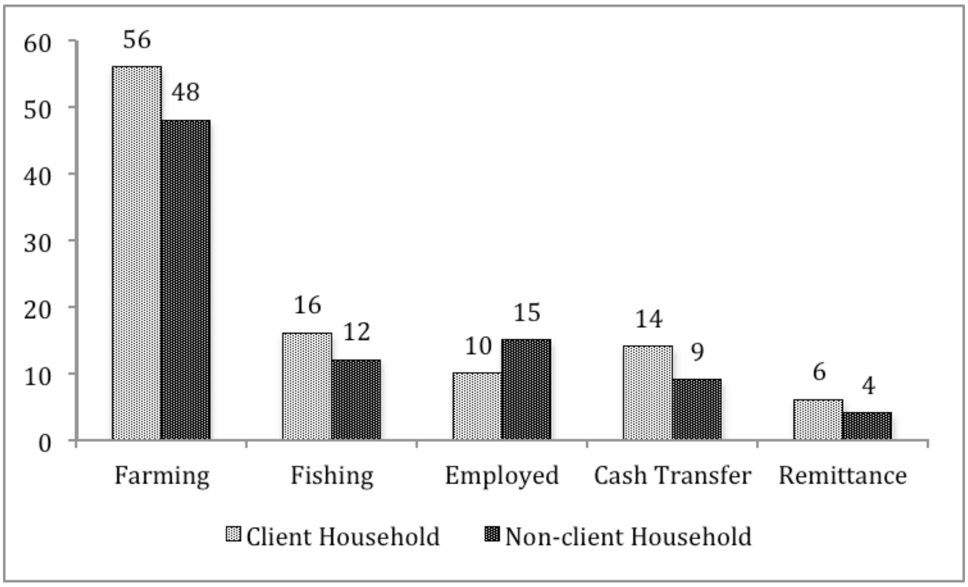
Figure 5.5 Regular Sources of Income of Households



Source: Derived from survey data.

Figure 5.6 presents the distribution of selected regular sources of income of client and non-client households. The distribution shows that except for paid employment, client households have slightly higher number of farmers, fisherfolk, conditional cash transfer beneficiaries and remittance recipients. Interestingly, it is surprising to find that a good percentage (13.3 per cent) of microfinance recipients are likewise benefitting from conditional cash transfers from the national government. If CBI purposely did this, this could provide a direct link towards helping the CCT beneficiaries become self-reliant given that the CCT program will only run for a maximum of five years or only until 2014. It is a condition of the program that the grants provided to beneficiaries are used only for the educational needs of the children and for the health and nutrition of households (Department of Social Welfare and Development, 2013). In relation to this and possibly in cognizance of the end of the CCT program in 2014, the DSWD launched a 'Modified CCT Program' by piloting an innovative, microcredit and food production program with the aim of wiping out malnutrition and food shortage in rural areas as well as helping CCT beneficiaries be self-reliant by 2014.

Figure 5.6 Distribution of Regular Sources of Income of Client and Non-client Households (selected sources)

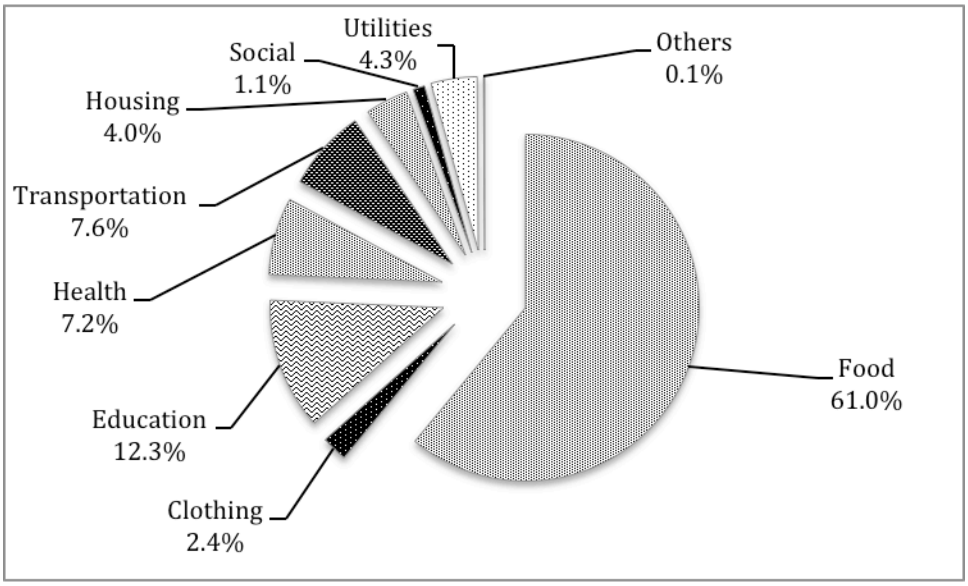


Source: Derived from survey data.

Figure 5.7 shows the household expenses or disbursements by different types of expenditure items of all surveyed households. On the average, 61.0 per cent of all household expenses are devoted to food expenditures. This closely resembles the spending behaviour of poor households based on previous studies. For example, according to the study by the Food and Agriculture Organization (2011), poor people in developing countries spend more than half of their income on food. Further, the results of the 2009 Family Income and Expenditure Survey (FIES) conducted by the National Statistics Office found that poor families allot 59.9 per cent of their incomes to food expenditures compared to 40.5 per cent for non-poor families (NSCB, 2012). This is likewise consistent with the Engel's Law, which states that poorer families allot a greater part of total expenditures on food.

In terms of non-food expenditures, human capital investments in education (12.3 per cent) and health (7.2 per cent) come in at second and fourth on the list of major household expenditures. Transportation expenses represent 7.6 per cent of all household expenses with utilities (light and water) accounting for 4.3 per cent and housing expenses at four per cent. Clothing (2.4 per cent) and social expenses (1.1 per cent) have the least allocation among the surveyed households.

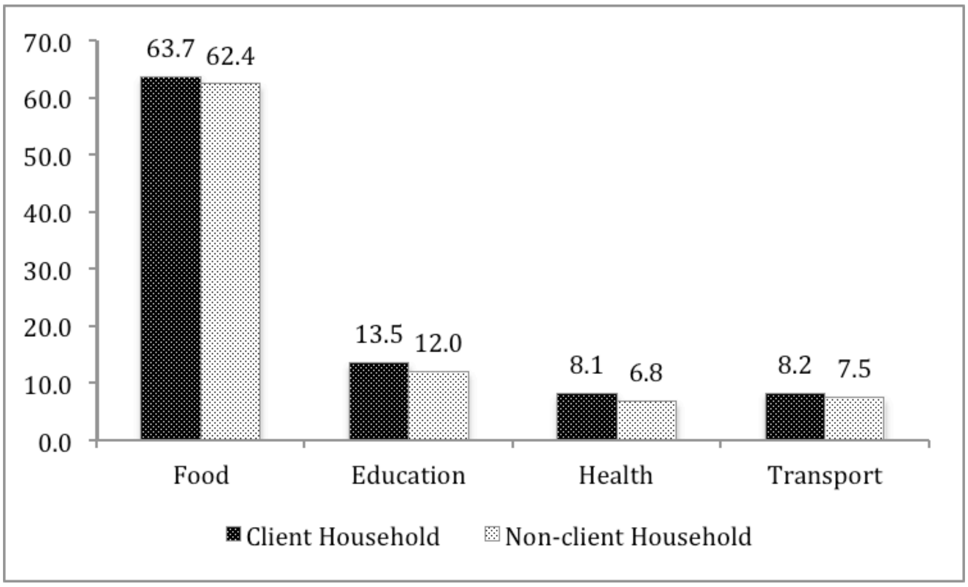
Figure 5.7 Household Disbursements by Expenditure Type



Source: Derived from survey data.

Figure 5.8 presents the distribution of selected household disbursements by different types of expenditure items of client and non-client households. The distribution shows that client households have marginally higher expenses across the major expenditure items (e.g., food, education, health and transportation) compared to non-client households.

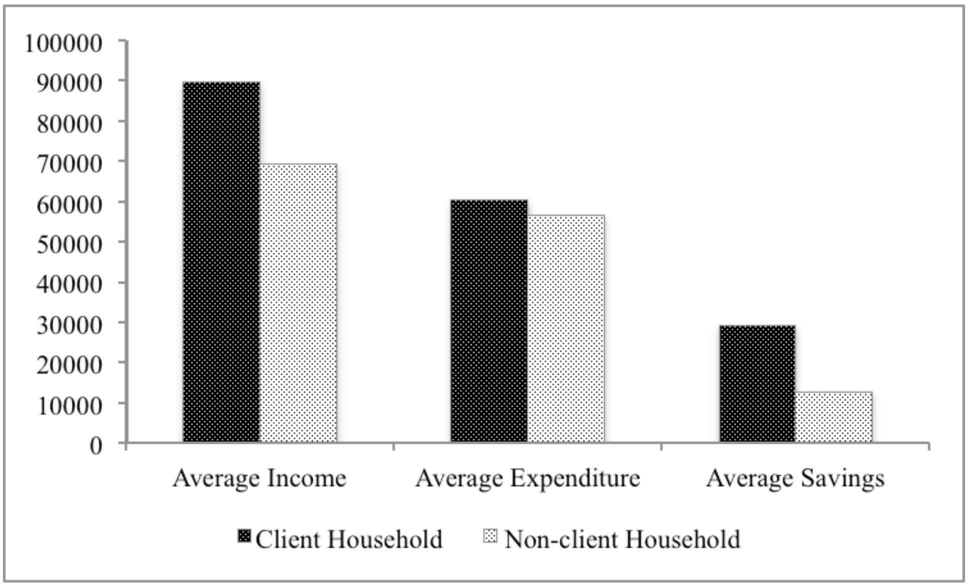
Figure 5.8 Household Disbursements by Expenditure Type of Client and Non-client Households (selected expenditure types)



Source: Derived from survey data.

Figure 5.9 and Table 5.4 shows the basic welfare indicators of survey respondents and compares the average per capita income, average per capita expenditure and average per capita savings of client and non-client households. The survey results show that client households have significantly higher average per capita income and average per capita savings compared to client households. There was, however, only a marginal difference between average per capita expenditure between the two household groups. In terms of absolute value expressed in thousand of pesos, the surveyed households have significantly lower average per capita income and expenditure compared to the 2009 national average of PhP206,000.00 and PhP176,000.00, respectively (National Statistics Office, 2011). Finally, in terms of per capita food expenditure, there is only a marginal difference between client households and non-client households.

Figure 5.9 Average Per Capita Income, Expenditure and Savings of Client and Non-client Households



Source: Derived from survey data.

Table 5.4 Basic welfare indicators of survey respondents

Variable (in pesos)	Old client [A]	New client [B]	Non-client [C]	Total	Differences [A-B]	[A-C]	[B-C]
Per capita income	87,554	102,720	69,220	79,422		*	
Per capita expenditure	57,625	77,242	56,591	58,500			
Per capita savings	29,929	25,478	12,629	20,922			
Per capita food expenditure	35,787	39,200	35,168	35,718			

Note: *, **, *** signifies significance at 10%, 5% and 1% level respectively.

