Chemonics International, Inc.
1133 20th Street, NW
Washington, DC 20036
Telephone: (202) 955-3300
Fax: (202) 955-7540

AMIR Program
Access to Microfinance & Improved Implementation of Policy Reform

USAID Contract No. 278-C-00-98-0029-00

Policy Envirnoment Review for Financial Services to Micro and Small Enterprises in Jordan

Submitted to:
United States Agency for International Development

Submitted by:
Chemonics Interntaional Inc.

July 1998

I. Executive Summary

The purpose of this study is to identify existing policy constraints to the expansion of sustainable micro and small enterprise (MSE) finance as an industry in Jordan and to recommend specific changes in the form of a well-supported, prioritized Action Plan for implementation by the Government of Jordan. Considering the current economic situation, and in comparison with other countries that have implemented successful MSE finance programs, Jordan is well-situated to initiate a major microfinance program.

The methodology used for carrying out this study included a review of pertinent documentation and in-depth interviews with government, banking, NGO and other private sector representatives. The consensus of opinion among the interviewed was that the MSE sector is big and growing, and that, overall, the environment for expansion of the sector is positive. Further consensus was that MSE finance programs can proceed within the present framework of major government policies; however, some specific financial policies, and legal and regulatory issues are of concern.

Micro and small finance programs exist in a variety of policy settings. This study first identifies policy constraints that impact enterprise development from a *global perspective*, based on international **best practices** criteria. They are then prioritized and examined to determine their potential negative effect in Jordan. The most debilitating obstacle to MSE programs is financial repression. Fortunately, a significant degree of financial liberalization has already taken place in Jordan over the past six years through the structural reform program. Consequently, USAID and the government have the opportunity to deepen policy reforms to sub-category or *second-generation* constraints.

Policy reform directed specifically at the MSE sector has been undertaken in very few developing countries. Therefore, the objective here is to encourage policy reform that recognizes the special needs of the sector. The **Regulatory and Legal Changes to Improve Micro/Small Financial Services in Jordan** section assumes that the favorable monetary and fiscal policies currently in place will be maintained. The **Recommended Policy Reforms** contained in that same section are listed under three categories: Financial Policies, Regulatory Controls and the Legal Environment.

Finally, the recommended policy reforms are prioritized in the **Action Plan for Policy Reform Implementation by the Government of Jordan.** Constraints are listed on the basis of those that have the *most negative impact* on the development of MSE finance services in Jordan. Specific tasks and a reasonable timeframe to complete them are also included.

In conclusion, the importance of addressing institutional constraints is briefly reviewed. This is, of course, the primary MSE sector work of the AMIR Program. Best practices program design and USAID's essential role in dialogue with the government will greatly influence the long-term success of the program.

II. Introduction

The United States Agency for International Development (USAID) is supporting a project to strengthen access to microfinance and improved implementation of policy reform (AMIR) in Jordan. The goal of the project is to increase economic growth through sustainable microfinance initiatives, to stimulate greater investment and to assist the Jordanian business environment to become more globally competitive. The Microfinance Component of the AMIR Program will provide support for sustainable bank and non-bank financial institutions to provide credit and other financial services to micro and small-scale Jordanian entrepreneurs.

The purpose of this study is to identify existing policy constraints to the expansion of sustainable micro/small finance as an industry in Jordan and to recommend specific changes in the form of a well-supported, prioritized Action Plan for implementation by the Government of Jordan[1]. The challenges to be addressed include an analysis of the legal, regulatory and policy environment in order to make recommendations for changing that environment to be more supportive toward organizations seeking to implement international best practices in sustainable micro/small finance.

III. Background

A. Methodology

The methodology used for carrying out this study commenced with extensive briefings from the AMIR staff and consultations with USAID. A review of pertinent documentation listed in Annex B was undertaken before conducting in-depth interviews with government, banking, NGO and other private sector representatives. Annex C contains the questionnaire used in these interviews and a list of the people interviewed is included in Annex D. Because the only official versions of Jordanian law are in Arabic, AMIR commissioned a Jordanian law firm to review certain laws and regulations prior to the arrival of the consultant for use in this analysis. The final report from the law firm is contained in Annex E.

Based on the findings of the above work, the Action Plan for Policy Reform Implementation by the Government of Jordan is recommended in order to assist the AMIR Program achieve its objective of 25,000 active borrowers by 2002.

