

EMPLOYMENT SECTOR
— SOCIAL FINANCE PROGRAM —

Linking Debt Relief to Microfinance

- An Issues Paper

Danny Cassimon
Jos Vaessen

Working Paper N° 42

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Geneva



Social Finance Programme

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- An Issues Paper**

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Foreword

Concern about Africa's debt burden has been repeatedly voiced in international fora, notably in the ILO Governing Body. In 2001 the Social Finance Programme initiated a series of 5 country debt reviews to explore how debt relief could be used more effectively for a sound and sustainable pro-poor financial sector. This led to an international expert meeting in December 2001: Debt Conversion and Micro-Finance Development.

Since then most countries in Sub Saharan Africa worked out Poverty Reduction Strategy Papers (PRSPs) showing how public finance would be directly targeted at pro poor actions. Not surprisingly microfinance figures prominently here. This shows that policy making has substantially advanced since 2001 in the direction of a more operational link between debt reduction, poverty reduction and microfinance development. Still, many challenges remain as the Extraordinary Summit of the African Union in Ouagadougou in 2004 made clear, putting microfinance and debt relief high on the agenda, as reflected in the Declaration and Plan of Action.

In response to the mandate given by the Governing Body in November 2005¹ the Social Finance Programme reactivated work in this area and commissioned a paper to Danny Cassimon and Jos Vaessen of the University of Antwerp. The paper gives an overview of the conceptual and operational issues in linking PRSPs to microfinance promotion in Sub Saharan Africa. It is part of a larger joint initiative by the ILO and the Government of France². It provides a framework for ongoing field operations by the Social Finance Programme advising – in the context of Decent Work Country Programmes - the governments and social partners in Madagascar, Mali and Tanzania on building pro poor sustainable microfinance capacities.

Bernd Balkenhol
EMP/SFP

¹ www.ilo.org/public/english/standards/relm/gb/docs/gb294/pdf/esp-3.pdf

² «Convention France – BIT dans le domaine des finances solidaires », June 2006

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Introduction

Debt relief and microfinance development appear as two important themes in the current new development architecture, especially within the framework of reaching the Millennium Development Goals (MDG). Both themes also appear prominently at major international conferences or meetings, be the G8, the recent UN Millennium Summit in New York, the Ouagadougou Declaration of the African Union, or other regional African initiatives such as NEPAD.

In recent years, debate on debt relief was dominated by the HIPC-Initiative (Heavily Indebted Poor Countries), for which around 40 countries, most of them from Sub-Sahara Africa, were eligible. After being stalled during a number of previous G8 meetings, the most recent G8 meeting in Gleneagles provided a breakthrough in deciding to grant additional debt relief, within a clear MDG perspective, albeit for the same countries. At the same time, it continued to further explore other avenues for 'scaling up' aid, by looking for other sources of additional funding such as the International Finance Facility, with the aim of frontloading future development aid, or global taxes, such as airline ticket levies.

At the same time, also microfinance continued to gain prominence, spearheaded by the Micro Credit Summit Campaign and the 2005 UN International Year of Microcredit. Inspired by the examples of leading microfinance institutions as Grameen Bank, BRAC and ACCION, the microfinance sector has experienced a substantial increase in outreach during the last ten years. The Microcredit Summit Campaign has set the target of reaching 100 million of the world's poorest families in 2005. Next year in 2006, evidence will be presented to what extent this target has been reached. Notwithstanding the increased popularity and outreach of microfinance institutions (MFIs), in most countries huge areas and sectors of the population are still unable to access microfinance services. In addition, much remains to be done in terms of building capacities, developing different financial products in cost-effective ways and creating and strengthening appropriate institutional and regulatory environments.

Although both themes always appear in these declarations, they can be found in separate chapters, without any attempt whatsoever to link them. This is not so strange. Although establishing a stronger link between both debt relief and microfinance development has a natural and clear intuitive appeal, the conditions for linked initiatives to become optimal interventions might not materialize as easily as expected.

This concept paper tries to make a brief but concise appraisal of the potential for linking both issues. It is structured as follows. The first section looks at the issue from a theoretical point of view, establishing first the necessary conditions for donor operations on debt relief to be optimal interventions, focusing on the aspects of additional resource generation and desirability of earmarking; this general conceptual frame is then specifically applied to ‘debt-for-microfinance swaps’. Section two then reviews linking practices that are already active, while section three suggests some practical steps for further study and operational networking on the issue. In developing our ideas and reviewing current practice, we will focus on Sub-Saharan African countries.