Source: Derived from survey data.

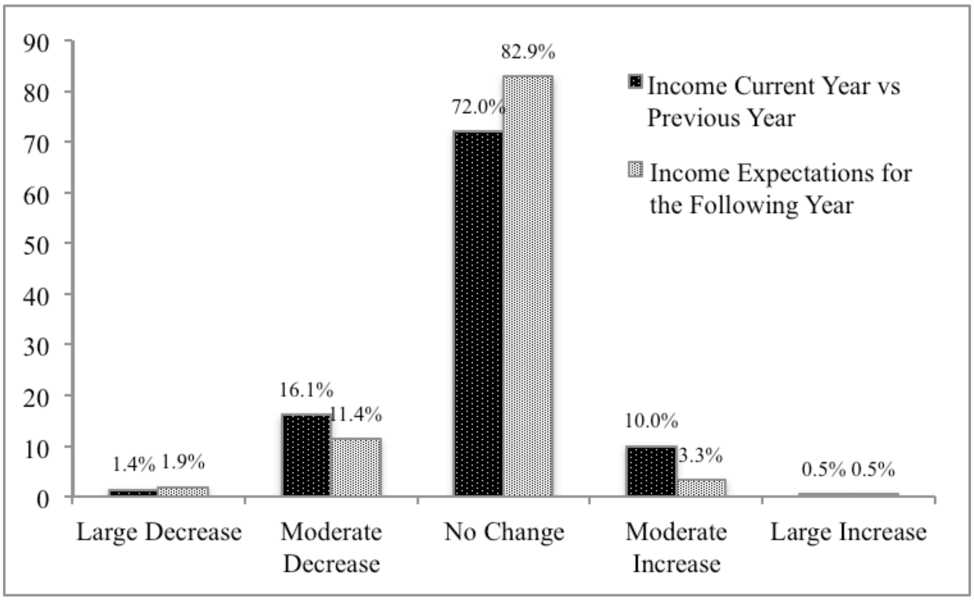
Figure 5.10 shows the perception of all surveyed households in terms of their household income. In particular, the survey respondents were asked the following questions:

1) *"How would you compare your household's income this year compared to last year?"* and,
2) *"How would you expect your total income to be next year?"*

The survey results show that an overwhelming majority (72 per cent) felt that there was no change in their household income for the current year compared to the previous year. The survey findings likewise indicate that eight out of ten households do not expect their income to change the following year.

Further, a certain level of pessimism could be inferred given that more households felt a moderate decrease (16.1 per cent) in their current income vis-à-vis the previous year compared to those who felt a moderate increase (10.0 per cent). The difference is greater in terms of household income expectations as more households expect their income to moderately decrease (11.4 per cent) compared to those who expect their income to moderately increase (3.3 per cent).

Figure 5.10 Income comparison and income expectations of surveyed households



Source: Derived from survey data.

5.4 Poverty Status of Surveyed Households Using Different Poverty Measures

This section provides the poverty status of surveyed households using three different poverty measures. The first poverty measure is the self-rating approach where the measure of poverty is subjective and entirely dependent on the perception of the survey respondents. The second poverty measure is the poverty line approach where poverty is measured using some predetermined official national and regional food and non-food thresholds expressed in absolute terms. Finally, the third poverty measure is the Multidimensional Poverty Index (MPI) where poverty is measured by capturing the deprivations that each person faces across three dimensions of poverty – education, health and living standards – at the same time. For the study, a slight variation of the MPI will be utilised given some data constraints.

5.4.1 Self-rated Poverty Approach

Table 5.5 provides the level of poverty of all household survey respondents using the self-rated poverty approach. The self-rated poverty approach measure subjectively assessed poverty rather than measure a set of standard poverty measures and is premised on the understanding that poverty is both an objective and subjective phenomenon. The survey results show that an overwhelming majority of survey respondents felt that they are *poor* when asked to rate their households on a range of socioeconomic indicators.

The survey respondents felt *most poor* in terms of their overall standard of living and their food expenditure, with 95.7 per cent of households identifying themselves as *poor*. This is followed by household income with 94.3 per cent of households feeling *poor* and in terms of health expenditure with 93.8 per cent. The survey respondents felt *least poor* in terms of their level of education; however, this is still at a very high percentage of 87.7 per cent of households.

An analysis of the self-rated poverty approach by Datt (2002) suggests that poverty level estimations by survey respondents tend to be higher relative to the national poverty lines. Further, Datt (2002) suggests that poverty level estimation of respondents tend to differ between poor and non-poor households with poor households surprisingly situating their poverty lines just slightly lower than that of non-poor households. In a study about the subjective poverty and affluence in the Philippines, Mangahas (2001) finds a strong inverse relationship between self-rated poverty and educational attainment but finds no significant relationship to sex and age of household head. Given the above, it is therefore not surprising to find that self-rated poverty figures are consistently and significantly higher than that of official poverty figures.

Further, if we are to compare the self-rated poverty figures[32] gathered in 2006 and 2009 by the Social Weather Stations (SWS) with the 2006 and 2009 Philippine poverty statistics from the NSCB, we will find that the official poverty incidence of 26.4 per cent (2006) and 26.5 (2009) per cent of the population is only around half of the SWS self-rated poverty figures which ranged from a low of 47 per cent to a high of 59 per cent (see Figure 5.11). It is important to note however that the self-rating approach may not be used to establish the existence of poverty at an individual household level, as it was not designed for such purpose (Mangahas, 2004).

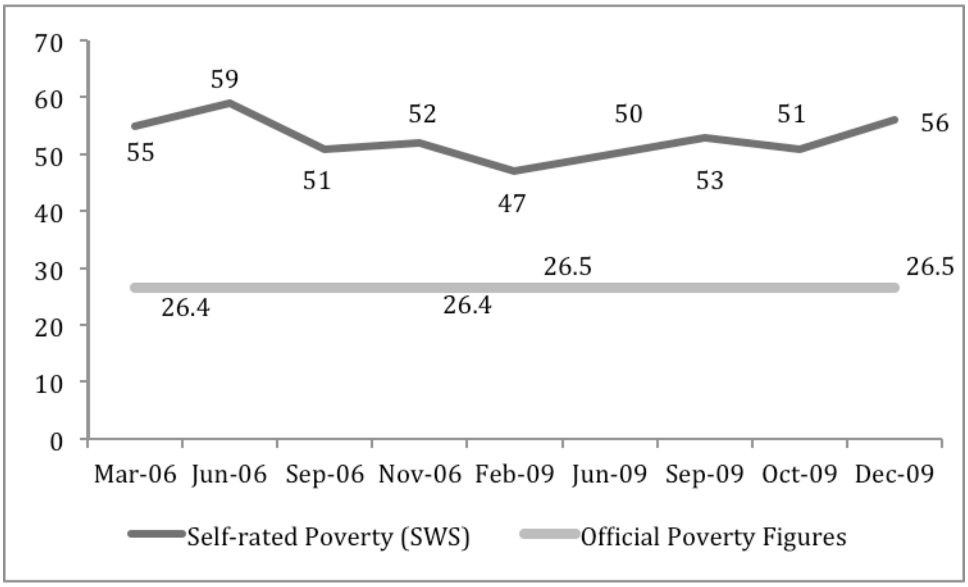
[32] The Social Weather Station's survey poverty indicator is the proportion of household heads who rate their own households as *mahirap*, the Filipino word for poor. Survey respondents are likewise asked to indicate their household's self-declared poverty threshold.

Table 5.5 Self-rated poverty of surveyed households

Do you consider your household poor in terms of the following?	Old client	New client	Total client	Non-client	Total household
Level of education	0.911	0.733	0.886	0.868	0.877
Standard of living	0.989	0.933	0.981	0.933	0.957
Income	0.967	0.867	0.952	0.934	0.943
Food expenditure	0.978	0.933	0.971	0.943	0.957
Health expenditure	0.967	0.733	0.933	0.943	0.938

Source: Derived from survey data.

Figure 5.11 Comparison between 2006 and 2009 self-rated poverty data with official poverty figures



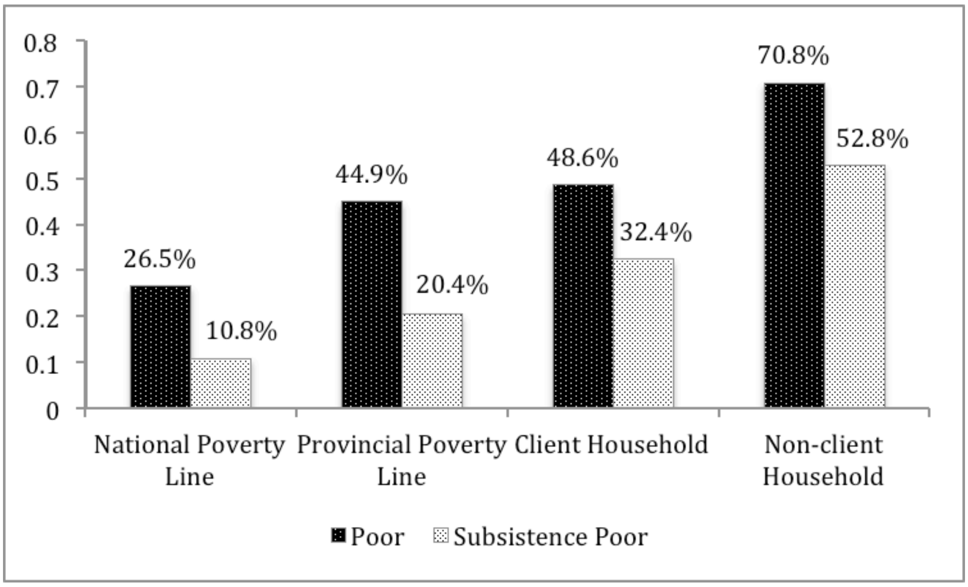
Sources: 2009 Philippine Poverty Statistics (NSCB, 2011); Third Quarter 2011 Social Weather Stations Survey (SWS, 2011).

5.4.2 Poverty Line Approach

In 2009, a Filipino family of five needed PhP4,869.00 monthly income to meet the food threshold and PhP7,017.00 to meet the income threshold and stay out of poverty (NSCB, 2011). On the other hand, based on the provincial poverty figures, a family of five living in Surigao del Sur, Caraga Region needed PhP4,563.00 to meet the food threshold and PhP6,530.00 to meet the income threshold, both slightly lower than the national average (NSCB, 2011).

Applying the poverty line approach in measuring the poverty status of the survey respondents and their respective families reveal that almost half of the client households (48.6 per cent) are poor with non-client households registering a poverty incidence of 70.8 per cent (see Figure 5.12). Further, in terms of food thresholds, around three out of ten (32.4 per cent) client households are subsistence poor (i.e., do not meet the per capita food threshold) while slightly more than half (52.8 per cent) of non-client households do not meet their food needs.

Figure 5.12 Poverty incidence and subsistence poor incidence of client households and non-client households



Source: Derived from survey data.