B. The Jordanian Economic Situation

Recent studies under the auspices of the AMIR Program, and other current documents discuss the economic situation in Jordan, and, therefore, it is not felt necessary to reiterate that same detailed information. However, the current discussion between the

[1] See Annex A for the Scope of Work

Government of Jordan and the World Bank concerning economic growth rates in 1996 and 1997 is of critical importance to the launching of a major micro/small finance initiative. On June 30th, the World Bank announced a discrepancy between the economic growth indicators reported by the government and those calculated by the World Bank. The Government had reported that economic growth rates in 1996 and 1997 reached 5.2 and 5.3 percent respectively, but World Bank sources say that rates did not exceed one percent in 1996 and 2.5-3.0 percent in 1997[2]. Regardless of the outcome of the follow-on discussions, it is apparent that the macroeconomic environment in Jordan is less positive than thought even at the time that most of the above-mentioned reports were written. That was as recently as May. This situation, coupled with the continuing political problems associated with the peace process and U.S./Iraq confrontations, results in a very conservative atmosphere in the business and banking sectors. Fortunately though, the tough IMF restructuring program undertaken after the severe economic crises in the late 1980s has borne fruit. The past six years have produced overall successful economic reform, which, if maintained, will greatly assist the country in overcoming the current economic slowdown.

C. Policy Environment for Micro and Small Finance Programs

As was pointed out during the Jordan Microfinance Conference held in March, 1997[3], four aspects of the policy environment are, in particular, critical in providing the overall climate in which micro/small finance programs operate.

First, the level of development of the country, and especially its recent growth rates.

Second, the government's ability to maintain a low rate of inflation and stability in foreign exchange rates.

Third, the extent of financial liberalization achieved by the government.

Fourth, the degree that reforms in the regulatory and legal environment have taken place.

Based on the current economic situation, Jordan scores relatively well using these criteria. Recent growth rates are in question; however, inflation is under control at approximately 3-4 percent, foreign exchange rates remain stable, good progress has been made in financial liberalization, and the government appears committed to continue pursuing legislative and regulatory reforms as well as implementing sound investment programs. Therefore, on balance and in comparison with other countries around the

[2] Jordan Times, July 1, 1998
[3] Jordan Micro Finance Conference Report, March 17-19, 1997

world that have implemented successful MSE finance programs under worse conditions, Jordan is well-situated to initiate a major microfinance program effort. Although the objective of this study is to examine the fourth area above, the other three were an integral part of the review and influenced the recommendations of the Action Plan.

D. Institutional Capacity

There are a variety of microcredit initiatives operating in Jordan. These vary from about 50 very small revolving funds managed and owned by local voluntary associations or community associations in close cooperation with the local development agencies, to foreign NGOs such as Save the Children. The outstanding portfolio is approximately JD 25 million serving about 11,000 borrowers. The government-owned Development and Employment Fund is the dominant organization accounting for 62% of the total portfolio and servicing 27% of all borrowers and continues to loan at subsidized rates. These organizations deliver their microfinance programs through a network of branch offices or local centers. Collectively, they have 211 locations to reach their target groups, and about 75 of these locations are in use to deliver micro credit.

As is generally the case, all of these organizations have their strengths and weaknesses. Collectively, their main strengths lie in their outreach potential through 211 centers/branches. Nevertheless, each has in varying degrees weaknesses that constrain their ability to achieve their goals, and many of these programs experience poor repayment and high default rates. Thus, operational efficiency and self-sufficiency strategies are urgent requirements for these networks.

E. The Jordanian Micro/Small Entrepreneur

The current estimate of Jordan's population is 4.3 million residents. Approximately 46% of the population is between the ages of 15 and 59 years old and assumed to be employable; albeit, in the face of a high national unemployment rate. The official unemployment estimate is 19%, but in some areas of the country unemployment reaches 45%. Predominate industries include textiles, cement, mining and food processing. However, at least 80% of existing private businesses have less than ten employees, with most having less than five. These activities fall into the microenterprise or small business sectors and, under a more favorable environment, could be expected to grow and become the largest creators of employment in Jordan.

The recent AMIR Program micro and small-scale enterprise survey[4] contains a detailed description of the characteristics of these enterprises and entrepreneurs. A brief summary of those findings is germane to the analysis undertaken for this report.

