



LAO PEOPLE'S DEMOCRATIC REPUBLIC
Peace Independence Democracy Unity Prosperity

Policy Statement for the Development
of
Sustainable Rural and Micro Finance Sector

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SECTION I: INTRODUCTION

1. Overview

Lao PDR is one of the least developed countries. 80% of Lao people live in rural areas. The number of poor households are estimated to total 252,449 households¹, which accounts for 28.08% of the total number of households in the country. However, it is estimated that only 7% of the total number of poor households have access to rural and micro finance services. Access to basic financial services, such as a safe place to deposit savings and to borrow money at affordable rates, is an important tool for people to be able to increase their income, build their businesses, and manage shock throughout their life cycle. Therefore, the Government is intended to promote the development of the rural and micro finance sector (RMF) to increase outreach so that people who do not have access to the banking system's services can satisfy their financial needs. Substantial and sustainable development of the sector can significantly contribute to the implementation of the Government's policy for poverty reduction, as codified in the Millennium Development Goals and the National Poverty Eradication Paper.

The Government's vision for the financial sector reflects these poverty reduction goals, and the objective of meeting international standards. The financial sector will be supportive of broad-based sustainable economic growth and reduction of poverty. The financial sector will help enable the Government to achieve its goal of graduating from the least developed country status by 2020. The financial system will have the depth needed for economic growth and development and will promote macroeconomic stability. There will be strong bank and non-bank institutions that efficiently allocate the country's resources to the most productive investments and income generating activities of people nationwide. The sector will be diversified and will provide wide access to financial services and extensive market reach.

2. Definitions of key words

Some key words to be referred in this document have following definitions:

2.1 Micro Finance: means the provision of a broad range of financial services, such as cash based credit, deposits, insurance, etc, **to the poor, low-income households, and their micro-enterprises.**

2.2 Rural Finance: means the provision of a broad range of financial services, such as cash based credit, deposits, insurance, etc, **to people and enterprises located in rural areas.**

¹ From the National Meeting for Poverty Reduction I, 2003

SECTION II: CURRENT SITUATION OF RURAL AND MICRO FINANCE SECTOR IN THE LAO PDR

Rural and Micro Finance Sector (RMF) in the Lao PDR is still in its infant stage, which could be contributed by supply, demand, and policy constraints. On the supply side, while there are several RMF initiatives in rural and urban areas, operated by many domestic and international organizations, such programs have only limited outreach due to inadequate funds and limited variety of services, which do not fit clients' needs. On the demand side, existing and potential RMF clients in general still lack awareness and understanding of how they can use financial services from RMF sector to improve their living conditions. Additionally, existing policy and regulatory framework do not provide an enabling environment for a sustainable development of the sector. Aware of these constraints, during 2002-2003, Bank of the Lao PDR (BOL) had conducted an extensive data collection and consultation with the key parties nation-wide, including domestic and international agencies, involved with RMF sector, to assess the current situation of the RMF sector. Major findings are as follows:

1. Strengths

- RMF services are able to mobilize local savings and enhance effective use of fund that can contribute to living condition improvement and poverty reduction among Lao people.
- Most of RMF methodologies are suitable to the needs of the Lao people.
- Some pilot Lao Microfinance initiatives are successful and can become sustainable.
- Potential demand for such services is very high.

2. Constraints and Weaknesses

- The supply cannot fully reach the demand².
- Some policy makers, local authorities and donors still lack a solid understanding of sustainable market-oriented RMF.
- The emerging microfinance institutions are crowded out by the existing subsidized credits programs.
- There is a lack of exit options for sustainable projects, as they cannot transform themselves into institutions.
- The existing regulation restricts the development of the microfinance sector.
- Management capacity of micro finance initiatives is limited.
- A majority of RMF initiatives are not sustainable.
- Lack of understanding that RMF is not suitable for poorest, who lives in very remote areas. These groups need other kind of assistance.

