Draft Policy Brief Arminio Rosic - 1013-FIN-ROS-YU

Scaling Up Microfinance to Increase Access to Financial Services in Serbia

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Based on the research recorded in the paper: "Scaling Up Microfinance to Increase Access to Financial Services in Serbia", a number of recommendations can be devised for the Serbian authorities with the goal of making microfinance accessible to the Serbian general public. Ideally, all the recommendations should be applied cumulatively in order to have the desired impact. In parallel, a recommendation for the donors interested in the Serbian microfinance sector is devised on the end of this paper.

A) Recommendations for the Serbian Authorities

I. Link microfinance to the restructuring of the banking sector

The development of the microfinance sector in Serbia should be linked to the restructuring of the banking sector. The rationale for such an approach is that since the traditional microcredit scene is not already existing, the development of the microfinance sector can start fresh from the beginning, on a healthy ground.

II. Link microfinance to bank downscaling

In connection with the above recommendation, in case of choosing downscaling economically viable commercial banks for microfinance programs, the downscaling process should be done together with introducing microcredits in Serbia. This would include incentives for banks to downscale and specialize in microcredit provision.

III. Involve the same players in bank restructuring and downscaling into scaling-up microfinance

Involve the same players to deal with bank restructuring and downscaling of economically commercial banks with the introduction of microcredits in Serbia. The proposed actors for bank restructuring are the: National Bank of Serbia, the Ministry of Finance, the Agency for Bank Restructuring and similar. The proposed actors for bank downscaling would be KfW and the EBRD.

IV. Amend the Banking Legislation

Microfinance could be regulated through amending the existing banking laws which would create a possibility for the functioning of microfinance providers. The amendments would primarily provide incentives for MFIs to function in the formal financial system, as it is expected that the MFIs will recognize themselves in this legal system.

On the other side, it is also possible to leave space in the Banking Law for a by-law regulation of control and supervision. However, in this case, the supervisory body should be the National Bank of Serbia.

V. Provide Tax Incentives

For this purpose, the Serbian legislator should provide a number of tax incentives for banks issuing microloans. For instance the 20% tax requirement which is dependant on the monthly coefficient of the living cost should be abolished.

All other services provided by FFIs, (opening bank accounts, administrative fees) should be taxed accordingly. However, income generated from the portfolio should have a preferential tax treatment. This way, the microloans would be cheaper and thus more accessible to the Serbian public.

VI. Strengthen the Existing Strategic Partnership between MFIs and FFIs

So far, the provision of microcredits in Serbia is done through a strategic partnership between MFIs and FFIs. As there is worldwide trend is partnering up of MFIs with FFIs, this trend should be continued in Serbia as well, and even more since it has provided positive results so far.

VII. Consider EU Regulations

Take into consideration EU Instructions and Directions of importance for microfinancing. These would primarily be banking regulations, since the EU regulations do not recognize MCOs as they are established in developed and transition countries, and microloans are issued through the banking regulations.

Taking into consideration EU Regulations is also important in view of the foreseen EU membership.

VIII. Consider Basel Capital Accords

In order to scale up microfinance for the purpose of increasing access to financial services, it is important to regulate and supervise microfinance institutions according to rules stated in the Basel 1 and Basel 2 Capital Accords.

This recommendation particularly relates to principles of prudential and safety regulations and requirements. For instance, in order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individual on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.

B) **Recommendations for the Donors**

IX. Use the existing legal framework for microfinance

This survey shows that it is possible to use the existing legal framework for providing microcredits in Serbia. However, as NGOs can not register and get involved into on-lending, donors are pulling out. Donors should become more flexible and consider other structures for operating microloans in the field of formal financial institutions (FFIs). This is supported by the general worldwide trend of scaling-up microfinance into NGOs, regardless of the fact that traditional microfinance has started through NGOs.

In that sense, the Serbian legislation provides a number of FFIs which could serve as micro credit providers: the Savings-Credit Cooperatives, Savings-Credit Organizations, Savings Bans and finally Greenfield microfinance banks.

On the other side, if donors feel that funds aimed for development should not be taxed and therefore do not wish to support FFIs, the counter-argument is that a regulated microfinance market will help more develop Serbia then a parallel NGO microfinance market.

Consequently, if micro-finance in Serbia is scaled-up, no new MCOs should be registered and no specific microfinance legislation should be sought, especially since the previous years show that the process of promulgating specific microfinance regulation in Serbia showed no result. Therefore, it can be expected that the years to come may presumable include the same obstacles and thus using FFIs as a vehicle for microcredit seems like a very reasonable one.