[4] The Demand for Microfinancial Services in the Micro and Small Scale Enterprise Sector in Jordan, May 31, 1998

An important distinction is made in the statistics presented in the demand study between the *enterprise survey* and the *potential enterprise survey*. That is, those micro and small entrepreneurs who are already in business and those who are interested in going into business. Existing registered businesses identified in the enterprise survey will be candidates for credit from the AMIR Program. However, a large number of unregistered, potential entrepreneurs also will be required to participate in order to achieve the AMIR Program's objective of 25,000 active borrowers by 2002, since the program calls for more than doubling the current borrower base of 11,000.

The most dynamic MSE sub-sectors consist of garment manufacturing, handicraft production, food processing, wood processing, metal production, general services, hairdressers, restaurants, and the retail and wholesale trade. Official statistics suggest that the population of registered entrepreneurs in these sub-sectors is about 74,000 establishments. The majority of the *enterprise survey* was proprietorships (79%) with less than one fifth (17%) partnerships. The predominance of men in the labor force is evident in the sample with 63% of the entrepreneurs being men and 37% women. It is significant that 74% of the entrepreneurs interviewed in the survey used personal savings for investment capital, with 14% sourcing from family and friends and 10% relying on bank loans. Only a couple reported taking an NGO loan. Important, though, is that 43% of this group are interested in gaining access to new loans.

The *potential enterprise survey* estimates that there are 43,000 potential entrepreneurs in the northern part of Jordan (Amman, Irbid and Zarqa). Although the majority of the respondents are unemployed (68%), most reported that there is another working individual in the family earning JD 195 per month on average. A very positive finding is that over half of the respondents (57%) own their own home, although 46% stated that they did not have any collateral. Additionally, 70% indicated they would seek bank financing or would borrow from NGOs to start their businesses, while only 27% suggested they would resort to family financing. This is almost the reverse of those interviewed in the *enterprise survey*. This is a significant finding since this group will represent a large portion of the demand pool under the AMIR Program.

IV. Policy Reform Framework

A. Global Perspective

In analyzing the constraints to the development of a sustainable MSE industry in Jordan, the term "Policy Constraints" will include regulatory, legal and institutional (formal and informal sectors) constraints. Each of these sub-categories impact MSE programs and helps to determine whether the desired outcomes of the programs are achieved. Collectively, they interact to create the policy environment in which the programs operate. Many different economic policies and regulations influence the performance of private sector enterprises. The following inventory lists those that should be reviewed from a global perspective.

Table 1
Inventory of Policies Affecting Enterprise Growth and Employment

1. Trade Policy
    a. Import Duties
    b. Import Quotas
    c. Export Taxes or Subsidies
    d. Exchange Rates
    e. Foreign Exchange Controls

2. Monetary Policy
    a. Money Supply
    b. Interest Rates
    c. Banking Regulations

3. Fiscal Policy
    a. Government Expenditures
    b. Taxes

4. Labor Policies
    a. Minimum wage laws
    b. Labor Codes Covering Working Conditions, Fringe Benefits, etc.
    c. Social Security
    d. Public Sector Wage Policy

5. Output Prices
    a. Consumer Prices
    b. Producer Prices

6. Direct Regulatory Controls
    a. Enterprise Licensing and Regulations
    b. Monopoly Privileges
    c. Land Allocation and Tenure
    d. Zoning
    e. Health Regulations

Source: Haggblade, Liedholm and Mead, 1986 and 1990.

Most of these economic policies are enacted by national governments in most developing countries; however, the entire framework can be seen as either friendly or unfriendly to business in general. Nearly all governments in developing countries have issued policy statements supporting micro and small enterprises. Nevertheless, the impact of government policies on the MSE sector is far from consistently positive, and many of the policies and regulations favor large businesses[5].

[5] Snodgrass, Donald, “The Economic, Policy and Regulatory Environment”, August, 1996

1. Impact on Micro and Small Enterprise Programs

In an effort to prioritize the above inventory and its impact on the potential success of MSE programs, historical analyses[6] indicate that the most critical policies required for the success of micro/small enterprise programs are those that create favorable financial markets. Rarely have these programs been successful operating under a regime of financial repression. The formal financial sector is most affected by these policies and regulations since it is supervised by the government. Informal sector NGOs generally operate without supervision; however, any effort at sustainability will be adversely affected by the resulting negative market conditions created with poor financial policy reform and implementation. Therefore, along with financial policies, the list of constraints that most affect micro and small enterprises can be prioritized as follows:

Table 2

Prioritized Constraints Affecting Micro/Small Enterprise Lending

1. Financial Policies

   a. Inflation Rate
   b. Deposit and Loan Interest Rates
   c. Reserve Requirements
   d. Exchange Rate
   e. Subsidized Credit