1. Debt relief and microfinance: finding the link

When evaluating the impact of debt relief initiatives, including debt swaps, it is helpful to disentangle total impact into two broad components, hereafter labeled the impact on the amount of resources available, and their productivity on the one hand, and ways donors try to influence to what purposes the funds are used, described by the general term ‘conditionality’, on the other hand. We will briefly assess both components before applying this to the link between debt relief and microfinance development.

1.1. Debt relief and its potential for resource additionality

First of all, we consider the impact on the amount and productivity of resources available. In principle, debt reduction, be it in the form of debt service or debt stock reduction, frees resources that can be rechanneled towards other spending. This is only the case when, in the absence of debt relief, debt would have been (fully) serviced. If this is not the case, the resource impact of debt reduction is limited to an accounting clean-up of historical and future arrears accumulation. Real resource savings equal the share of debt service actually transferred in the absence of debt relief. And, as such, one dollar of debt relief is not necessarily equivalent to one dollar of new money. But even such an ‘accounting clean-up’ can still be useful because of indirect impacts.

Such an indirect effect occurs when excessive debt service severely crowds out spending on development priorities and provokes sub-optimal fiscal and other government decisions (excessive domestic borrowing, excessive inflationary financing, excessive taxation of some sectors in the economy), as well as weakened incentives for economic reform. As a consequence,

both private domestic as well as foreign investors might be discouraged to invest in the economy. The overall result will be, among other things, a depressed economic growth rate. This is sometimes referred to as the debt overhang hypothesis³. Debt relief can then be an important element of a package triggering return to a virtuous circle, increasing resources from private and public sources. This works in two ways. First, under debt overhang, donors may intervene to allow the country to stay current on debt service payments, rather than for genuine development purposes; debt reduction can stop this. Second, following the new aid effectiveness literature, once the debt problem solved, it is optimal to increase interventions in that country since the productivity of one more dollar of aid is higher there.

Obviously, debt reduction as an intervention can shift donor interventions towards countries with a substantial debt, at the expense of others. Debt relief enables donors to attract additional resources that would otherwise not have been available. This ‘additionality of donor resources’ is one of the essential features of major recent debt reduction initiatives, and especially the MDG logic: debt reduction should be ‘additional’ to traditional aid⁴.

Many ‘marginal’ debt reductions are not likely to generate a substantial development effect, and will not generate this additionality. In a small debt reduction operation, the probability will be very low that the last dollar reduced from a relatively large debt stock would have been repaid by the debtor government. Consequently, it does not free resources at the level of the recipient country, change the economic behaviour of debtor governments or induce external finance providers (Bulow and Rogoff, 1988), instead it will generally consume donor resources that would otherwise be used for alternative purposes⁵. Debt swaps also entail high transaction costs because of legal problems and the large number of intermediaries, especially when involving commercial debt.

³ A lot of authors question the negative strict causality relation between external debt and growth for low-income countries. Rather, an excessive external debt is one of the symptoms of the systemic development problem of these countries. As such, a lasting solution calls for systemic changes, including tackling institutional, political and other weaknesses, in which debt reduction will be a necessary ingredient.

⁴ Additionality might be difficult to measure in reality. On the one hand, we have to watch out for symptoms of ‘false additionality’, such as increases of ODA due solely to the generous OECD/DAC rules with respect to ODA-accountability of debt relief. On the other hand, situations of ‘quasi-additionality’ can arise, such as increases in the aid budget utilization rate due to the relatively high speed and ease, with which debt cancellation can be executed, relative to other interventions such as project or even budget support.

⁵ For example in case there are important differences in discount rate between the debtor and the creditor.

1.2. Appropriate debt relief conditionality and earmarking

The fact that more resources are available does not automatically mean that they will be used for a desired, e.g. development purpose. Donors, therefore, want to influence the utilization of funds, or change recipient country behavior in another way, by using ‘earmarking’ whether micro-earmarking, sector-earmarking or macro-earmarking⁶.