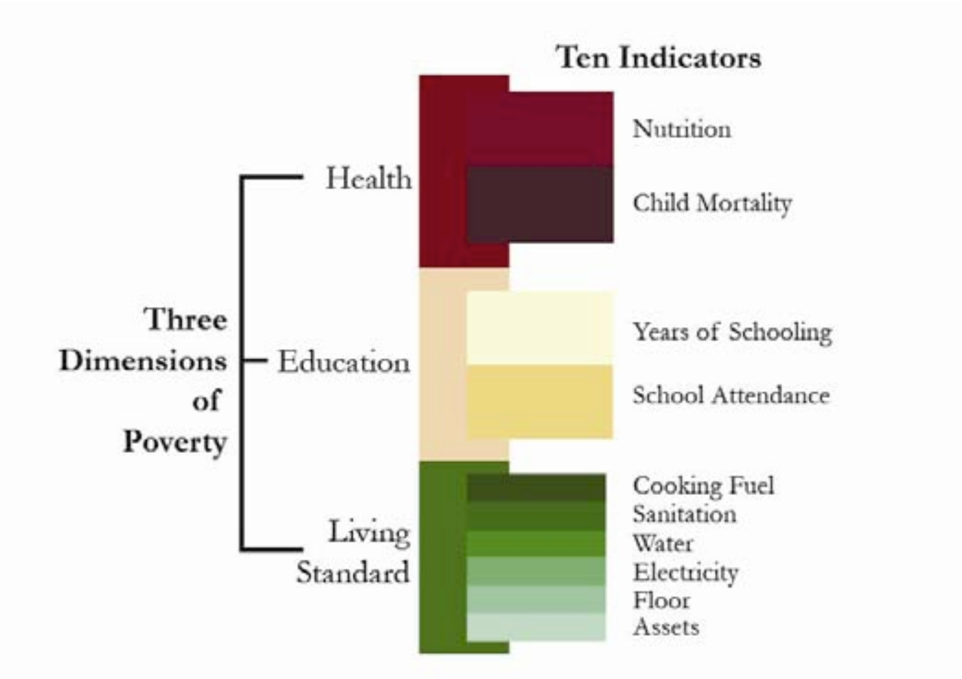
Comparing the poverty status of client households with the official provincial poverty line reveals that the poverty incidence of client households (48.6 per cent) is slightly higher than that of the official provincial poverty incidence rate of 44.9 per cent. On the other hand, the poverty incidence for non-client households is significantly higher than the provincial average. Given the above data, it is important to note that a major limitation in the conduct of household surveys is that it does not normally generate reliable and accurate income and expenditure figures, as these are mostly dependent upon the estimates provided by the survey respondents.

5.4.3 Multidimensional Poverty Approach

The multidimensional poverty approach recognises the multidimensional nature of poverty and attempts to capture deprivations that each individual faces across different dimensions of poverty. This is in line with the human development approach, which argues that income measures should be complemented by more direct poverty measures (Anand and Sen, 1997). For this study, an attempt is made to apply the Multidimensional Poverty Index (MPI) – which replaced the Human Development Index (HDI) previously reported in the Human Development Reports by the United Nations. This study uses the data gathered from the household survey to compute an MPI for clients and non-clients in the Philippines.

The MPI is designed to capture the severe deprivations that each individual faces and reflects both the incidence and intensity of multidimensional deprivation (Alkire and Santos, 2010). It identifies overlapping deprivations at the household level across three dimensions of poverty – education, health and living standards – and shows the average number of poor people and their level of deprivations. Figure 5.13 and Table 5.5 from Alkire and Santos (2010), shows and describes the indicators used in the MPI corresponding to the three dimensions of poverty. In calculating the final MPI, each dimension is given equal weighting and the indicators within the different dimensions are given equal weighting as well.

Figure 5.13 Multidimensional Poverty Index



Source: Alkire and Santos (2010)

In order to calculate the MPI for the respondent households, a slight variation of the MPI will be utilised for the study. Given data constraints on the nutritional information of households, a proxy variable is used to measure nutrition instead. Following Melville et al. (1988), where they find a strong correlation between per capita food expenditure and nutritional status in childhood malnutrition in Jamaica, per capita food expenditure will be used as a predictor for nutrition. Tables 5.6 and 5.7 provide the multidimensional poverty index of all surveyed households.

Table 5.6 The dimensions, indicators, deprivation cut-offs and weights of the Multidimensional Poverty Index

Dimensions of poverty	Indicator	Deprived if…
Education	Years of Schooling	No household member has completed five years of schooling
	Child School Attendance	Any school-aged child is not attending school up to class 8
Health	Child Mortality	Any child has died in the family
	Nutrition	Any adult or child for whom there is nutritional information is malnourished
Living Standard	Electricity	The household has no electricity
	Improved Sanitation	The household's sanitation facility is not improved (according to MDG guidelines), or it is not improved but shared with other households
	Improved Drinking Water	The household does not have access to improved drinking water (according to MDG guidelines) or safe drinking water is more than a 30-minute walk from home, round-trip.
	Flooring	The household has a dirt, sand or dung floor.
	Cooking Fuel	The household cooks with dung, wood or charcoal.
	Assets Ownership	The household does not own more than one radio, TV, telephone, bike, motorbike or refrigerator and does not own a car or truck.

Source: Adapted from Alkire et al., 2013

Table 5.7 Measures of deprivations experienced by surveyed households using the Multidimensional Poverty Index

Indicator	Old client	New client	Total client	Non-client	Total household
Education					
Years of schooling	0.000	0.000	0.000	0.019	0.009
School attendance	0.000	0.000	0.000	0.009	0.005
Health					
Child mortality	0.033	0.000	0.029	0.009	0.019
Nutrition	0.778	0.800	0.781	0.783	0.782
Living Standard					
Cooking fuel	0.989	1.000	0.990	0.991	0.991
Sanitation	0.089	0.000	0.076	0.113	0.095
Water	0.022	0.000	0.019	0.028	0.024
Electricity	0.067	0.067	0.067	0.066	0.066
Floor	0.111	0.000	0.095	0.104	0.100
Asset ownership	0.989	1.000	0.990	0.991	0.991

Source: Derived from survey data.

Applying the MPI to calculate poverty incidence of the surveyed households reveal that almost all households are not deprived in terms of the two education indicators, years of schooling with only 0.9 per cent of households considered deprived and school attendance with only 0.5 per cent of households considered deprived. In terms of child mortality and improved drinking water, only 1.9 per cent and 2.4 per cent of households are considered deprived, respectively. On the other hand, an almost unanimous percentage (99.1 per cent) of households are deprived in terms of cooking fuel as the surveyed households cook with either wood or charcoal. Further, a similar percentage (99.1 per cent) of households are considered deprived in terms of asset ownership. The only other indicator where a significant number of households are considered deprived is nutrition, with 78.2 per cent. Given the different deprivations experienced by the surveyed households, we can now determine the percentage of MPI poor. Table 5.7 provides the multidimensional poverty index of the surveyed households.

Table 5.8 Multidimensional Poverty Index of surveyed households

	Old client	New client	Total client	Non-client	Total household
Percentage of poor people (H)	22.2%	6.67%	20.0%	22.6%	21.3%
Average intensity across the poor (A)	26.1%	24.8%	25.9%	26.4%	26.2%
Multidimensional Poverty Index (MPI = HxA)	0.058	0.017	0.052	0.060	0.056
Percentage of households vulnerable to poverty	56.7%	73.3%	59.0%	55.7%	57.3%
Percentage of households in severe poverty	0.0%	0.0%	0.0%	1.9%	1.0%

Source: Derived from survey data.

As shown from the data above, around one in five (21.3 per cent) surveyed households are classified as 'MPI Poor' as they are deprived in at least one-third of the weighted indicators. Further, the poverty rates for both client (20 per cent) and non-client (22.6 per cent) households using the MPI approximates the multidimensional poverty index figure for the Caraga region (17.5 per cent) as calculated by the Oxford Poverty and Human Development Initiative (OPHI) using the 2008 Philippines Demographic and Health Survey

On the other hand, more than half of surveyed households (57.3 per cent) are 'Vulnerable to Poverty' as they are deprived in 20 per cent to 33 per cent of the weighted poverty indicators. Considering that poverty is not a static condition – as people living close to the poverty line constantly slip in or out of poverty – the 'vulnerable to be poor' is a relevant segment for MFIs targeting the poor to reach and serve. This is because the 'vulnerable to be poor', while not officially classified as *poor* using the MPI poverty measure, is probably only a natural calamity or health shock away from slipping back into poverty (Chua et al., 2012). Counting the *poor* and 'vulnerable to be poor' therefore results in almost eight out of ten (78.6 per cent) households being classified as either MPI Poor' or 'Vulnerable to Poverty', representing a high depth of outreach for CBI.

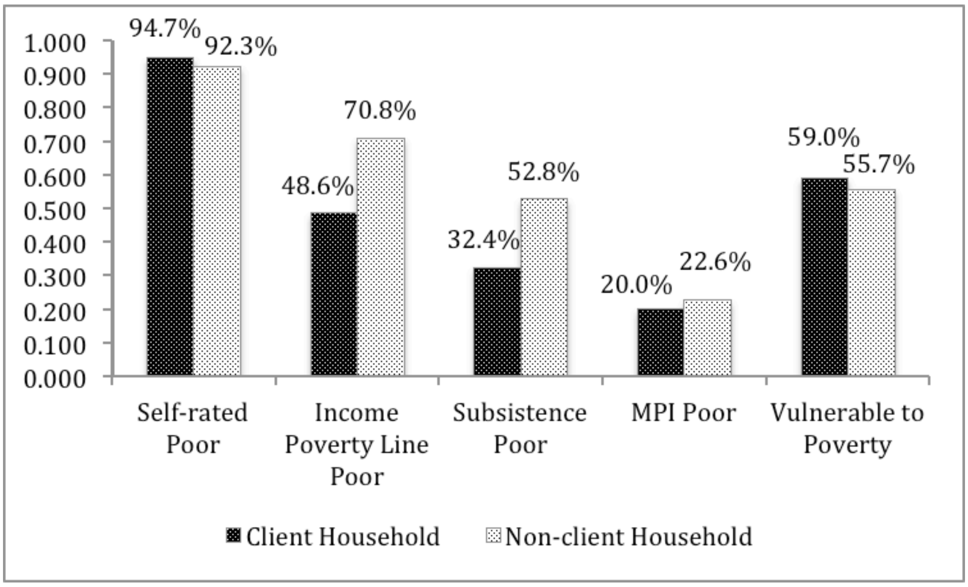
5.4.4 Poverty Rates of Surveyed Households Based on the Different Poverty Measures

Figure 5.14 provides a comparison of the poverty rates of the client households and non-client households using three different poverty measures. As expected, the self-rated poverty approach resulted in the highest number of households ‘feeling poor’ (Datt, 2002). The poverty rates are however on the high side – 94.7 per cent of client households and 92.3 per cent of non-client households – relative to similar self-rated poverty surveys regularly conducted in the Philippines (see for example Social Weather Stations, 2011). This suggest that there may be a need to refine the survey methodology in future studies particularly in the phrasing of self-rating questions as suggested by Mangahas (2001). This is expected to result in a more accurate reflection of the true self-rated poverty figure.