3. Some causes for under-development of the sector

- The concept of RMF is not fully disseminated.
- Low population density and difficult market access.
- Policy, legal and regulatory frameworks are not conducive for MFIs yet.
- Subsidized credit affects the rapid development of MFIs.
- Coordination among different key stakeholders is inadequate.

² (Approximately 7% of total number of poor households have access to RMF services excluding money lenders)

4. Opportunities

- Potential demand for such services is very high.
- Some donors and private businesses, both local and foreign, would invest in RMF sector if environment were conducive.
- Conducive policies for the private sector would increase emergence and expansion of MFIs.
- Development of infrastructure and education increases access to RMF.
- A developed rural and microfinance sector could foster savings mobilization amongst Lao people.
- GOL is committed to reform APB into a sustainable market-oriented institution.
- GOL is committed to create a supportive environment for the development of a variety of microfinance institutions.

5. Threats

- High inflation could de-stabilize the RMF sector.
- Lack of a certain and simple process for registration and restrictions on mode of operation could discourage the emergence of MFIs and could lead to increasing power of moneylenders.
- Pressure to continue subsidized lending could undermine RMF by crowding out MFIs and by requiring MFIs to charge un-sustainable interest rates.
- Lack of an adequate awareness and understanding of an importance of the RMF sector could delay the implementation of this policy and action plan.

SECTION III: POLICY AND VISION FOR DEVELOPMENT OF RURAL AND MICRO FINANCE SECTOR

This policy is aimed to create an enabling environment for a sustainable development of the rural and micro finance sector in the Lao PDR. As the RMF sector cannot be viewed in isolation of the whole financial system, the reform program should enable the RMF sector to be integrated into the overall financial system. Specific policy and vision for the sector have been identified. A time-bound action plan to reform the sector together with roles and responsibilities of parties involved in RMF sector are determined. This can serve as key milestone to monitor progress of the reform program. By taking into account the findings in SECTION II regarding the current situation of rural and micro finance sector as well as the socio-economic situation as a whole, the following program of policy and vision reform for the RMF is to be implemented.

1. General statement

Sustainable rural and micro finance can be effective tools for poverty reduction, which can help Lao PDR to emerge from LDC status by 2020. The GOL reform program in rural and micro finance will enable the sector to expand significantly, with diversity, security and future sustainability. The RMF reform program is a major contribution into the implementation of the National Socio-Economic Development Plan.

2. General vision for development of Rural and Micro Finance Sector

Vision for development of the rural and micro finance sector will focus on the four areas of activities as follows:

2.1 The RMF sector will expand significantly:

RMF will significantly expand over time to increase outreach to the greater number of poor in Lao PDR. Currently, the sector reaches only a small percentage of the Lao population.

2.2 The sector will include a diversity of independent MFIs:

The sector will comprise several new MFIs with a diversity of legal ownership, including private and/or public ownership. It will also develop a variety of methodologies, to reflect the diversity of the Lao people and situation. The MFIs will be managed and governed autonomously. The national laws and legal instruments will support the development of the sector.

2.3 The sector will gradually become sustainable:

By 2005, most of the people involved in RMF will share common understanding of RMF best practice and sustainability. RMF initiatives will have a plan to become sustainable. Interest rate will be set by MFIs' management based on full cost recovery, profitability and market demand. The management of MFIs will be fully accountable and skilled.

2.4 The environment will ensure security for depositors:

An appropriate legal and regulatory framework will be designed and implemented. Supervision of MFIs, especially large deposit taking MFIs, will be strengthened in order to ensure depositors' protection.

3. Clarification on the four areas of the vision

3.1 Expansion

According to the estimation, while 28.08% of total number of households is poor, but only less than 7% of total number of those poor households have access to rural and microfinance services. The existing number of rural and micro finance institutions is not sufficient and they have not yet been properly promoted to be able to expand and meet the current demand. To ensure access to financial services by the poor and outreach, the sector will need to expand significantly but not recklessly. This calls for the need of enabling environment to allow the emergence of new RMF institutions and the expansion by existing MFIs.