- Micro-earmarking implies that debt relief savings are placed in jointly-managed counterpart funds, outside the government budget, using separate implementation and monitoring mechanisms (Project Monitoring Unit, PMU) outside the government’s public system. Its features are ‘old’ project logic, high donor commitment, ease of monitoring and effectiveness evaluation high degree of donor accountability, fungibility, high transaction costs, lack of long-term capacity building and strengthening of the public management and M&E system, and weak ownership and sustainability.
- Sector-earmarking refers to the mechanism in which funds released from debt service obligations are used to support the government budget in specific sectors, such as health, education, environmental conservation or, more specific, HIV/AIDS. It is equivalent to sector budget support. It is typically integrated into the government budget, and execution and monitoring is aligned, using as much as possible the government’s own systems. Donors might prefer this option because they may have a comparative advantage in a given sector.
- Macro-earmarking, can be defined as a mechanism in which funds released from debt service obligations are used to support the government budget in specific (jointly established) areas of social intervention, in more than one sector. The same basic reasoning developed for sector-earmarking applies here, but from a multi-sector perspective.
- An extreme form of macro-earmarking refers to debt relief savings that are not tied to specific activities. It is ‘deliberate fungibility’, where funds from debt relief are pooled with budget resources, to be spent on the government’s priorities according to development plans such as the Poverty Reduction Strategy Paper (PRSP), a

⁶ Note that this classification is not specific for debt reduction-related interventions, but is used for aid interventions in general.

MDG plan, etc. In principle, they could be called debt-for-PRSP swaps, or debt-for-MDG swaps. The term *non-earmarked* use highlights the alignment with donor development priorities, and government systems of implementation and M&E.

1.3. Why link debt relief to microfinance?

Are there opportunities to link debt relief to microfinance? As MF is a multi-purpose vehicle that can help attain several MDG at the same time, it is certainly legitimate to explore the scope. Donor support to microfinance, through grant or loan funding, can be enhanced by links to debt relief, which could help up-scale operations. ‘Marginal’ operations involving small amounts of debt, which are then micro-earmarked to microfinance sector will not make a dent in terms of development impact. Moreover, whatever marginal gain to be derived, it will most likely be dissipated away by the high transaction costs involved. Sector level interventions of debt relief in favour of microfinance and at the expense of other sectors could be justified by the expected substantial social benefits, for example employment, social inclusion and encouragement.

Integration in current debt relief practices

Assuming that microfinance sector development support is a legitimate priority sector the question is how to integrate it in current (or prospective) debt relief practices. Another question is how to differentiate their application between different types of debtor countries, HIPC countries and non-HIPC low-income countries (LICs).

Debt swaps, from the mid eighties to the beginning of the nineties, was executed by bilateral Paris Club donors on their own debt claims, were carried out through counterpart funds. Debt swaps were also managed by multilateral donors or organizations (such as UNICEF), or NGOs, exchanging commercial debt, bought at a discount, for local counterpart funds. This was changed by stock debt relief, as embedded in the Paris Club Naples terms, soon followed by the HIPC Initiative (see box 1). Swaps have lost their appeal to both debtor and creditor countries. Earmarking has been replaced by 100% bilateral debt cancellation. HIPC introduced a practice of

implied non-earmarking, with (real) debt relief saving spent according to the priorities set forth in the PRSP of each HIPC country⁷.

Box 1: The Heavily Indebted Poor Countries (HIPC) Initiative

The HIPC-Initiative envisages debt sustainability for heavily-indebted poor countries, by reducing debt to a common threshold debt level, expressed as a present value (PV) of debt to exports ratio of 150%, or in fiscal terms (a PV of debt to fiscal revenues ratio of 250%). All creditors reduce their claims proportionally.

At present, 18 countries fully completed the HIPC process, having reached the ‘completion point’, and received irrevocable debt stock relief¹. 10 more countries are halfway, having reached a decision point agreement, in which the amount and additionalities of HIPC debt relief is determined in principle, these countries receive so-called interim debt relief. 10 more countries still have to fulfil some entry requirements. Furthermore, the extension of the so-called sunset clause up to the end of 2006 potentially enables more countries (such as Haiti, Kyrgyz Republic and Nepal) to qualify as HIPC country. Overall, currently committed debt relief amounts to about 33 billion USD in present value terms.

The HIPC initiative is more than an ‘accounting clean-up’. Half of total debt relief reflects real savings, available for additional priority spending. A joint IMF/WB forward-looking monitoring framework, the Debt Sustainability Framework (DSF), combined with prudent borrowing guidelines (e.g. minimal grant elements) should ensure future debt sustainability, not only for HIPCs but for all LICs.

¹ Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda and Zambia.

The G8 Initiative builds on the HIPC-initiative, granting additional multilateral debt relief to post-HIPC countries (only). It is not clear what the conditionality implications of the new G8 initiative will be.