In terms of the poverty line approach, the poverty rate of the client households – while slightly higher – closely resembles the official provincial poverty line for both the poor (48.6 per cent vis-à-vis 44.9 per cent) and subsistence poor (32.4 per cent vis-à-vis 20.4 per cent). The poverty rate for non-client households however is significantly higher than the official provincial poverty line.

In terms of the MPI approach, the results suggest that there is no significant difference between client households and non-client households in terms of being ‘MPI poor’. Further, the poverty rates for both client (20 per cent) and non-client (22.6 per cent) households closely approximates the MPI score for the Caraga region (17.5 per cent). Finally, eight out of ten households are either ‘poor’ or ‘vulnerable to be poor’.

Figure 5.14 Poverty rates of surveyed households according to different poverty measures



5.5 Chapter Summary

This chapter about the socioeconomic and demographic characteristics of randomly selected households in the survey area can be summarised into three major discussions, namely: 1) demographic characteristics of randomly selected households; 2) socioeconomic characteristics of randomly selected households; and 3) determining the poverty status of randomly selected households using different poverty measures.

The results of household survey indicate that the profile of the 'average' CBI microfinance borrower is a 47 years old married woman, living in a male-headed household with her husband and three children. She has also acquired secondary education and is able to read and write. Her decision to take a loan in order to meet her household's food and daily needs is supported by her husband. Her husband works in a farm from which they source their income. She has been living for 31 years in a family-owned residential house and land situated five kilometres from the town centre. Her dwelling is made up of light materials, with roofs made from thatch and walls and flooring made from bamboo or wood. Further, her dwelling has electricity and she has access to safe drinking water and improved toilet facilities; however, she still cooks using charcoal or wood.

Survey results indicate that CBI has been effective in terms of targeting and reaching their clients, the 'entrepreneurial poor' (rather than the 'poorest of the poor') or those with incomes near the poverty line. The enterprising poor likewise do not have permanent sources of income on a monthly basis but are able to earn from various livelihood activities. Combining households who are vulnerable to slip back into poverty and those who are just above the poverty line with households who are poor per official definitions suggest that the majority of CBI clients belong to the relevant segment of the CBI's target clientele. This indicates that CBI has been effective in terms of depth of outreach with regards to targeting the enterprising poor and not the poorest of the poor.

Many studies suggest a regressive impact of microfinance on per capita income of the poorest households but a positive impact on per capita income of the less poor households (see for example, Asian Development Bank, 2007). In addition, some argue that lending to the poorest households entails high transaction costs and risks (see for example, Churchill et al., 2002; Ivatury, 2005; Pischke, 1991). On the other hand, Maes and Foose (2006) claim that despite the inherent challenges of lending to the poorest of the poor some MFIs are specifically targeting the poorest of the poor with ingeniously designed microfinance programs. Given the foregoing, it is surprising to find out that almost half of CBI clients are income poor (according to the regional poverty line) and one in five clients are 'MPI poor' even though its microfinance program is targeting the enterprising poor. One can conclude that this drive towards attaining greater outreach may be attributed to a strong organisational commitment towards the provision of alternative financial and countryside development services accompanied by an across the board institutional buy-in of the organisation's social mission and objectives.

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CHAPTER SIX

UNDERSTANDING STAKEHOLDERS' PERCEPTION OF IMPACT AND EFFECTIVENESS OF MICROFINANCE PROGRAMS IN THE PHILIPPINES

6.1 Introduction

This chapter reports and discusses stakeholders' perception of impact and effectiveness of microfinance in the Philippines. The results of Chapter 5 revealed that almost half of CBI microfinance clients are poor. This may be attributed to CBI's strong organisational commitment to deliver microfinance in their operational areas.
It is therefore important to understand the perception of microfinance clients as to the impact and effectiveness of microfinance programs in the continued development and delivery of more appropriate microfinance products and services. Further, an understanding of the insights from key informants of the Philippine microfinance industry is important in the formulation and implementation of policies and regulations that will further promote the growth of microfinance in the Philippines.

The rest of the chapter is organised as follows. Section 6.2 reports and discusses the result of the FGDs conducted with selected microfinance clients in Northeastern Mindanao. On the other hand, Section 6.3 reports and discusses the result of the in-depth interviews conducted with key informants of the Philippine microfinance industry consisting of key government officials, policymakers and microfinance practitioners. Section 6.4 summarises the findings of the chapter.

6.2 Client Perception of Microfinance Impact

6.2.1 Microfinance Understanding and Awareness

The discussions regarding microfinance understanding and awareness reveal that focus group participants demonstrate a clear understanding of the concept of microfinance. Participants point out that microfinance provides the poor with access to financial services. The participants likewise indicate their general awareness of the different microfinance products and services being offered by formal financial institutions in their respective villages as well as in nearby towns. The participants add that they primarily access microfinance to avail of small loans but they also value the savings and insurance services that are packaged with the loans. The results of the FGDs suggest that clients differ in terms of leveraging their access to microfinance.

Many participants say that they use their loans to make investments in income-generating activities. They establish new micro enterprises or expand their existing businesses (for example, see Box 6.1), buy farm inputs, pay for farm labour or purchase fishing nets and motors. On the other hand, some participants state that they use their loans to smooth or shift their consumption patterns or invest in their children's education and health. They use a good portion of the loan proceeds to provide for their families' basic and social needs such as food, education, health, and house repairs/construction, among others. Microfinance has therefore spurred and increased economic activity in the different study villages. Microfinance has likewise become a source of financing in order for some of the poor meet their basic needs.

Box 6.1 Expanding Her Microenterprise with a Refrigerator

A female client from Magsaysay town has been operating a small *sari-sari* store (corner store) for a few years already. It has been a regular source of income for her family, effectively augmenting her husband's meagre income as a farm labourer. There are times, however, when she feels that she needs to earn some more. When the bank approved her application for a relatively bigger loan, she used the loan to expand her existing micro enterprise.

"When I was able to avail of a PhP10,000.00 (A$250.00) loan, I was able to buy a refrigerator on an instalment basis. I used the refrigerator to sell ice and ice candies. I earned huge profits from selling these products because there are only three stores here in Magsaysay that sell ice and ice candies. I can say that our lives are a little better now because of the added profit from my purchase of the refrigerator."

Prior to gaining access to microfinance, a significant majority of focus group participants have no previous experience in dealing with formal financial institutions. Many participants first learned about microfinance from CBI when it initially conducted orientations and marketing activities across Surigao del Sur from 1999-2001. These activities led to the formation of different microfinance groups and centres across various villages in Surigao del Sur. Some founding members of these centres are still active clients of CBI and have also participated in the FGDs.

After participation in the microfinance program of CBI, many focus group participants observed significant improvements in their financial capabilities such as in terms of managing their small enterprises or handling household finances. They also now have a more favourable view and relationship with formal financial institutions, CBI in particular, because of microfinance (for example, see Box 6.2). What first started as a process of financial self-exclusion due to some pre-conceived notions as to how the formal financial system works, a clear understanding of microfinance and an awareness of how it operates have brought many poor people to the fold of the formal financial system.

Box 6.2 A Married Couple No Longer Afraid of Banks

"I was afraid to go to banks because I thought banks were just for the rich and well-educated. My husband felt the same way," relates a female client who currently lives in Madrid, Surigao del Sur. *"So when CBI conducted an orientation for possible new clients, I was hesitant to go at first. But then, I realised that I have nothing to lose by going to the orientation. So it all started when I decided to attend the orientation in 2001. That was the beginning."*

"Today, I am no longer afraid of banks. I am also more confident now and I am also very proud of myself because I can honestly say that I have a very good credit history. Microfinance really changed our lives and our perception of the banking system. We are very thankful to CBI because we were able to use our loans to put up our little projects."

6.2.2 Microfinance Access

The focus groups unanimously declared that the selection criteria and selection process in accessing microfinance from CBI is systematic, fair and reasonable in general. They state that the process of accessing microfinance is both transparent and easy to follow. They also say that some of the documents required in applying for a loan such as the *barangay* (village) clearance and *cedula* (community tax certificate) are readily available from the village office. In general, prospective clients did not face major challenges in accessing microfinance from CBI with only a few clients having had experienced difficulties in accessing microfinance. One such client shared that he believed CBI denied his initial application for a loan because he lacked the residency requirement, although this is not an explicit part of the requirements in accessing microfinance (for example, see Box 6.3).

Box 6.3 The Importance of Establishing Residency

Like many of his neighbours before him, a male client from Magsaysay town was looking forward to getting his application for a loan from CBI approved and subsequently released after a few days. He was therefore surprised to learn that his application was denied. He however eventually came to a conclusion that this could be because he just recently re-established residence in his home village after living in the city for many years.

The said male client shares, *"I have been working in Manila for many years as a security guard. After working and living away from my family for a long time, I have decided to go back to my home village to be with my family and start all over again. That is why I immediately applied for a loan upon my return to Magsaysay. I was disappointed when my initial application was denied. Personally, I came to a conclusion that I need to clearly establish my residence here for CBI to grant me a loan. After a year, I applied again for a loan and fortunately it was approved. That was more than five years ago and I have been a loyal CBI client since."*

For the initial loan, focus group participants say that they were required to attend an orientation about microfinance before the loan was released. The process starting from the submission of all the requirements until loan release normally takes from one to two weeks on average. According to the participants, CBI normally conducts field verification if the loan was used for the intended purpose after the initial loan has been released. For the subsequent loans, the participants observe that CBI no longer conducts field verification. They only need to submit a duly accomplished loan renewal form and with a good repayment record, repeat loans are normally released after three days on average. That is why the focus groups cite the importance of maintaining a good repayment record as this ensures their continued access to microfinance in the future.

Recently, the high repayment rates reported by many MFIs have come under close scrutiny. This includes the practice by some micro lenders of understating subsidies that they receive and overstating profits that they earn in their reports (Cull, et al. 2008). Further, upon closer inspection, some of the reported figures were found to be misleading, with the high figures actually either misreported or overstated (Engler, 2009). As Rosenberg (1999) points out, “there is no internationally consistent terminology for portfolio quality measures.” For example, what an MFI reports or calculates as its ‘repayment rate’ may also be called as ‘collection rate’ or as ‘recovery rate’ by other MFIs in their reports. What these suggest therefore is that in the absence of a clearly defined measure, we cannot interpret with certainty what a measure or reported figure is telling us. Consequently, these MFIs figures and reports regarding extraordinarily high repayment rates should be viewed with caution as it may not be prudent to take these at face value.

The focus groups however offer an interesting insight as to why some poor borrowers may have higher repayment rates compared to conventional borrowers. Faced with the reality that the MFIs are their only reliable source of micro credit, poor borrowers resort to any means possible just to maintain a good credit record. The results of the focus groups suggest that this may be the case for CBI clients. The high repayment rates of some MFIs or the good credit records of some poor borrowers therefore cannot be taken as an indicator that microfinance clients are successfully engaging in profitable and sustainable micro enterprises (for example, see Box 6.4). While some may actually be succeeding – as depicted in various microfinance success stories – some may just be surviving. This may however be not a necessarily negative outcome for some MFIs that would like to improve access to microfinance, including both depth and breadth of outreach. As pointed out earlier by Pitt & Khandker (1998), one of the key outcomes of microfinance is consumption smoothing. In relation to this, we can see from the experience of a micro credit borrower in Box 6.4 that loans used solely to smooth consumption can still lead to high repayment rates and positive social impact and returns.