This expansion will take time and require experimenting of different types of methodologies, based on the diversity of the Lao population. In simple words, the RMF services should be reached by the larger number of people. However, the RMF sector should not be expected to reach the most remote areas of the country, or serve the poorest population who live in the subsistence economy without access to markets for their products. This segment of the population needs other types of assistance such as the donation or aids from domestic and/or foreign charities, public and/or private and/or international funds etc. in order to help improve their economic and living conditions before they can have access to services provided by the formal financial sector.

3.2 Diversity

Currently, most of the RMF programs have been operated under the public authorities. The reform program will enable different models of MFIs to emerge, such as private companies, credit unions, cooperatives, private and/or public specialized banks. It will be particularly important to encourage private initiatives, considering the limited resources of the public sector. New initiatives will require autonomy in their management, hiring procedures, interest rates, access to capital, and choice of products, clientele and geographical areas etc.

3.3 Sustainability:

Sustainability is essential to:

- Ensure longevity of sector;
- Ensure integrity of the financial system and ensure an integration of RMF sector into the financial system;
- Ensure large outreach;
- Ensure independence from national budget;
- Enable RMF initiatives to stand on their own feet and live long;
- Avoid relying on subsidies from the Government or donors for many years;
- Allow people to have many loan cycles, which is very important for the poor to have enough time to step out of poverty.

Some conditions needed for achieving sustainability include:

- Rural and microfinance projects and institutions need to have legal status.
- MFIs need to have management with appropriate skills, knowledge, and ethical standard (financial discipline). In addition, the management of RMF projects and institutions needs to have a clear vision on sustainability since the very beginning.
- MFIs need to be autonomous and accountable by being allowed to make management decisions regarding products and services to offer, clients and areas to serve, staff to hire, and price to charge.
- MFIs need to operate in a level playing field without having to compete unfairly with subsidized credit from institutions and projects.

- RMF institutions need to have access to national and international public and private investors to expand.

3.4 Security:

Clients who deposit their savings with an MFI need to have security. Therefore, in order to protect depositors, MFIs, which mobilize voluntary saving from general public and whose assets reach a certain size should be required to comply with prudential regulations. Supervisory agent and prudential regulations for large MFIs will be developed and implemented. Capacity of supervisory authority will be strengthened to ensure effective implementation. However, the implementation of prudential regulations should not constrain the emergence of MFIs.

SECTION IV: ACTION PLAN FOR IMPLEMENTATION OF THE REFORM PROGRAM FOR RMF SECTOR IN THE LAO PDR

The action plan to implement the RMF reform consist of three main areas as follows:

1. Build common understanding and consensus on the government's policy and vision in RMF reform. To ensure successful implementation of the government policy, key stakeholders in the sector (policy makers, local authorities, donors, and practitioners) need to be aware of the policy, be consulted on and understand its content.
2. Strengthen existing RMF initiatives and institutions to ensure that the industry will become sustainable and can contribute to poverty reduction. Currently most existing initiatives in the sector do not appear sustainable.
3. Develop enabling legal and policy environment for the establishment and operation of different types of MFIs. Currently, the majority of RMF initiatives are operated by the public agents (APB, LWU and local authorities). This can constrain the industry growth and outreach since the public sector has limited access to human and financial resources. As private MFIs have better access to financial and human capital and can contribute significantly to the growth of the industry, MFIs with private ownership should be allowed to operate.

NOTE: See appendix for the details of the action plan with proposed responsible authorities and expected time frame for each action.