⁷ Even in the HIPC-Initiative ‘non-earmarking’ is not the automatic option taken. In some countries, where e.g. PFM systems were felt to be insufficient, even HIPC (usually interim) debt relief relied on micro-earmarking, in principle as a transitory mechanism. This was done using the so-called ‘institutional fund mechanism (IFM), having all the characteristics of what we call micro-earmarking. Sometimes, donors rely on intermediate types of earmarking, such as the so-called virtual fund mechanism (VFM) in which HIPC relief and its designated expenditures were integrated into the budget, but accounted for separately using separate budget lines (IMF/WB, 2001). De Groot, Jennes and Cassimon (2003) have shown that only VFMs are useful as a transitory mechanism.

Box 2: The new G8 debt relief initiative

The new proposal builds on the HIPC Initiative and will result in the cancellation of all remaining debt outstanding vis-à-vis three major multilateral creditors, notably the World Bank (IDA), the African Development Bank (AfDB) and the IMF, for all HIPC countries that have reached completion point status (only). Currently, 18 countries are eligible for this additional debt reduction.

This additional cancellation will free additional resources for debt reduction, to be spent on development priorities within the MDG/PRSP framework. For the beneficiary countries, this additional debt cancellation will result only partly in additional net flows: with respect to IDA/AfDB claims, the debt service cancellations will be subtracted from the countries' prior allocations of new money, so net flows will not immediately increase. However, since IDA/AfDB are supposed to be compensated for the debt reduction 'dollar for dollar' by additional bilateral contributions, these additional bilateral contributions will increase funds available to IDA/AfDB, to be spent on all countries eligible for IDA/AfDB funds. As a result, all countries will benefit in terms of slightly higher net flows, as compared to the situation prior to the G8 proposal, and fairness rules are maintained between HIPC and non-HIPC eligible countries. For the IMF, it will have to cover the full cost of the initiative with its own resources, but the G8 proposal does ensure that the IMF continues to have sufficient financial capacity to continue to assist low-income countries.

The PRSP approach is extended to all LICs that want to remain eligible for concessional IMF or WB finance in future. Here, supporting debt relief operations could be optimal for countries that are on schedule in servicing debt, but show signs of debt overhang characteristics. To the extent that microfinance sector development is identified in the PRSP of these countries, this might provide the international community with a strong case to advocate the link of microfinance promotion by debt relief in these countries.

1.4. Possible uses of debt relief in microfinance

Debt relief can help correct market failure by:

- correcting biases in outreach of MFIs
- making available types of funding that are undersupplied by the 'market'
- supplying public goods in microfinance (providing adequate regulation, enhancing the delivery capacity of MFIs, supporting APEX institutions).

Outreach bias

Outreach of microfinance to rural areas, home to the majority of the approximately 1.2 billion people living on less than 1 US\$ a day, remains underdeveloped. The costliness of delivering financial services to the poor is compounded by long distances and obtaining credible in-

formation on potential clients. Not surprisingly, many MFIs mainly operate in urban and peri-urban areas. Microfinance in rural areas in the world is an exception. Governments could correct this bias by giving an appropriate incentive combination of grant and refinancing support to pioneering MFIs who venture into rural areas. Such pioneering MFIs generate positive externalities (e.g. in terms of screening out bad borrowers, creating a repayment culture) for other MFIs. Consequently, a case for subsidizing these institutions can be made (Hulme and Mosley, 1996).

Adequate type of funding

Donor support for MFIs is often in the form of funds for onlending. They are easy to monitor for donors and have high impact. However, in many cases the availability of funds for onlending is not the most limiting factor for increasing outreach (Pearce, 2001)⁸. Worse, the continuing practice of donors to provide funds for onlending to successful MFIs might crowd out commercial funding, which is increasingly available for established MFIs. In such cases public funds should be diverted to promoting linkages between MFIs and commercial institutions, for example by supporting guarantee funds or supplying funds to MFIs with which they can leverage external commercial funds for onlending (Gibbons and Meehan, 2002). In situations when MFIs are legally allowed to capture savings, support could go to the build-up of adequate capital reserves.

One of the major challenges for an MFI concerns the ability to cover operational expenses in the start-up phase as well as in periods of rapid expansion of outreach. As argued by Gibbons and Meehan (2002) donors could provide finance in the form of quasi-equity, e.g. soft loans subordinated to other debt, as illustrated by PROFUND, an investment fund providing equity finance to MFIs in Latin America (Silva, 2005).

Supply of public goods

Public goods are undersupplied by the market. As a result of the growing popularity and outreach of MFIs the demand for public goods has grown substantially and measures are being taken to provide them by, for example,

- creating an appropriate framework of legislation and regulation

⁸ It is worthwhile noting that in many instances cumbersome procedures and conditionality of donor funds do constitute a problem for MFIs.