Box 6.4 Microfinance as a Means to Make Both Ends Meet

"Microfinance really helped us especially during the time of loan release," relates a female client from Consuelo town. *"We used the loan proceeds to pay for our children's educational expenses, buy some groceries, rice, etc. But when the weekly repayment day comes, that is when we find it difficult to source enough money to pay back our loans. There are times when I could not afford to pay the weekly dues. I just talk to the loan collector and they understand our situation. The bank normally gives us another week to pay back our loans so in a way it relieves a bit of pressure and anxiety."*

The payment flexibility provided by CBI to its clients who could not afford to pay during a given week is probably what makes their clients loyal to them. An overwhelming response gathered during the focus groups was that CBI does not force their clients to pay when their clients fall on hard times. The female client from Consuelo town adds, *"I do not have a problem dealing with CBI. Their employees are very kind. But if I have a choice, I would prefer not to have a loan. But then, I have no other choice but to get a loan to make both ends meet. Having a loan makes me more hardworking and resourceful so I do not think there is anything bad or negative about getting a loan."*

6.2.3 Microfinance Borrowing Experience

In terms of borrowing experience, the focus group participants relate that they prefer borrowing from MFIs such as CBI to informal moneylenders, more popularly known in the Philippines as '5-6' moneylenders. These informal moneylenders charge an interest of 20 per cent over the term of the loan which is normally 30 days on average, thus the name '5-6'. For example, a borrower will have to pay back PhP6,000.00 for a PhP5,000.00 loan over the course of 30 days or any other agreed period of time. Micro entrepreneurs and the poor people in both urban and rural areas usually patronise this type of informal lending due to their lack of access to financial services from formal financial institutions. The rapid growth of microfinance in the Philippines during the last 15 years have however led to more options for the poor with many shifting away from '5-6' moneylenders to MFIs. The '5-6' moneylenders have however remained popular among poor micro entrepreneurs (Kondo, 2007). During the focus groups, a small number of participants admit that they still borrow from informal moneylenders, but only as a last resort during times of emergency.

The participants state that they prefer the weekly repayment schedule of CBI compared to the daily repayment schedule of informal moneylenders. They likewise cite the lower interests charged by CBI and other MFIs in general to their clients compared to the very high interests charged by informal moneylenders. In terms of loan processing, it was observed during the focus groups that there is no longer a big difference in terms of processing times. Participants share that 'repeat loans' or second loan onwards from CBI can now be processed and released in two to three days on average compared to the same day release by the '5-6' moneylenders. First time CBI loan applicants however would have to wait from one to two weeks on average, which is significantly longer compared to '5-6' moneylenders and other lenders in the informal sector.

A significant finding during the FGDs is the extent through which the participants value their access to formal savings facilities. Many participants express that one of the advantages of borrowing from CBI is that they are also able to save through the mandatory savings facility attached to their weekly repayment schedule. The mandatory savings facility have somehow made CBI clients more conscious of saving money for the 'rainy days' as well as made them more self-aware of their spending behaviour. In contrast, informal moneylenders do not offer this valued service. A thorough discussion on the impact of microfinance on savings behaviour will follow next.

6.2.4 Microfinance Impact on Savings Behaviour

Participants of the focus groups overwhelmingly proclaim their need for savings facilities. They also enthusiastically state how having access to microfinance has changed their savings behaviour. Some even say that they value access to savings and credit facilities equally. The clients themselves observe huge improvements in their savings behaviour. Further, prior to gaining access to microfinance, a significant majority of focus group participants do not have any cash savings at all. These are consistent with results from other studies that suggest that even the poorest people require, value and do indeed save (Wright & Mutesasira, 2001; Dupas & Robinson, 2009).

After gaining access to microfinance, all *MAKITA* members now have access and avail of the savings facilities provided by CBI. This is primarily given the fact that savings is a mandatory component of all *MAKITA* loans. Majority of focus group participants however, indicate that they intend to save more than the minimum requirement provided they have extra funds. Some of the participants have already experienced saving more than the minimum required every week. This suggests that microfinance clients now realise the value of savings and probably use it as a buffer in times of economic or medical shock. This also proves that savings facilities – whether in the form of mandated small and regular deposits ('compulsory' savings) or flexible savings – are valuable on its own and often attracts more clients than a lending program (Johnson & Rogaly, 1997).

A concrete evidence of the value of the savings component of microfinance to the borrowers is that microfinance savings have already outpaced loans in 2013. According to the data from BSP (2013), the savings accounts of microfinance clients have overtaken the amount of loans they took out from financial institutions in 2013, making microfinance borrowers 'net savers'. This trend may likewise indicate that the microfinance borrowers have achieved a certain level of financial independence.

Many participants also share that they have become more conscientious with regards to their spending decisions after gaining access to microfinance. They now make sure that they only buy things they need and if it cannot be entirely avoided, limit their expenditures on unnecessary items. For some clients however – especially those who do not operate income-generating micro enterprises – there are times when simply scrimping on expenditures is not enough to pay off the weekly loan repayments including the mandatory savings. It is during these 'lean times' when CBI clients could count on their savings to fully or partially pay off their weekly repayment dues without selling off income-generating assets. It is therefore not surprising that the focus groups place significant value on the mandatory savings component of microfinance.

Another important finding from the focus groups is that it reiterates the difficulties faced by the poor to save on their own. While it is clear in the literature that even poor people have surplus money and do save (Banerjee & Duflo, 2007), saving on their own is not easy. Some people even go to the extent of accepting negative interest rates on their savings just to have access to formal savings facilities (Rutherford, 1999). Without access to basic savings services, many participants state the lack of financial discipline required to save on a regular basis especially in times of prosperity (for example, see Box 6.5). Gaining access to microfinance therefore not only allowed them to enjoy the benefits of formal financial services but also made them more financially disciplined, being aware that continued access to the benefits of the formal financial system ultimately depends on their credit performance.

Box 6.5 Loans as Pathway to Savings

A female client and a mother of three come from the fishing village of Consuelo in Cantilan, Surigao del Sur. Like majority of people in her village, she does not have access to formal financial services. She likewise does not have any cash savings. Things changed for the people of Consuelo, including the said female client, when CBI started its microfinance operations in Consuelo in 2001.

The female client shares that *"for my PhP5,000.00 (A$125.00) loan, I pay PhP270.00 (A$6.75) weekly with PhP45.00 (A$1.13) forming part of my mandatory savings. Without microfinance, I do not think I could save PhP45.00 (A$1.13) every week. I would just end up spending it buying unnecessary items. But now, I try do add to my weekly mandatory savings every time I have some extra money. That is why I am thankful that I have a loan from CBI because I am now able to save."*

6.2.5 Microfinance Impact on Health Shocks

The existing literature confirms the overwhelming burden of serious health shocks on poor households (Gertler & Gruber, 2002; Banerjee, Duflo & Hornbeck, 2014; Lindelow and Wagstaff, 2007; Islam & Maitra, 2012). Most of the world's poor do not plan for health shocks such as serious injury or chronic illness when they make plans for the future. Similar to other shocks, health shocks can arise any moment and can linger for an indefinite period of time. For many people, particularly the world's poor, health shocks can have adverse consequences for households and can trigger a health-poverty trap. This is because most of the world's poor do not have access to affordable healthcare insurance that will help insure against health shocks. They likewise lack significant savings to cover substantial out-of-pocket healthcare costs that health shocks may entail.

There is evidence to suggest that microfinance can help mitigate the negative impact of health shocks (Cochrane, 1991; Banerjee, Duflo & Hornbeck, 2007; Metcalfe & Sinclair, 2008). This is probably due to the confluence of a number of factors. First, large commercial financial institutions do not adequately service the financial needs of the poor due to among others, the high transaction costs related to delivering small financial packages that the poor require. Second, the existence of a huge financing gap to cater to the needs of poor households and micro entrepreneurs provides an avenue for specialised financial institutions like MFIs to operate. Third, the aim of most microfinance programs is to cater to the financing needs of the poor, underserved and financially excluded. Fourth, an insurance component is normally bundled with micro credit.

Foregoing considered, MFIs hold significant promise in insuring poor households against unanticipated health shocks as microfinance programs typically targets the poor who normally lacks access to affordable healthcare insurance. That is why many poor households in rural and hard-to-reach areas avail of microfinance services, which normally includes insurance, in order for them to build productive assets and better cope with future risks and shocks (Dunford, 2013).

This behaviour is likewise reflected during the focus group discussions on the impact of microfinance in mitigating the significant effect of idiosyncratic and unanticipated health shocks on the poor. Many participants report that they try to cushion the impact of major illnesses in the family by withdrawing their *MAKITA* program savings and/or by applying for renewal of their existing loans. Some participants also resort to selling off their assets such as farm animals, household appliances and jewellery. On the other hand, others report that they try to borrow from their future income on their farm labour jobs.

What the foregoing illustrates is that poor families are more vulnerable to economic shocks such as major illnesses and other health shocks. As such, they need to have access to financial services that would allow them to better manage their lives in times of economic shocks in general and health shocks in particular without leading to households losing all of their productive assets or be burdened by excessive debts (for example, see Box 6.6).

Box 6.6 The Story of a Sick Pregnant Wife

"I am thankful for microfinance because if not for microfinance, I would not have enough money when our family had a medical crisis," said a male client of CBI from the farming village of Patong Patong in Madrid, Surigao del Sur. A few years ago, his wife had an ectopic pregnancy and needed to undergo an emergency operation. He went to the CBI office in Madrid and withdrew almost all of his accumulated savings. He likewise asked the bank manager if he could already apply for a renewal of his existing loan, with the end of his six-month loan term still a month away.

"It is very important that I meet the health care needs of my wife and our baby in her womb," said the male client. *"I do not know where I could have gotten the money to pay for my wife's operation if I had no savings and had no access to microfinance. Most of my relatives, neighbours and friends were in no condition to lend me money at the time."*

"It helped that CBI showed great understanding and flexibility when I had a crisis on my hands. I realised the importance of savings especially in times of medical shock. I likewise felt the need to be better secured just in case a similar problem arises in the future. I hope that CBI will also offer us some form of family medical insurance in the future."

The participants also share that it is very difficult to borrow from relatives and friends during times of health-related economic shocks because most of them are also poor. That is why they find the microfinance services offered by CBI valuable in dealing with these potential shocks. The participants consistently state that they now feel a higher sense of security in coping up with potential shocks compared prior to their participation in the *MAKITA* program because they know that they have easy access to credit and savings facilities. Participants who have already suffered major illnesses in their households likewise shared their confidence in the system by stating that they have never experienced any difficulty in withdrawing money from their savings during those times.

