

The impetus for this study of the role of central banks in microfinance was provided by an interim action plan for microfinance approved by the President of the Asian Development Bank (ADB) in May 1998 (ADB 1998). This action plan proposed that ADB's assistance for microfinance should focus on creating an enabling policy environment, improving financial infrastructure, building the capacity of microfinance institutions (MFIs) and their potential clients, and providing catalytic support in mobilizing resources. Following extensive discussion of the action plan, a microfinance development strategy (ADB 2000a) was approved in June 2000. This study is intended to contribute to the state of knowledge on creating an enabling policy environment and improving financial infrastructure.¹

We believe this present study is the first to focus specifically on the role of central banks in microfinance.² Certainly, it is the first to deal with the subject in regard to the Asia-Pacific region. Central banks have potentially an important role to play in the development of sustainable microfinance and the integration of microfinance into the broader financial sector. However, this role has not previously been examined in a systematic manner. While the study focuses on the Asia-Pacific region, many of the principles are also applicable in other regions.

The purpose of the study is to consult with and examine the role and operations of central banks in microfinance development in twelve developing member countries (DMCs) of ADB, and to make recommendations on the role of central banks in the sustainable development of microfinance. The specific objectives are:

- (i) To document microfinance-related activities of central banks in the selected DMCs, and to assess how they influence the development of microfinance.
- (ii) To examine the role of central banks in the context of the microfinance sector in these DMCs and international best practice in microfinance.
- (iii) To develop country-specific recommendations on the role of central banks in sustainable microfinance development.

The twelve countries in the study were selected to be representative of DMCs in the Asia-Pacific region in general. They include all of the most populous DMCs. Indeed,

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Context of This Study

This study derives from ADB's microfinance strategy which includes:

- commitment to policy reforms essential for the development of microfinance
- support for the development of critical financial infrastructure.

Central banks have a potentially important role to play in both of these efforts.

1 It also builds on previous work by The Foundation for Development Cooperation on the policy and regulatory environment for microfinance in Asia, in particular, a report by McGuire, Conroy, and Thapa (1998).

2 AFRACA, the African Rural and Agricultural Credit Association, has published a set of papers presented at an African regional conference on central banks in rural finance, conducted in Harare in October 1999 (Ruotsi 2000). This included some discussion of microfinance.

Twelve countries were selected, representative of developing member countries of ADB

they include five of the ten most populous countries in the world, namely, People's Republic of China (PRC), India, Indonesia, Pakistan, and Bangladesh. Another four countries from South and Southeast Asia with significant microfinance sectors — Nepal, Philippines, Sri Lanka, and Viet Nam — are also included.

The remaining three countries have much smaller populations. The inclusion of these countries was intended to highlight issues specific to smaller countries and to countries in their regions. For instance, the Papua New Guinea (PNG) and Vanuatu country studies deal with many issues relevant to the role of central banks in microfinance in the Pacific Island countries. Similarly, while the Kyrgyz Republic is the only Central Asian country included in the study, many of the issues raised are also relevant to other Central Asian countries engaged in the transition to market economies.

The country studies have been published in a companion volume.³ Each provides a detailed review and analysis of central bank activities that have a direct and indirect bearing on the development of the microfinance sector in the particular country, including financial and technical support for microfinance, regulation of licensed banks, and regulation of nonbank MFIs. In addition, each makes a number of specific recommendations on the role of the central bank in the development of a sustainable microfinance sector. These country-specific recommendations are offered for consideration by central bankers as well as other policymakers concerned with microfinance and poverty alleviation, in each country. They can be seen as applying the more general principles laid down in this overview to the particular circumstances of each of the twelve countries studied.

A companion volume includes detailed studies and recommendations for each country

This overview of the study performs two main functions. First, it provides a detailed analytical framework, based on theoretical considerations and practical experience, for considering the role of central banks in microfinance (McGuire and Conroy 1999).⁴ In many respects this serves as a benchmark for evaluating the activities currently undertaken by central banks, as identified in the country studies. There is considerable evidence that certain central bank activities have facilitated the development of a sustainable microfinance sector, while others have had a negative impact. At the same time, the country studies highlight the reality that any framework for the role of central banks in microfinance must take account of a range of country-specific factors; the optimal role for a central bank will differ from country to country and from time to time.

Second, it provides a synthesis of the key issues arising out of the country studies. In so doing, it takes a thematic approach rather than a country-by-country approach. It draws together findings from the country studies to highlight common developments and experiences, and provides examples of good (and bad) practice in individual countries. The country studies provide numerous instances of activities that have been either successful or unsuccessful; these examples inform and enrich the analytical framework that is developed in this volume.

This volume presents the analytical framework for the whole study

Following this introduction, chapters 2 and 3 outline various issues that form the background to an understanding of the role of central banks in microfinance. Chapter 2 provides a brief overview of the countries included in the study, and of the development of microfinance in those countries. Chapter 3 focuses on the role and objectives of central banks, making an important distinction between developmental and promotional activities undertaken by central banks, and applying this distinction to the microfinance subsector within the broader financial system.

3 ADB. 2000. *The Role of Central Banks in Microfinance in Asia and the Pacific: Country Studies*. Manila: Asian Development Bank.

4 This analytical framework was presented at an ADB regional seminar on microfinance in September 1999, convened in connection with ADB's microfinance development strategy.

Chapters 4, 5, and 6 provide a comprehensive discussion of the role of central banks in microfinance, both from an analytical perspective and from empirical study of the experiences of the countries in the study. The scope for central banks to support microfinance initiatives through developmental and promotional activities is explored in Chapter 4. Chapter 5 considers how central banks can establish a framework for prudential regulation and supervision of licensed financial institutions that facilitates their engagement in microfinance, while Chapter 6 considers whether there is a role for central banks in the regulation of nonbank MFIs. Finally, Chapter 7 provides some concluding comments.