- enhancing the delivery capacity of MFIs (e.g. providing support for capacity building initiatives, facilitating learning processes by promoting the dissemination of information on good practices and innovations in financial services)
- supporting APEX institutions (wholesale institutions) and loan and deposit guarantee funds (available to all licensed/registered/approved MFIs).

2. Debt relief and microfinance: Some examples

2.1. Multi-sector earmarked operations

‘Macro-‘ or ‘multi-sector-earmarked’ debt relief concerns the situation in which funds released from debt service obligations are used to support the government budget in specific agreed upon areas of intervention. An example of ‘macro-earmarked’ debt relief is the French C2D initiative.

Box 3 : C2D: ‘Contrats de Désendettement et de Développement’

The C2D initiative of the French government seeks to reduce of the bilateral debt burden of debtor countries tied to investments in sectors that contribute to the development of the debtor country. Upon completion point of the HIPC initiative an agreement between France and a debtor country is signed for three years regarding the further reduction of remaining outstanding bilateral debt not covered by the HIPC initiative. Although the C2D is closely aligned with the HIPC initiative there are at least two major differences. First, in C2D the debtor country actually pays the debt to the French Treasury upon which the French government pays an equivalent sum into the Treasury of the debtor country. Second, in C2D the French government has a substantial say with regard to the allocation of the funds in comparison to the HIPC which concerns ‘non-earmarked’ debt. While the C2D initiative aims to support activities in line with the Millennium Development Goals and a debtor country’s PRSP, it specifically focuses on four sectors: education and vocational training, primary health and combating endemic diseases, physical planning and infrastructure at the level of local administration, natural resources management. Priorities within these sectors are determined in consultation with civil society. Allocation of funding within these sectors can be in the form of more general budget support or tied to specific projects (determined jointly by France and the debtor country).

From the operational side, C2D is managed on the French side by three different governmental actors. Financial transactions and negotiations with the debtor country are managed by the Ministry of Economics, Finance and Industry and the Ministry of Foreign Affairs. Implementation of the C2D is the responsibility of the French Agency for Development (AFD). In principle, 22 countries have been identified as eligible for the C2D initiative. Currently nine countries have signed a contract or are in the process towards negotiating a C2D contract: Bolivia, Cameroon, Ghana, Madagascar, Mauritania, Mozambique, Nicaragua, Uganda and Tanzania.

Example: Mozambique

In 2001, a short time after Mozambique had reached the HIPC completion point, a C2D contract was signed with the French government. On top of the debt relief for Mozambique under the HIPC initiative it was decided to proceed towards 100% bilateral debt cancellation, reducing the remaining outstanding debt of approximately 95 million Euros by means of the C2D initiative. The conversion of this debt is distributed over different contracts, the first C2D (2001-2004) covering 29,8 million Euro and the second one (2005-2007) 21,5 million Euros.

One of the components of the debt conversion package under the first C2D is the support for the micro-credit project ‘Les Caixes Comunitarias de Credito e Poupança’. A grant of 3,1 million Euros has been allocated to broaden the outreach and strengthen the financial and institutional sustainability of the MFI. The MFI has an outreach of approximately 10 000 clients of whom 60 % are women. The project envisages reaching more small farmers in two provinces and informal sector micro-entrepreneurs in Maputo.

Sources: Ministry of Foreign Affairs, France: <http://www.diplomatie.gouv.fr/solidarite/economie/c2d/>
DAC Peer Review of France, 2004: <http://www.oecd.org/dataoecd/31/40/32556778.pdf>

2.2. 'Non-earmarked' debt relief in a PRSP context

'Non-earmarked' HIPC debt means that, funds released from debt relief will be spent according to the priorities set forth in the PRSP of each HIPC country. In Africa most countries are HIPC countries and over the last five years have produced a (interim) PRSP. Support for microfinance in HIPC countries should first and foremost be based on the specific microfinance related priorities stipulated in each country's PRSP. Table 1 provides a overview of the role of microfinance in the different poverty reduction strategies of the 30 HIPC countries as well as non-HIPC countries for which a PRSP is available.