The focus group participants unanimously declare that they will avail of health protection services like medical insurance for themselves and their family should this be offered to them in the future. They feel that having some form of medical insurance will make them less vulnerable to potential health shocks. On the side of the MFIs, there are clear benefits to offering health protection services to their clients knowing that health shocks can have significant impact on their clients' ability to pay back their loans (Metcalfe & Sinclair, 2008). By offering insurance products bundled with credit or as a separate financial product to microfinance clients, MFIs are in a way also hedging against future loan defaults that may arise from health shocks

6.2.6 Microfinance Impact on Education

Filipino families have always placed education on top of their priorities. In particular, poor families consider education as an important instrument to rise out of poverty. It is therefore not surprising that a majority of focus group participants report that they use their income from their regular jobs and earnings from their income-generating business activities to send their children to school. They resort to using part of the proceeds of their loans to pay for their children's educational expenses only when their primary source of income is not sufficient to cover for these expenses. This normally happens either at the beginning or towards the end of the school year when educational expenses are high. Many participants also resort to using part of the loan proceeds for educational expenses when their children are already doing university studies where the associated costs are substantially higher. A number of participants, however, state that they primarily use their loans to pay for their children's education (for example, see Box 6.7).

Box 6.7 Microfinance as a Ticket to a Better Future

"As a single parent, I usually get money for my children's tuition from my microfinance loan," relates a female CBI client and a long-time resident of Consuelo in Cantilan, Surigao del Sur.

"Without microfinance, I do not think I can send my children to school. I source the money for my weekly loan repayments from my earnings derived from providing nail services around Consuelo. I do not find it hard to pay for my weekly repayment dues because I normally earn every day."

The focus group participants also expressed feeling more secured now knowing that they can easily withdraw their savings or apply for loan renewal whenever they need substantial amounts of money to pay for significant educational expense items such as school uniforms, tuition fees and graduation expenses, among others. Further, given that focus group participants use their primary source of income to pay for their children's education, it is not surprising to find no significant difference in the education of client and non-client households as discussed in the previous chapter. This is similar to the study results reported by Coleman (1999) and the Asian

Development Bank (2007), which found no significant difference in the education of households with access to microfinance to those without access to microfinance.

6.2.7 Microfinance Impact on Women Perception of Empowerment

During the focus groups, the participants were asked about their understanding of women empowerment. Majority of the participants relate women empowerment to their comparative position to men in the household, particularly in terms of managing household income and assets. They commonly cite their role as household 'budget officers' as well as rising expectations for women to take a more proactive role in helping provide for the needs of their children. Many participants felt the need to complement their husband's income and relate empowerment along these lines. Other participants also relate women empowerment in terms of acquisition and ownership of assets. Not a single participant however mentioned anything about women's wellbeing in terms of reproductive health and birth control and birth spacing when they talked about women empowerment. In general, the focus groups define women empowerment in terms of the household decision-making process and the women's relative position to men in that regard.

The focus group participants expressed feeling empowered after gaining access to microfinance. Many cite improvements in terms of acquisition and ownership of assets (for example, see Box 6.8), financial literacy and management, self-confidence and self-esteem, dietary options and quality of food, and wellbeing of children and other dependents in the household (for example, see Box 6.9). In terms of acquisition and ownership of assets, many have used the earnings from their investments in physical assets (e.g., refrigerator, motorcycle, fishing motor, fishing net, etc.) and farm inputs (e.g., seeds, fertiliser, etc.) to pay for their children's education or to accumulate additional assets.

Box 6.8 Loans Invested in Physical Assets and Improved Wellbeing

A female client from Patong Patong in Madrid, Surigao del Sur shares, *"because of microfinance, I was also able to build a small house. When the house was finished, I was very happy. Even though it is just a small house, I felt really proud of what I have accomplished because of microfinance. We now have a house with electricity. It makes me really proud as a mother."*

Box 6.9 Better Diet, Better Life and One Proud Mother

Evidence suggests that when poor people have some extra money to spend on food, they buy better-tasting and more expensive calories rather than maximise calorie intake (Banerjee & Duflo, 2007). The experience of a female client and a mother of three from Magsaysay in Madrid, Surigao del Sur, is an example of this.

The said female clients relates, *"because of microfinance, I was able to buy my children new school uniforms and shoes and better food like milk and some meat. It makes me feel happy and proud seeing my children happy and knowing that they are not different from other kids from better-off families. I use the rest of the loan proceeds for my business selling processed foods so that I will have a regular source of income for my weekly repayment dues."*

This is consistent with other studies on women empowerments where women are considered empowered when they have the ability to make meaningful choices and has control and/or experience an increase in 'relative share of power' over household resources (Hobcraft, 2000; Malhotra et al., 2002; Alsop & Heinsohn, 2005). Further, Mahmud (2003) posits that women are likewise deemed empowered with the improvement in their wellbeing as a direct result of the improvement in the wellbeing of their children and other household members.

A notable theme observed during the focus groups is the remarkable solidarity between the participants and their respective husbands and in a couple of cases their respective wives. This was clearly demonstrated in the fishing villages where many participants used their loans to buy fishing motors and nets for use by their husbands. The women in turn were the ones selling the fish catch in the local market or around the village (for example, see Box 6.10). This strong collaboration between husbands and wives were likewise demonstrated in the farming communities where participants reported helping their husbands in various ways. Some women tend to their micro enterprises and other income-generating activities while others resort to being farm labourers themselves in order to supplement their household income. What is evident in both the fishing and farming villages where the focus group participants reside is that the close collaboration between husbands and wives allow the households to diversify their economic portfolios to include a range of different activities and types of enterprises.

Box 6.10 Husband and Wife Teamwork

"Our boat was heavily damaged during a strong typhoon," relates a female CBI client and long-time resident of the fishing village of Consuelo in Cantilan, Surigao del Sur. The said female client adds, *"we used our loan and all our savings so that we can repair the boat because it is our only means of livelihood. My husband is a fisherman and I sell the fish that he catches around our village. We have been working closely together so that we will be able to pay back our loan and provide for the needs of our family."*

This is similar to the findings by Wright et al. (1999) where they discovered a notable level of cooperation and teamwork in the management of household financial resources between husband and wife among selected microfinance clients in Uganda. What is more noteworthy is that the cooperation departs significantly from traditional cultural practices and household norms (Wright et al., 1999). In general, the focus group participants reported that microfinance have encouraged them to be more hardworking, resourceful and allowed them to work more closely with their respective partners. Many participants also mentioned that the opportunity to help their husbands provide for the needs of their children have brought them immense satisfaction and happiness and increased their influence and bargaining power within the household as a result of their contributions to the household income.

6.3 Key Informant Assessment of the Philippine Microfinance Industry

6.3.1 Supply of Microfinance Funds in the Philippines

The selected key informants of the Philippine microfinance industry were unanimous in stating that there is enough supply of microfinance funds in the Philippines, both at the wholesale and retail levels. Some of the key informants however qualify their views by stating that supply of microfinance funds is only sufficient at the market segment where MFIs currently operate and for the existing range of microfinance products and services they offer. They argue that the current supply of microfinance funds may not be enough to cater to the demand of the microfinance industry in the strictest sense. They however concede that supply may be enough in terms of meeting the needs of the enterprising poor segment of the microfinance market.

On the wholesale level, the key informants cite the entry of private commercial banks in the provision of wholesale funds to MFIs as a sign of the willingness of formal financial institutions to channel funds into the microfinance industry. They likewise state that many private commercial banks have now entered into direct partnership agreements with retail MFIs. Some key informants however point out that the private banking sector may still not be sufficiently supplying the funding needs of the microfinance industry. They cite the continued heavy government involvement as a wholesaler of funds through various GFIs as one of the reasons. Looking at the various official reports from the BSP, MFPC and MCPI, we can indeed observe that government financial institutions supply roughly 40 per cent of the wholesale funds in the microfinance market, with the rest coming from private financial institutions. This may be indication that the private commercial banks continue to be cautious of the microfinance market and lending to the poor in general. On the other hand, this can likewise be argued as simply a case of public sector money crowding out private sector money.

On the retail level, the key informants say that MFIs in general remain very liquid. They cite some MFIs' action of pre-paying their wholesale loans from banks as proof of their liquidity. In fact, they state that some MFIs are now instead using the deposits they have generated from their microfinance clients as loanable funds. This is consistent with what was mentioned earlier in the chapter that microfinance clients in the Philippines are now saving more than they are borrowing from MFIs. This does not however imply that aggregate demand for microcredit might be decreasing, as the opposite is true. There is continuing demand for microcredit and funds are constantly being channelled to microfinance clients. What is probably happening is that many MFIs have now built up a strong capital base from years of profitable operations and also have access to cheaper sources of funds such as savings deposits, equity capital, donations, and grants.

6.3.2 Demand for Microcredit

In terms of the existing demand for microcredit, the key informants state that there is a huge demand for microcredit in the Philippines. They cite three key factors for this huge demand. First, a large segment of the Philippine population continue to be poor. According to the latest poverty statistics from the NSCB as presented earlier in

Chapter 3, the national poverty level during the first semester of 2013 was estimated at 24.9 per cent of the population. This is slightly lower compared to the back estimates of poverty figures of 26.6 per cent and 26.3 per cent recorded in 2006 and 2009, respectively. Using the projected population of 100.0 million in July 2014 from the Commission on Population (2014), an estimated 24.9 million of the Filipinos are poor. Together with a large number of low-income households living just above the national poverty line, this forms a huge demand base of potential microfinance borrowers. As pointed out by one of the key informants, microfinance is only reaching an estimated six to seven million borrowers but the potential demand for microfinance could be as high as 12 million borrowers. The foregoing data therefore may lead credence to the assumption that the potential demand for microfinance could be much higher.

Second, micro enterprises account for a huge majority of total establishments in the Philippines. As presented in Chapter 3, micro enterprises make up 89.4 per cent of total establishments and represent the bulk of demand for microcredit. They however cumulatively account for only 4.9 per cent of the total value in the economy and provide only 30.1 per cent of total employment (MSMEDC, 2010; Department of Trade and Industry, 2014). Some constraints cited by the key informants for the poor performance of micro enterprises are inadequate resources, limited access to finance particularly for graduating micro enterprises, low productivity and the lack of credit and market information. The foregoing constraints demonstrate the need for more funds to be directed to micro enterprises given that they are seen as critical drivers of economic growth in the Philippines. This was pointed out by one of the key informants, stating that there will always be demand for microcredit as long as micro enterprises remain an integral part of the Philippine economy.

Third, the poor are increasingly favouring MFIs to informal moneylenders as a source of financing. They cite the lower interest rates charged by MFIs compared to informal moneylenders ('5-6' moneylenders included) as one of the reasons. This was likewise confirmed during the focus groups when the participants themselves said that MFIs operating in their villages charge lower interest rates compared to informal moneylenders. Other reasons cited by the key informants for the huge demand for microcredit from MFIs are the attractive savings and microinsurance components normally packaged with microcredit. Recent developmental endeavours pursued by some MFIs such as the provision of business development services, community development and health and feeding programs have likewise helped spur the demand for microcredit in poor communities. The foregoing demonstrates the continuing need for microfinance from current and future micro entrepreneurs and other users of microfinance.