APPENDIX

Table 1: Build common understanding and consensus on the government's vision and policy in RMF reform:

Actions	Organization in charge	2003					2004						2005	
		8	9	10	11	12	1	2	3	4	5	6		
		Disseminate the policy statement, vision and action plan to high level authorities and other key stakeholders (donors, and practitioners) at central level after policy documents are endorsed by PMO.	BOL		■	■	■	■	■	■	■	■	■	■
Organize provincial workshops to sensitize officials at different local-levels on the Policy, Vision and Action Plan for RMF sector.	RMFC				■	■	■							
The mandate of the RMFC, with appropriate budget, will be revised and expanded to be responsible for the oversight and co-ordination of the implementation of the Action Plan.	BOL					■								
In addition to the Policy Statement, Vision and Action Plan, develop strategy and legal framework to support the development of RMF sector	BOL, RMFC ³	■	■	■	■	■								
Organize a high level workshop annually to monitor progress in the implementation of the reform program	BOL, RMFC					■							■	■

³ with FIRST/ADB's TA

Table 2: Strengthen existing RMF initiatives and institutions to ensure that the industry will become more sustainable:

Actions	Organization in charge	2003					2004						2005	
		8	9	10	11	12	1	2	3	4	5	6		
		Reform APB into a market oriented institution and remove interest rate subsidies	MOF, BOL, APB ⁴											
Develop appropriate prudential regulations to supervise APB and large deposit-taking MFIs; the prudential regulations can be implemented in stages, depending on the depth of the industry and size of MFIs.	BOL, RMFC ⁵													
Strengthening the supervisory capacity to prudentially supervise APBs or large deposit taking MFIs.	BOL ⁶													
Disseminate and build awareness of rural and microfinance best practice by organizing nation-wide workshops and seminars for all relevant provincial officials and practitioners. Capacity building or training program on best practices for practitioners and officials.	RMFC ⁷													
Quarterly consultations take place between related government authorities and RMFIs to review progress with the implementation of the Action Plan, constraints and issues encountered in resolution and mutually agreed action for their remedy.	RMFC ⁸													
Encourage the RMF service providers to conduct market survey and organize training on effective use of fund for their clients, this will help to ensure the using of fund in line with the set purposes and to ensure the collection of loan granted.	RMFC ⁹													
Conduct the studies and disseminate their results on different micro finance methodologies and best practices for all related parties (both supply and demand sides) to enhance their understanding and to facilitate their decision making on the options that are better suit to their activity and need.	RMFC, NERI ¹⁰													
Make assessment of large initiatives for their potential as well as the pitfalls that need to be adjusted to ensure their sound operation/being able to use as model for others.	BOL, RMFC, NERI ¹¹													
Coordinate rural and micro finance reform program with SCB restructuring program.	MOF, BOL, RMFC, SCBs													

⁴ with ADB's TA

⁵ with FIRST/ADB's TA

⁶ source of funding is to be determined

⁷ with ADB's TA and other source of funding (CGAP or others)

⁸ with FIRST/ADB's TA

⁹ source of funding is to be determined

¹⁰ with support from Concern Worldwide

¹¹ source of funding is to be determined

Table 3: Prepare an enabling legal and policy environment for the emergence of private MFIs.

Actions	Organization in charge	2003					2004						2005	
		8	9	10	11	12	1	2	3	4	5	6		
		Review existing Lao policy and legal issues and cross-country experiences and best practice to develop appropriate legal instruments (decree, guidelines, regulation, and registration) for Lao RMF sector. The legal framework should allow for autonomy in management by MFIs, the diversity of MFIs both in forms and ownership structures, the transformation of MFI initiatives into institutions. The development of legal framework should be on a consultative approach.	BOL, RMFC ¹²											
Disseminate the legal documents to policy makers, local authorities, donors and practitioners as references for their roles and responsibilities.	BOL, RMFC ¹³													
Promote the effective implementation of such legal instruments, especially on the issue of autonomous management and operation of the RMF institutions, through the close and regular coordinating among all relevant authorities.	BOL, RMFC ¹⁴													

NOTE: Abbreviation

- ADB** : Asian Development Bank
- BOL** : Bank of the Lao PDR
- GOL** : Government of the Lao PDR
- MOF** : Ministry of Finance
- MOJ** : Ministry of Justice
- RMFC** : Rural and Micro Finance Committee
- WB** : World Bank
- RMFI** : Rural and Micro Finance Institution

¹² with FIRST/ADB's TA

¹³ with FIRST/ADB's TA

¹⁴ with FIRST/ADB's TA