2. Regulatory Controls

   a. Financial Intermediary Regulation and Supervision
   b. Enterprise Licensing and Regulation
   c. Tax Policies

3. Legal Environment

   a. Court System
   b. Labor Laws

2. Institutional Constraints

Financial liberalization and other favorable government policy reforms have succeeded in greatly increasing outreach to micro and small entrepreneurs in many countries over the past decade[7]. Nevertheless, *best practices criteria* indicates that at the

[6] Baydas, Mayada M., Graham, Douglas H., and Valenzuela, Liza, "Commercial Banks in Microfinance: New Actors in the Microfinance World", August, 1997

[7] Christian, Robert Peck, Rhyne, Elisabeth, Vogel, Robert C., "Maximizing the Outreach of Microenterprise Finance: An Analysis of Successful Microfinance Programs", June, 1995. Programs

operational level of the financial intermediary and the micro/small enterprise, other serious obstacles must be overcome within the context of the market structure. These include:

- Lending Practices: Financial intermediaries, specifically commercial banks, must adopt a lending strategy that meets the needs of the low-income borrower.
- Market Demand: Expanded production from micro/small enterprises must be directed towards growing market demand.
- Preparation: Financial intermediaries and potential borrowers must train in order to develop a specialized market within the low-income business culture.
- Savings Mobilization: One of the major challenges for intermediaries is effective savings programs.

B. Programs Outside of Jordan Where Policy Reform is Taking Place

Policy reform directed specifically at the MSE sector has only begun taking place within the past few years. Consequently, even the medium term effects have not been thoroughly evaluated. For the purposes of this study an effort was made to select one formal sector program and one informal sector program. Although "The Rural Philippine Banking System" does not focus on the urban market, it still contains valuable policy reform lessons for encouraging commercial banks to participate in micro/small finance lending. The Honduras "Opportunities and Obstacles for Private Development Organizations" work concentrates on modifications to the Financial Institution System Law in order to expand NGO financial services to microenterprises.

1. The Philippine Rural Banking System[8]

The commercial rural banking system in the Philippines has a presence in 75% of all cities in the country with the objective of bringing loan and deposit services to predominately poor households and microentrepreneurs[9]. Many of the larger, regional cities are commercial centers and, in that respect, could qualify as urban markets (much like Irbid and Zarqa). Rural commercial banking began in the Philippines in 1952, and at the time of the study there were 1,274 outlets operating. The system had survived more than three decades of unfriendly government policies, but only a small percentage of the units were operationally efficient. The financial reform process started in the early 1980s, and the Rural Banking Act was revised in 1992. Among numerous reforms, the revised act:

---

analyzed were in Bangladesh, Bolivia, Colombia, Costa Rica, Dominican Republic, Indonesia, Kenya, Niger and Senegal.

[8] This review was conducted prior to the current Asian economic crises.

[9] Agabin, Meliza and Daly, Jorge L., "An Alternative Approach to Rural Financial Intermediation: The Philippine Experience", May, 1996

a. Liberalized interest rates.
b. Lifted the ban on licensing new banks.
c. Removed bank monopoly/franchise rights.
d. Increased the Central Bank's minimum paid-up capital requirement for banks.

As a result, the banking system has shown signs of increasing strength and vitality. Nevertheless, further policy reforms are required to address existing inefficiencies in order to sustain the growth process. Such inefficiencies include:

a. Laws that mandate banks to allocate credit to specific sectors.
b. Cheap rediscount credit lines from the Central Bank.
c. Overly generous tax breaks.
d. Non-competitive deposit mobilization instruments.
e. Government participation in private bank capitalization.

The lesson from this brief overview is that policy reform is a continuing process that should deepen as positive results from each stage of market liberalization is verified. An interesting scenario has evolved in the Philippines wherein the largest commercial banks are increasingly interested in exploiting business that services the MSE sector and in introducing new banking procedures to reduce transaction costs.

2. Honduras: Private Development Organizations (PVOs)

There are a large number of PVOs (very similar to an NGO organization) in Honduras that offer support to the micro and small-scale enterprise sector. Most use local branches to serve their client base. Some have developed adequate lending methodologies to meet the needs of microentrepreneurs, such as group guarantees, small and scalable loan size, rapid disbursement and simple procedures. Approximately 40% of the participants in these programs are women.