In general, there seems to be unanimity in the responses provided by the key informants that the present demand for microfinance are adequately being met by the MFIs, with some areas even already saturated with microfinance funds. The key informants however differ in their interpretation of what comprise an entire microfinance market. Some suggest that the microfinance market should include all the presently unserved and underserved areas as well as potential market segments not currently targeted but are in need of access to formal financing. On the other hand, others argue that the microfinance market should include only areas and segments that have the capacity to absorb and sustainably use microfinance. A clear understanding and interpretation of what comprise an entire microfinance market is therefore crucial to the continued growth of the microfinance industry in the country especially in unserved and underserved areas.

6.3.3 Unserved and Underserved Areas and Challenges to Financial Inclusion

Over the past decade, the Philippine microfinance industry has grown not only in terms of the number of financial institutions that are engaged in microfinance but also in terms of the diversity and innovativeness of the products and services they offer. While significant progress has been made, the key informants acknowledge that there remains a big gap in financing that needs to be filled. They add that the growth of outreach has only been moderate and some areas in the country remain unserved or underserved. The key informants cite some areas in Eastern Visayas, ARMM and CAR that continue to have limited or no access to microfinance. These areas are difficult to reach and have poor infrastructure, are densely populated and have low economic activity, and are affected by continuing armed conflict. Further, other informants consider indigenous people and agrarian reform communities as presently constituting the unserved or underserved areas.

The key informants are however divided in terms of whether to consider the above areas as target markets for microfinance or as missionary areas for social do-gooders given that these areas are presently underdeveloped and has yet to mature in terms of microfinance at least. Those who consider the above areas as target markets cite the need for the MFIs themselves, in partnership with government and nongovernment organisations, to develop and prepare these areas to receive microfinance. On the other hand, those who consider these places as missionary areas cite the lack of incentives for MFIs to go into these areas. They argue that the low presence or even the total lack of presence of MFIs in many villages in these areas will continue for as long as it is not economically feasible to operate in these areas.

The key informants however agree that a holistic approach should be taken to develop these areas to minimise the big gap in financing. They recognise the need to first adequately prepare the underdeveloped markets by providing social interventions such as trainings and capacity building activities. Further, they also recognise the need to address information asymmetry issues, provide a wider range of appropriate products and services, lower barriers to access financial services and provide innovative delivery channels. These efforts should go together with government initiatives to improve infrastructure to boost economic activity and ensure peace and security in these areas. It is only after these various interventions and strategies have been undertaken can the unserved and underserved areas become economically feasible and adequately prepared and capacitated to receive formal financing from banks and other financial institutions.

6.3.4 Policy and Regulatory Environment

The key informants believe that a number of policies and regulations are in place to address issues of financial exclusion in unserved and underserved areas. They cite initiatives by the BSP to encourage financial institutions to expand their operations in unserved and underserved areas. Some of these initiatives include the provision of scope for establishing microfinance-oriented branches and innovative delivery systems in the said areas. These policies are geared towards lowering the cost of delivering services to these areas.

Some key informants however feel that the above initiatives are not enough to motivate MFIs to expand their operations into these areas. They add that incentivising cost of entry alone would not be sufficient to address the lack of access to microfinance to these areas. They argue that the economic feasibility of expanding to these areas is still the critical factor for many MFIs. They add that policy reforms or initiatives alone would not enhance the desire of MFIs to enter these markets. Some key informants add that these policy initiatives should be backed by concrete incentives such subsidies and tax incentives, among others. Given the foregoing views from the key informants, it is apparent that much needs to be done in terms of microfinance policies and regulations to minimise the gaps in access to microfinance in unserved and underserved areas. It is however also necessary to take stock of the country's achievements as pointed out in Chapter 2 of being the best in the world in terms of terms of policy and regulatory framework for microfinance from 2009 to 2012 (BSP, 2012). These achievements should be used as benchmarks going forward as policymakers and regulators craft future policies and regulations.

6.3.5 Strengths of Philippine Microfinance Industry

The key informants identified at least four major strengths of the Philippine microfinance industry. These are the following, namely: 1) supportive policy and regulatory environment; 2) strong social conscience and value system; 3) private sector-led growth; and 4) diversity of financial institutions engaged in microfinance. The vibrant policy and regulatory environment for microfinance have already been discussed earlier. In terms of having a strong social conscience and value system, some key informants point out many of the Microfinance NGOs are either church-based organisations or have some kind of religious backing. These Microfinance NGOs promote Christian values through the delivery of microfinance services to the poor. They are not only focused on the bottom line but also in community development and holistic transformation. This is also evident in their strong advocacy for the improvement of social performance management, protection of client welfare and the provision of solutions to the problems of the poor. These microfinance NGOs care deeply about the welfare of their clients and are aware of the global issues facing microfinance.

It was pointed out earlier in the chapter that there is still a strong government involvement in microfinance. This involvement is however limited to the provision of wholesale funds to retail MFIs. For the most part, the big strides made in the Philippine microfinance industry during the last two decades are led primarily by the private sector. Some informants even went as far as to state that government policymakers and regulators may actually be lagging behind market developments in microfinance. They add that some policies and regulations crafted are just in reaction to the growth and popularity of microfinance during the past two decades. They note that while the country was recognised for its policy and regulatory framework for microfinance, some initiatives cited by the EIU in its report have nothing to do with what government has done. An initiative cited by the EIU for example is the establishment of the Microfinance Data Sharing System (MiDAS), a credit bureau for micro borrowers founded by seven of the biggest microfinance institutions in the Philippines. MiDAS aims to address the difficulties in credit access and is expected to help boost growth in lending to the poor. MiDAS likewise intends to help participating MFIs remain true to their social mission of poverty alleviation by establishing and implementing programs with the aim of helping financially troubled clients. This is in contrast to traditional credit bureaus that build a 'negative list' or 'caution list' of clients.

The need to establish a credit bureau for microfinance was also recognised in the Regulatory Framework for Microfinance to address potential problems associated with credit pollution, multiple borrowings and over-indebtedness. The Philippines remains among the few countries in Southeast Asia without a fully functioning credit bureau. The Philippine Congress passed a law in 2008 creating the Credit Information Corporation (CIC) to serve as the country's credit bureau. The CIC is mandated to "establish a comprehensive and centralized credit information system for the collection and dissemination of fair and accurate information relevant to, or arising from, credit and credit-related activities of all entities participating in the financial system." Unfortunately, it is still not fully operational six years from its inception. As pointed out by some of the key informants, the private sector has been leading the way in advancing the development of the Philippine microfinance industry and is one of the strengths of the industry.

Another strength of the Philippine microfinance industry is in the diversity of financial institutions that are engaged in microfinance. As discussed in Chapter 3, three different types of financial institutions presently provide microfinance products and services in the country. These are microfinance banks (thrift and rural banks), nongovernment organisations with microfinance services (microfinance NGOs), and cooperatives with savings and credit services. This diversity in the type of financial intermediaries engaged in microfinance leads to continued product and service delivery innovations and competition among these intermediaries to achieve and maintain financial sustainability. Further, the diversity of demand for microfinance products and services require a varied range of financial intermediaries given their unique capabilities and specialisations operating in various markets and sectors across the country.

6.3.6 Major Issues and Challenges for the Philippine Microfinance Industry

The key informants of the Philippine microfinance industry identified a number of major issues and challenges that needs to be addressed in order for the industry to remain dynamic and continue its robust growth. Below are some of the major issues and challenges.

6.3.6.1 Multiple Borrowing and Over-indebtedness

Majority of the key informants cite multiple borrowing and over-indebtedness as the greatest challenge facing the industry. They cite how the over-concentration of MFIs in highly profitable and developed markets have led to multiple borrowings and over-indebtedness by some microfinance clients. The heavy market penetration and stiff competition in some markets has encouraged some borrowers to get a loan from one MFI to repay a maturing loan in another MFI. Further, there are cases where some microfinance clients have multiple loans from one MFI. Again, some microfinance clients resort to paying off their maturing loans with the proceeds from their upcoming loans. The practice of multiple borrowing is what led to the eventual collapse of many MFIs in India, Pakistan and Nicaragua. The most common policy response to the issue of multiple borrowing is the setting up of a credit bureau. The problem is, as discussed earlier in the chapter, the national credit bureau is not yet operational. The best resort then is for other MFIs to join MiDAS or similar initiatives by other institutions engaged in microfinance to give them more confidence in extending loans to their clients until the time when the national credit bureau is fully operational.

One key informant however suggests that multiple borrowing and over-indebtedness can still happen regardless if there is a national credit bureau or not. He posits that the industry should first determine if the phenomenon of multiple borrowing is such a bad thing for clients and if it actually leads to over-indebtedness. In reality, some MFIs have no choice but to resort to multiple lending to ensure institutional survival. In this case, the establishment of a national credit bureau will not be enough to address the problem of heavy indebtedness. As Rozas (2011) suggests, what is needed aside from a credit bureau is a strong client protection regulation that requires MFIs to prove that they have done due diligence to validate that the borrower is able to pay back the loan within the accepted credit standard or norms.

6.3.6.2 Transparency and Consumer Protection

The key informants cite the need for greater transparency in the reporting of financial and social performance of MFIs. They likewise state that greater transparency not only protects borrowers but also improves the performance of MFIs as this allows them to identify areas for improvement and benchmark against industry standards. They say that it is now time to stop romanticising microfinance and to start reporting the true picture of the Philippine microfinance industry. Some key informants cite that some MFIs continue to report extremely high repayment rates and very good portfolio quality. Given recent experiences and developments in the industry across the world where many financial institutions engaged in microfinance were closed due to high past due rates and portfolio at risk, reports on very good performance along these lines may seem improbable.

Further, some key informants cite the need to ensure that microfinance clients have a better understanding of the cost of funds that they borrow so that they can make informed decisions. They laud recent efforts by BSP in ensuring greater transparency and disclosure in pricing which was likewise cited by the EIU in its evaluation of the country's policy and regulatory framework for microfinance. They however cite the need build on this efforts in order to have greater transparency across all credit intermediaries. Greater transparency fosters competition as it allows better comparison of prices across all credit providers that may ultimately lead to the lowering of lending rates for microfinance clients.

6.4 Chapter Summary

The results of the focus group discussions show that participants demonstrate a clear understanding of the concept of microfinance. Further, many participants use their loans to make investments in income-generating activities. They also unanimously describe that the selection criteria and selection process in accessing microfinance from CBI as systematic, fair, and reasonable in general. In terms of borrowing experience, the focus groups reveal that they prefer borrowing from MFIs such as CBI to informal moneylenders as they favour the weekly repayment schedule and lower interest rates of MFIs. The focus groups likewise reveal that there is no longer a significant difference in terms of loan processing times between MFIs and informal moneylenders, particular the '5-6' moneylenders.

A significant finding during the focus groups is the extent through which the participants value their access to formal savings facilities and how access to microfinance improved their spending and savings behaviour. This is probably due to their common experience of having difficulties saving on their own. This is consistent with findings from other studies that suggest that the poor needs access to formal savings facilities.

In terms of microfinance impact, the focus group participants experienced positive impacts on their savings behaviour, ability to respond to health shocks and educational needs and women empowerment after having access to microfinance. Further, access to microfinance instilled financial discipline among participants and increased their awareness on the value of their credit performance and how it affects their continued access to the benefits provided by formal financial system.