Table 1: Tentative overview of the role of microfinance in the PRSP in SSA

Country	type of document	reference to microfinance ¹	separate sub section ²	microfinance sector perspective? ³	type of support	target sectors/ groups
Benin	PRSP	yes	yes	yes	outreach ⁴ , regulation ⁵ , capacity building ⁶	rural, agriculture ⁸ , women, youth, SMEs
Burkina Faso	PRSP	yes	no	yes	outreach, regulation	rural, agriculture, fisheries, handi-crafts, farmers, women
Burundi	Interim-PRSP	yes	no	yes	outreach, capacity building	rural, agriculture, fisheries, handi-crafts, housing (rural and urban), SMEs
Cameroon	PRSP	yes	no	yes	outreach, regulation, linkages between conventional financial institutions and MFIs, capacity building ⁷	rural, agriculture (and environmental conservation), artisanal mining, SMEs
Cape Verde	PRSP	yes	no	no	outreach, capacity building	rural, agriculture, fisheries, SMEs
Central African Republic	Interim-PRSP	yes	no	no	outreach	women, youth
Chad	PRSP	yes	yes	yes	outreach	rural, agriculture, SMEs
Democratic Republic of the Congo	Interim-PRSP	yes	no	no	outreach	rural, urban, agriculture, women
Republic of the Congo	Interim-PRSP	yes	yes	no	outreach, regulation	rural, agriculture, women
Cote D'Ivoire	Interim-PRSP	yes	no	yes	outreach, regulation	rural, women, SMEs
Ethiopia	PRSP	yes	yes	yes	outreach, linkages between conventional financial institutions and MFIs, regulation	rural, agriculture, urban, women
The Gambia	PRSP	yes	no	yes	outreach, regulation	rural, agriculture, SMEs
Ghana	PRSP	yes	yes	yes	outreach, capacity building	rural, agriculture, fisheries, handi-crafts, youth, women, disabled persons, other vulnerable groups, SMEs
Guinea	PRSP	yes	no	yes	outreach, regulation, capacity building	rural, agriculture, fisheries, women, SMEs
Kenya	PRSP	yes	yes	yes	outreach, linkages between conventional financial institutions and MFIs, regulation	rural, agriculture, women, youth, SMEs

Country	type of document	reference to microfinance ¹	separate sub section ²	microfinance sector perspective? ³	type of support	target sectors/ groups
Lesotho	PRSP	yes	no	no	outreach	rural, agriculture, urban, women, SMEs
Madagascar	PRSP	yes	yes	yes	outreach, regulation	rural, agriculture, fisheries, construction, SMEs
Malawi	PRSP	yes	yes	yes	outreach, regulation, impact analysis, research on new lending methodologies, capacity building, linkages between conventional financial institutions and MFIs	rural, agriculture, women, artisanal mining, SMEs
Mali	PRSP	yes	no	yes	outreach, regulation	rural, agriculture, handicrafts, housing, women, SMEs
Mauritania	PRSP	yes	no	yes	outreach, regulation, capacity building, linkages between conventional financial institutions and MFIs	rural, agriculture, fisheries, peri-urban, housing, handicrafts, women, SMEs
Mozambique	PRSP	yes	no	yes	outreach, regulation, capacity building	rural, agriculture, youth, SMEs
Niger	PRSP	yes	no	yes	outreach, regulation	rural, agriculture, handicrafts, women, youth, SMEs
Rwanda	PRSP	yes	yes	yes	outreach, regulation, research	rural, agriculture, commerce, (urban) housing, SMEs
Sao Tome and Principe	PRSP	yes	no	no	outreach	rural, agricultural
Senegal	PRSP	yes	no	no	outreach, regulation, linkages between conventional financial institutions and MFIs	rural, agriculture, handicrafts, SMEs
Sierra Leone	PRSP	yes	yes	yes	outreach, regulation, linkages between conventional financial institutions and MFIs	rural, agriculture, housing, mining, youth, women, SMEs

Country	type of document	reference to microfinance ¹	separate sub section ²	microfinance sector perspective? ³	type of support	target sectors/ groups
Tanzania	PRSP	yes	no	no	outreach	rural, agriculture
Uganda	PRSP	yes	yes	yes	outreach, regulation, capacity building, linkages between conventional financial institutions and MFIs	rural, agriculture, SMEs
Zambia	PRSP	yes	no	no	outreach, regulation	rural, agriculture, youth, women, SMEs

Source: elaborated on the basis of the (interim-)PRSP documents available at:

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/EXTPRS/0,,contentMDK:20195487~menuPK:421515~pagePK:148956~piPK:216618~theSitePK:384201,00.html>

¹ Does the (interim) PRSP refer to microfinance activities (e.g. microfinance, microcredit, finance to poor sectors of society, etc.)?

² Is there a separate section on microfinance or financial sector development with specific (ample) attention to microfinance?

³ Is microfinance only perceived in terms of its contribution to alleviate poverty or strengthen productive sectors or are there also clear indications of developing the microfinance sector as such?

⁴ Expanding outreach of current MFI and/or creating new MFIs (incl. setting up guarantee and investment funds for MFIs). Support to MFIs without specifying the type of support.

⁵ Regulation is used here as to refer to a category of activities, including some of the following (depending on the country): improved legislative and regulatory framework, increased supervision and coordination, and/or policy development in general.

⁶ Training, technical assistance and other forms of support to MFIs.

⁷ And strengthening linkages with the government.

⁸ Including livestock.

Microfinance has a key role in the PRSP in SSA. All but one of the PRSPs in SSA emphasize the importance of microfinance. In some cases, e.g. Malawi, Uganda and Ethiopia the PRSPs contain quite elaborate analyses and strategies for the microfinance sector. In addition, PRSPs from a number of other countries spell out explicit microfinance strategies to be supported by HIPC funds. In the PRSP of Mali one can even find a concrete indication of the percentage of the funds released by HIPC that should be allocated to microfinance. The fact that quite a number of countries have dedicated a separate (sub) section of their PRSP to microfinance shows the importance attached to microfinance in SSA.

All PRSPs in some way or another discuss the constraints of limited access to finance for poor people. Increasing outreach (e.g through funding for on-lending, setting up guarantee funds, creating new MFIs) is considered a priority. Support for reinforcing the legislative and regulatory framework for microfinance also features prominently in the different PRSPs.

The different types of support for microfinance development can be grouped in four categories: outreach, linkages between conventional financial institutions and MFIs, regulation and capacity building. Examples are:

Outreach:

- Mauritania: creating a so-called Maturation Fund to strengthen MFIs in rural and outlying urban areas.
- Rwanda: recapitalizing the ‘Banques Populaires’ and encouraging them to develop mechanisms to finance farmers’ groups with seasonal and marketing credit.

Linkages between conventional financial institutions and MFIs:

- Cameroon: promoting good business relations between the MFIs and commercial banks in order to introduce microcredits to their portfolios.
- Ethiopia: promoting linkages between commercial banks and cooperatives which act as intermediaries between banks and farmers.

Regulation:

- Guinea: improving the role of the Central Bank as an oversight body for microfinance.
- Kenya: assisting the government in reviving and reforming the existing microfinance sector by improving the supervision and reform of MFIs with poor institutional capacities and unhealthy loan portfolios (high default rates).

Capacity building:

- Malawi: assisting MFIs to put automated management systems in place.
- Cape Verde: providing training to (potential) MFIs in basic management tools.

In a number of PRSPs no details are mentioned regarding the type of support needed. In some of these cases PRSPs refer to microfinance strategies with detailed priorities for intervention:

- developing the service of savings deposits for the poor: Cote D'Ivoire, Ghana, Malawi, Mozambique, Uganda;
- strengthening credit cooperatives: Cote D'Ivoire, Kenya, Zambia;
- establishing guarantee funds: Gambia, Lesotho;
- developing the service of microinsurance (especially in smallholder agriculture): Kenya, Mauritania, Niger, Zambia;

Further country-specific inquiry is needed with respect to the sectors and groups that receive priority attention in the expansion of microfinance outreach. In some PRSPs explicit reference is made to women's access to credit or to SME development. In other cases, separate sections on gender equality and support for women's entrepreneurial activities can be found (with ample attention for access to credit).

A recurring priority across countries is the demand for rural (micro)finance. In many SSA countries the vast majority of the poor lives in the countryside. In contrast, outreach of microfinance in the countryside is often weak or in many regions nonexistent. The (peri-) urban bias of microfinance is most clearly analyzed in the Ugandan PRSP. In Uganda (peri) urban outreach is considered more or less 'sufficient', whereas enhancing rural outreach is considered an absolute priority.

Box 4 shows some examples of the progress that is being made in Africa in employing funds released by debt relief to microfinance development.⁹

A recent comprehensive review of the PRSP process (World Bank and IMF, 2005) pointed at the need for a better prioritization of different sectors and objectives and a more specific elaboration of corresponding action plans. Currently, new initiatives like a donor-instigated Performance Assessment Framework are being developed to support this as well as donor harmonization.

There are no mechanisms that specifically monitor PRSP implementation on microfinance. On the other hand, the importance and diverse needs of microfinance development in Africa would clearly justify further work in terms of developing appropriate institutional arrangements and tools to improve the monitoring of the allocation of released HIPC funds in microfinance.

⁹ Progress in the PRSP process is monitored by both the World Bank and the International Monetary Fund (mostly in a joint arrangement). The following main principles for M&E of the PRSP can be identified:

- country-specific implementation of policies and activities set out in the PRSP is subject to M&E by the government of the PRSP country
- PRSP countries are required to produce annual progress reports on the implementation of the PRSP; these documents are submitted to the World Bank and IMF and are made available to the public.
- The IMF and World Bank jointly engage in a number of activities within the framework of M&E of the PRSP; most of the documents produced are available to the public:
- annual overall implementation reports
- punctual comprehensive review studies (the most recent one produced in September 2005)
- Joint Staff Advisory Notes to provide feedback to PRSP countries (formerly the more binding Joint Staff Assessments)
- punctual evaluations implemented by the evaluation offices of the World Bank and the IMF

Box 4: Use of debt relief for microfinance within the PRSP framework

In progress reports on the implementation of the PRSP examples can be found of debt relief being allocated to microfinance activities. A few examples:¹

Benin (PRSP progress report 2003):

- a pilot study was implemented in preparation of updating the legal and statutory framework of the microfinance sector
- 5,926 persons received microcredit through the newly established Support Fund for National Solidarity

Cameroon (progress report 2003/2004):

- improved regulation on conditions of operation for MFIs was created
- as a result of a restructuring exercise by the government 13 weak MFIs were closed down
- the national microfinance committee defined guidelines for partnerships between the Central Bank, commercial banks and MFIs
- specific MFIs were supported in order to increase outreach in rural areas

Ghana (PRSP progress report 2003):

- over C825 million allocated to microfinance directed at women (farmers and traders) by the Ministry of Women Affairs
- community banks in 38 districts received increased funding for onlending to farmer groups
- 43,156 farmers in 10 regions received loans through microcredit initiatives funded by the Office of the Senior Minister

Malawi (PRSP progress report 2003/2004):

- 285,074 clients accessed microcredits
- a microfinance network was established comprising 12 MFIs; one of the functions of the network is to enhance coordination between the private sector, NGOs, the government and donor organizations

Mozambique (PRSP progress report 2003):

- a new law called the 'Credit Institutions and Financial Companies Law' was drafted and submitted for approval to the appropriate organs
- 50,000 farmers received microcredit
- microcredit programs to support artisan aquaculture and rural commerce were established in some provinces

Tanzania (PRSP progress report 2002/2003):

- privatization of the National Microfinance Bank
- consultations between the government and the private sector on microcredit

Source: Worldbank, PRSP : <http://www.worldbank.org/prsp>

¹ Examples refer to progress within one year. Per country, examples are given (not representing total progress on microfinance support). In some cases results are presented as part of progress under the PRSP although the link with debt relief is not specified. Consequently, it cannot be clearly established to what extent the reported progress is due to funds released through debt relief.

3. How to proceed further

In 2001 the Social Finance Program of the ILO launched its initiative to explore the link between microfinance and debt relief and more particularly the potential for debt for microfinance swaps. The debt situation of most the countries in SSA was then quite different from today¹⁰. Most countries in SSA are HIPC countries and have experienced a substantial debt reduction which released non-earmarked funds to be allocated according to PRSP priorities. Given the importance and scale of this development in Africa and in the context of the Plan of Action adopted by the Ouagadougou Summit of the African Union in September 2004, the ILO in collaboration with other organizations should examine how to align debt relief and microfinance promotion within this new context.

The follow-up could be started by

- developing a tool for assessing the potential for debt relief tied to microfinance at country level covering;
- type of country: HIPC, non-HIPC LIC (MIC);
- current debt situation;
- microfinance sector needs and priorities (e.g. as stated in the PRSP, other country strategy plans);
- the potential for additionality in case of earmarking debt relief for microfinance.

Our analysis shows that microfinance is a priority issue in the allocation of funds from (HIPC) debt relief in almost all PRSP countries in SSA. Furthermore, several countries have detailed plans for microfinance support, either in their PRSP or in microfinance strategies referred to in the PRSP. One might wish to monitor the allocation of funds released by debt relief to microfinance as stipulated in the PRSP.

- a small conference attended by representatives of donor organizations and partners from Africa as a basis for further discussion and joint initiatives.

¹⁰ Within the framework of this initiative a number of country debt reviews were undertaken by the ILO in selected African countries.

Whatever the follow-up it is crucial to link further steps to initiatives that are happening in the region, notably to the actions of the African Union. The 2004 Ouagadougou Declaration and Plan of Action, emphasize the need to strengthen efforts both in the field of debt relief, as well as microfinance development, without however explicitly linking them. Linking both of them more explicitly, within the boundaries explained in this paper, might offer one of many fruitful ways of transforming the Ouagadougou process into concrete proposals.

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