Most of these organizations had implemented credit programs that were financially unsustainable. However, in 1997 The Interamerican Development Bank (BID) carried out a diagnostic study[10] of the PVOs and made policy reform recommendations concerning the potential transformation of two viable PVOs into formal sector financial intermediaries.

The main constraints identified were:

a. No legal personality.
b. No regulatory framework for PVO credit programs.
c. The lack of legal personality impedes these institutions from capturing deposits and having access to commercial sources of financing, such as rediscounts from the Central Bank, commercial loans and issuance of bonds.

[10] Chemonics International Inc., "Diagnostico de Servicios Financieros para la Microempresa y Recommendaciones para un Programa de Apoyo", April, 1997

d. The Usury Law contributes to non-profitable credit operations.
e. The Central Bank classifies bank loan portfolios according to the amount of collateral supporting each loan.

After this review, the BID recommended the following policy reforms to the Government of Honduras:

a. Modify the Financial System Institutions Law to permit the transformation of PVO organizations to formal financial intermediaries. This reform includes detailed regulations for registration and supervision.
b. Modify the Usury Law to allow interest rates that reflect all of the costs incurred in approving a loan.
c. Modify the Central Bank Law to reduce the reserve requirements imposed on financial intermediaries.

These interventions were recommended as necessary actions to expand financial services to Honduran micro/small enterprises. It is important to note that these reforms will only affect PVOs qualified to become formal sector financial intermediaries. Those informal sector organizations operating unsustainable credit programs will remain unregistered, unsupervised and unable to access formal sector funding.

V. Constraints to Expanding the Availability of, and Access to, Micro/Small Finance Services in Jordan

A. <u>Questionnaire Results</u>

As mentioned earlier, in-depth interviews were undertaken with public and private sector representatives in order to ascertain their opinions concerning constraints to MSE development in Jordan. Table 2 contains a summary of the Annex III interview questionnaire and the consensus of opinion from those discussions.

Table 3

Question	Consensus of Opinion
1. How do you view the current economic situation and the potential for micro/small enterprise growth in Jordan?	The political and economic situations are very difficult and much depends on the peace process. Therefore, forces outside of our control affect many of these problems. The micro/small enterprise sector is big and growing. Overall, the environment for expansion of this sector is positive. Bank activity is down and there is interest by formal and informal financial intermediaries to provide new or additional services to this sector.

2. What are the major constraints to micro/small enterprise growth in Jordan?	The major constraints are finance and training. There is suppressed demand for credit; however, both the financial institutions and micro/small clients must be prepared to do business.
3. What are the specific constraints to micro/small enterprise growth in Jordan? - Government issues - Legal issues - Private sector issues: Banking practices NGO practices	Government issues: - The consensus is that micro/small enterprise finance programs can proceed within the present framework of major government policies. However, some specific issues such as subsidized credit, the legal system, loan pricing, transaction fees, credit bureaus and others are of concern. Legal issues: - Among others, collateral on movable assets and the judicial system for claims. Banking practices: - Lending criteria and administrative costs. - Perception of risk in the MSE market. NGO practices: - Legal authority. - Lending methodology. - Judicial system for claims. - Cultural/religious bias.

B. Constraints/Impact Analysis

Constraints to expanding the availability of, and access to, micro/small finance services in Jordan are presented below. Table 2 lists the major constraints to be addressed from a *global perspective.* They are prioritized on the basis of importance to the development of a successful MSE finance program, and each sub-category is examined below to determine its potential negative effect in Jordan. The term **policy impact** is used to denote those considered having a **negative impact** on the development of a MSE industry.

1. Financial Policies

a. Inflation: The inflation rate is approximately 3-4 percent. This manageable level does not pose a major policy constraint for MSE development at this time. Nevertheless, this indicator must be closely monitored since it has the single most deleterious effect on MSE lending.

b. Deposit and Loan Interest Rates: Interest rates have been liberalized by the government. However, it is reported that the highest nominal rate at present is 16%, and the Central Bank would prefer lower interest rates in the market. Deposit rates have already declined due to lower rates offered on certificates of deposit auctioned by the government. This pressure to lower rates is not considered overly repressive as long as inflation stays under control.

c. Reserve Requirements: The current cash reserve requirement on deposits is 14%. This amount is not considered a potential impediment for commercial banks implementing a micro/small enterprise program. For example, successful MSE lending has been accomplished elsewhere with reserve requirements ranging from three percent to 35 %. Obviously, the lower the requirement, the more deposit base available for on-lending.

d. