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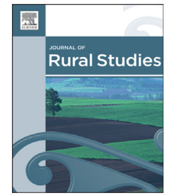

Does microfinance reduce poverty? New evidence from Northeastern Mindanao, the Philippines

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A B S T R A C T

This article focuses on understanding the impact of microfinance on poverty reduction and wellbeing measures of health, education and living standards in Northeastern Mindanao, the Philippines. We employ a mixed method approach involving a survey of 211 microfinance client and non-client households. We find that little over one in five households are multidimensionally poor, with non-client households being poorer than microfinance client households. Our results show that microfinance has had a mildly positive impact on poverty reduction with incomes and savings of microfinance client households being higher than those of non-client households. Based on the impact of microfinance on poverty reduction, we argue that it is important that policymakers implement strategies for promoting and creating greater access to microfinance as this has the capacity to reduce poverty and improve the well-being of the poor and marginalised in the Philippines.

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1. Introduction

Despite growing efforts by the international community to reduce poverty and the achievement of a significant reduction in those living below the poverty line, global images of poverty are still pervasive. Modern-day microfinance began in Bangladesh in the late 1970s through the pioneering efforts of Muhammad Yunus, a Bangladeshi economist and Nobel Laureate. Its objective was to reduce poverty through the provision of small loans to poor women (Yunus, 1999). The concept of the provision of small loans has evolved over the years and now encompasses the delivery of a multitude of financial and non-financial services to the poor. At present, microfinance is still used in policy circles as one of the tools to end poverty that is facing a growing number of the world's population. Using a range of financial instruments, microfinance institutions (MFIs) provide funds in small amounts to those traditionally excluded from formal borrowing. This process of making funds available to alleviate poverty is enacted through entrepreneurial ingenuities.

However, empirical studies examining the impact of microfinance on poverty reduction and lifestyles have drawn mixed conclusions on the effectiveness of microfinance as a poverty reduction tool. Proponents of microfinance point to cases wherein households that engage in microfinance activities increased their incomes, improved their daily life and had social standing. For example, small loans made to enterprises have lifted people out of poverty by raising household incomes and consumption (Dupas and Robinson, 2013; Khandker, 2001; Chen and Snodgrass, 2001; Dunn and Arbuckle, 2001; Wright, 2000; Zaman, 2000; Pitt and Khandker, 1996; Hossain, 1988). Others have found that microfinance has enhanced educational attainment (Pitt and Khandker, 1996) and improved health status (Pitt et al., 1999).

In contrast, opponents of microfinance argue that microfinance does not alleviate poverty. Rather, they claim that microfinance benefits only the 'middle and upper poor', not the 'poorest of the poor' (Banerjee et al., 2010; Kondo et al., 2008; Mosley and Hulme, 1997). Some scholars have found no empirical evidence of increased household income or consumption in the short run, although they have found other potential benefits (for a review, see Duvendack et al., 2011). Some have argued that microfinance was unsuccessful in targeting and reaching those gravely needing assistance in the community (Adjei and Arun, 2009; Kondo et al., 2008; Coleman, 2006; Amin et al., 2003). However, in recent times, some mildly positive results have spawned renewed debates

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among researchers and practitioners (Karlan and Zinman, 2011; Banerjee et al., 2010; Easterly, 2010; Banerjee et al., 2009; Bennett, 2009; Hartford, 2009) and microfinance network organisations (for a review, see Stewart et al., 2010). This welter of conflicting studies highlights the complex nature of assessing the impact of microfinance on household incomes (Copestake, 2002; Hulme and Mosley, 1996; Rogaly, 1996).

The Philippines was one of the earliest adopters of the microfinance model and considered microfinance an important development tool for reducing poverty. In recent times, the volume and outreach of microfinance in the Philippines have grown considerably (Bangko Sentral ng Pilipinas, 2015). However, even with a greater breadth of outreach, MFIs in the Philippines appear to be favouring the 'less poor' over the poorest in society. Indeed, the poorest in the Philippines appear excluded from microfinance programs. Understanding the socioeconomic characteristics of microfinance recipients and their impact on accessing microfinance is critical in formulating effective policies for large-scale poverty reduction in the Philippines. The focus of this study is therefore to examine the impact of microfinance on poverty reduction in Northeastern Mindanao, the Philippines.

This study makes two major contributions to the microfinance literature. First, despite the growing number of empirical studies directed to the topic, the impact of microfinance on the poor is unclear, particularly in the context of the Philippines. To Goldberg (2005), the differences in empirical results stem from the quality and rigour of microfinance evaluations resulting in varying conclusions. This study aims to bridge the knowledge gap by a rigorous analysis of new empirical evidence to assess the impact of microfinance on poverty in the Philippines. Our data indicate that microfinance has had a mildly significant impact in poverty reduction in the Philippines. Second, while a growing number of empirical studies have found that microfinance has led not only to improved access to formal financial services, but to poor households investing in education and health, thereby improving their wellbeing (DeLoach and Lamanna, 2011; Littlefield et al., 2003), no such studies within the context of the Philippines exist. We extend previous work by providing new empirical evidence of the impact of microfinance on lifestyles in the Philippines. Our findings indicate that participation in microfinance improves the incomes and savings of households and this has led to an improvement in health and educational status of microfinance client households.

The rest of the paper is organised as follows. The next section provides an overview of microfinance in the Philippines. Following, we describe the methodology employed in the analyses. Next, we report and discuss the empirical results. Finally, we discuss the implications of the findings and draw some conclusions.

2. Microfinance poverty reduction in the Philippines: an overview

Over the last half-century or so, the Philippines has experienced a boom and bust cycle of economic growth and development (Aldaba, 2002; Asian Development Bank, 2007). Coupled with this has been the failed poverty reduction strategies instigated by various Philippine governments (Albert and Martinez, 2015; Gerson, 1998). One such strategy started after the end of the Second World War. The Philippine government then implemented Direct Credit Programs (DCPs) to provide subsidised credit to target specific sectors of the economy (Bangko Sentral ng Pilipinas, 2014; Vogel and Adams, 1997). Until the early 1980s, DCPs were perceived as effective tools for reducing poverty, boosting domestic production, facilitating investments and correcting perceived flaws in financial markets (Vogel and Adams, 1997). Further, to address market failures in the domestic economy, the Philippine government and donor agencies embraced DCPs as an effective way to reduce poverty (Meyer, 2011). Indeed, in the 1960s, DCPs played a crucial role in stimulating food production (Micu, 2010; Vogel and Llanto, 2005). Consequently, the government followed a supply-led approach to credit delivery, characterised by a huge infusion of institutional credit using cheap government funds directed mostly towards the agricultural sector (Corpuz and Kraft, 2005).

The popularity of DCPs continued in the 1970s when loanable funds were earmarked for the provision of DCPs at highly concessional rates. In addition, rural banks, development banks and government financial institutions extended loans for DCPs, and in some instances even government agencies that did not have the mandate or the capability to implement DCPs were used as channel institutions (Llanto et al., 2005). These actions resulted in the proliferation of DCPs and permeated all development efforts until the early 1980s. The effect has been the displacement of commercial lending and this has impeded the emergence of new private financial institutions (Brooks and Nash, 2002). Furthermore, commercial banks neglected deposit mobilisation as a means to raise capital given the availability of cheap loanable funds (Llanto et al., 2005). During this time too, DCPs experienced massive repayment problems and this led to fund capture by large-scale borrowers resulting in huge losses for the government (Almario et al., 2006).

The mid-1980s saw the collapse of DCPs under the weight of poor repayment rates, low private sector participation and mounting loans of small farmers and other rural borrowers. Consequently, DCPs failed in their objective of reducing poverty and promoting a sustainable rural financial market, as they became an inefficient way of allocating limited government resources to curb poverty (Badiola, 2007). These events culminated in a shift to a market-based credit regime. Recognising that the low-interest rate policy regime had led to market failure and the closure of many rural banks, the Philippine government shifted its policy framework from subsidised credit to reliance on market principles. In the late 1980s, the Philippine government deregulated the financial sector. In particular, it deregulated interest rates, abandoned its restrictive bank entry and branching policies and encouraged the entry of new players into the banking sector (Quinones and Seibel, 2000). This led to an increase in the number of commercial banks and the expansion of branch networks (Lim and Esguerra, 1996). However, despite attempts to spur rural and agricultural credit, the initial financial liberalisation efforts failed to do so. In fact, the transition from a directed credit approach to a market-based paradigm resulted in a decline in agricultural lending by banks (Castillo and Casuga, 1999). Nevertheless, the government remained determined to pursue its financial policy reforms.

The late 1990s saw the institutionalisation of microfinance as a development tool. As part of its reform initiative, the Philippine government institutionalised a market-based credit policy environment. This included the creation of the National Strategy for Microfinance (NSM). The National Credit Council (NCC), in consultation with various stakeholders, drafted the NSM. It envisioned a sustainable microfinance market that would provide micro enterprises with access to financial services. It called for greater private sector role in a market-oriented paradigm, with the government providing an enabling environment. This embodied a new neoliberal paradigm of the private sector-driven market. After the issuance of the NSM, the NCC advocated the enactment of new laws to institutionalise the market-based policies (Micu, 2010). The Philippine Congress supported the market-based paradigm and enacted laws incorporating this policy thrust. For a review, Micu (2010) provides a critical review of the major enabling laws and measures enacted by the Philippine government.

In effect, the Philippine government is pursuing a policy of

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