The results of the in-depth interviews reveal that there is enough supply of microfinance funds in the country, both at the wholesale and retail levels. In terms of the existing demand for microcredit, the in depth interviews reveal that there is a huge demand for microcredit in the country. The key informants cite three key factors for this huge demand. First, a large segment of the Philippine population continue to be poor. Second, micro enterprises account for a big majority of total establishments in the Philippines. Third, the poor are increasingly favouring MFIs to informal moneylenders as a source of financing.

In terms of access to microfinance, the key informants acknowledge that there remains a big gap in financing that needs to be filled. They add that the growth of outreach has only been moderate and some areas in the country remain unserved or underserved. The key informants cite some areas in Eastern Visayas, ARMM and CAR that continue to have limited or no access to microfinance due to inadequate infrastructure and/or peace and order problems. They suggest that a holistic approach be undertaken in unserved and underserved areas through among other others, the provision of social interventions and capacity building activities, lowering of barriers to access to finance, provision of a wider range of appropriate microfinance products and services and more innovative delivery channels. This is in addition to government efforts of improving infrastructure and ensuring peace and order in unserved and underserved areas. It is only through holistic approaches can the unserved and underserved areas transform themselves into areas that can support and foster sustainable economic development that can ultimately lead to a more inclusive growth.

The key informants believe that some policies and regulations are in place to address issues of financial exclusion in unserved and underserved areas. They cite initiatives by the BSP to encourage financial institutions to expand their operations in unserved and underserved areas. Some key informants however feel that the above initiatives may not be enough to motivate MFIs to expand their operations to these areas. They argue that the economic feasibility of expanding to these areas is still the critical factor for many MFIs and that policy alone would not enhance their desire to enter these markets. It was apparent from the results of the in-depth interviews that a lot of things need to be done in terms of microfinance policies and regulations to minimise the gaps in access to microfinance in unserved and underserved areas. It is however also necessary to take stock of the country's achievements of being the best in the world for a number of years now in terms of terms of policy and regulatory framework for microfinance. These achievements should be used as benchmarks going forward and inspire policymakers and regulators as they craft future policies and regulations.

Further, the key informants identified at least four major strengths of the Philippine microfinance industry. These are the following, namely: 1) supportive policy and regulatory environment; 2) strong social conscience and value system; 3) private sector-led microfinance industry growth; and, 4) diversity of financial institutions engaged in microfinance. Finally, the key informants identified multiple borrowing, over-indebtedness, and the need for greater transparency and consumer protection as major issues and challenges that should to be addressed in order for the Philippine microfinance industry to remain dynamic and continue its path towards sustainable and more inclusive growth.

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CHAPTER SEVEN

SUMMARY, CONCLUSIONS AND POLICY IMPLICATIONS OF THE FINDINGS

7.1 Summary and Conclusions

The Philippine microfinance industry has gone a long way from its humble beginnings as a 'Grameen Bank' replicator to now being recognised as a global leader in terms of its regulatory framework and practices for microfinance. It is safe to say that a number of factors have contributed to the lofty status and continued growth of the Philippine microfinance industry. These achievements however should serve as a reminder that efforts to address challenges and constraints facing the microfinance industry should continue to ensure sustainable growth and financial inclusion.

It is given this premise that the study proposes to provide a deeper understanding of the structure, conduct and performance of the Philippine microfinance industry in order for it to reach its economic and social goals of financial sustainability and poverty reduction. This research aims to investigate the impact of microfinance on household income and expenditures, as well as on the social well-being measures of education, health and women empowerment.

The study utilised a mixed method approach. Primary qualitative data such as field notes, audio recordings and transcripts was collected through focus group discussions of client and non-client households in Northeastern Mindanao and semi-structured interviews of key Philippine microfinance industry stakeholders, namely: government officials and policymakers, government and private financial institutions, microfinance institutions and non-governmental organisations was also conducted. The key study results are as follows:

There is no statistically significant difference in the demographic characteristics of client households and non-client households. The results of the household survey indicate the absence of a statistically significant difference in terms of the different demographic measures of age, education, household size and distance to the town centre between client households and non-client households in the study area. This suggests that there is probably no direct relationship between the level of education and access to microfinance. The survey results also show that CBI does not focus its operations in areas near the centre as client households reside five kilometres from the nearest town centre on average. This indicates that CBI is reaching relatively hard-to-reach or remote rural areas.

There is no significant difference in the living standards of client households and non-client households. The household survey shows the lack of a significant difference in the living standards of client and non-client households in terms of land ownership, dwelling status, housing (roof, walls and floor) materials and basic housing amenities (drinking water, cooking fuel, toilet facility, and electricity). This is similar to the earlier finding of no statistically significant difference in the demographic characteristics of client households and non-client households.

There is only a mildly significant impact on the per capita income of microfinance client households. While there is no significant difference in the regular sources of income and expenditure type between client households and non-client households, the per capita income of client households is slightly higher at the 90 per cent confidence level compared to the per capita income of non-client households. This suggests that microfinance have a positive and mildly significant impact on the household income of client households. The significant impact in per capita income was however not reflected across the other basic welfare indicators (e.g., per capita expenditure, per capita savings, and per capita food expenditure) as there seems to be no difference between the two households.

There is a growing sense of pessimism in terms of household income outlook. An overwhelming majority of client and non-client households feel that there was no change in their income this year compared to the previous year (72.0 per cent) as well as that there will be no change in their income for the coming year (82.9 per cent). This may be an indication or a symptom of a bigger problem that has not been appropriately identified and addressed yet by the local and/or national government. There is therefore a need to go deeper on this issue so that the 'heart' of this growing pessimism is identified, better understood and addressed.

There is a very high level of self-rated poverty across households and that client households are 'poorer' on average compared to all other households at the provincial level. A significant majority of households rated themselves as poor, similar to other findings in the literature. On the other hand, using the official national and provincial poverty line, we can see that client households are still 'poorer' on average compared to all other households at the provincial level.

CBI is targeting the 'enterprising poor', yet is also reaching the poorer segments in its operational areas. This indicates that CBI has been effective in terms of depth of outreach with regards to serving those who are 'income poor' and 'MPI poor'. Given that CBI remains as one of the top rural banks in the Philippines, we can assume that CBI is achieving financial sustainability and depth of outreach probably through ingeniously designed microfinance programs. We can also conclude that this drive towards attaining greater depth of outreach may be attributed to a strong organisational commitment towards the provision of alternative financial and countryside development services accompanied by an across the board institutional buy-in of the organisation's social mission and objectives from top management all the way down to the people in the field.

Microfinance clients know and avail of microfinance of microfinance to improve their lives. Participants demonstrate a greater awareness and clear understanding of the concept of microfinance. Further, many participants use their loans to make investments in income-generating activities. They also unanimously describe that the selection criteria and selection process in accessing microfinance from CBI as systematic, fair, and reasonable in general.

Microfinance clients prefer to borrow from MFIs than to informal moneylenders. The results indicate that micro credit borrowers are increasingly favouring MFIs than informal moneylenders. This probably indicates improvements in microfinance features such as shorter processing times and more attractive bundled services such as savings and insurance facilities that are not usually offered by informal moneylenders. This will likewise result in greater demand for microfinance in the future.

Microfinance clients value access to savings facilities and note improvements in savings behaviour as a result of access to microfinance. A significant finding of the study is the extent through which the participants value their access to formal savings facilities and how access to microfinance improved their spending and savings behaviour. Some clients even value access to savings more than access to loans. This is probably due to their common experience of having difficulties saving on their own. This is consistent with findings from other studies that suggest that the poor needs access to formal savings facilities.

Microfinance clients report positive impacts of microfinance on savings behaviour, health, education, and women empowerment. In terms of microfinance impact, the focus group participants experienced positive impacts on their savings behaviour, ability to respond to health shocks and educational needs and women empowerment after having access to microfinance. Further, access to microfinance instilled financial discipline among participants and increased their awareness on the value of their credit performance and how it affects their continued access to the benefits provided by formal financial system.

There is enough supply of microfinance funds yet a huge demand remains. The study results reveal that there is enough supply of funds allocated for micro lending in the country, both at the wholesale and retail levels. In terms of the existing demand for microcredit, the findings reveal that there is a huge demand for microcredit in the country. The three key factors cited for the huge demand are the following: 1) a large segment of the population remains poor; 2) micro enterprises account for a large majority of total establishments in the country; and, 3) the poor are increasingly favouring MFIs to informal moneylenders as a source of financing.

The Philippine microfinance industry remains strong. The study identified at least four major strengths of the Philippine microfinance industry, namely: 1) a supportive policy and regulatory environment; 2) a strong social conscience and value system; 3) private sector-led microfinance industry growth; and, 4) diversity of financial institutions engaged in microfinance.

However, some key challenges remain. The study reveals the following issues and challenges that needs to be addressed in order for the Philippine microfinance industry to remain dynamic and continue its path towards sustainable and more inclusive growth, namely: 1) multiple borrowing; 2) over-indebtedness; and, 3) need for greater transparency and consumer protection.

7.2 Conclusions

A number of lessons can be drawn from this study of microfinance in Northeastern Mindanao, the Philippines. Although we can conclude that there is no significant difference demographically between microfinance client and non-client households, it is clear that there is a positive and mildly significant impact on income of microfinance. Moving forward, this needs to be better evaluated so that future microfinance programs will have more significant impact on the lives of the clients and their families.

There is now a growing awareness among various stakeholders of the Philippine microfinance industry that while supply of microfinance funds is sufficient, it seems to be not flowing towards the direction of those who demand such funds as evidenced by the huge financing gap that continue to exist.

The study did not identify any current legal or regulatory policy that explicitly hinders the growth of the Philippine microfinance industry. It is believed that some policies and regulations are in place to address issues of financial exclusion in unserved and underserved areas. The need to fast track initiatives such as the full operations of the national credit bureau (CIC) is however critical.

Clearly, the study shows some positive impacts of microfinance on savings behaviour, health, education, and women empowerment. The Philippine microfinance industry also remains fundamentally strong, however, some key issues and challenges lie ahead.

7.3 Policy Implications of the Findings

This section presents the policy implications of the study findings. This likewise addresses the study's objective of providing recommendations to assist in policy formulation and implementation for improving the impact of microfinance on poverty reduction in the Philippines. Several policy implications generated from the study findings for both policymakers as enablers and MFIs as implementers are raised for discussion in order to maximise the effectiveness of microfinance.

Microfinance institutions on the other hand should continue to develop and innovate their microfinance products and services especially in light of the growing preference of those in need of financial services to avail of such through MFIs and not through traditional informal moneylenders. MFIs should capitalise on this trend.

Policymakers should not rest on their laurels and continue to remain responsive in light of continuing industry development and constantly changing markets. Policies that promote an enabling environment for microfinance should be developed and further enhanced so that MFIs and other financial institutions that are engaged in microfinance will continue to channel funds into the sector. This is one way to address to significant finance gap that exist as well as support further poverty reduction and financial inclusion in the Philippines.

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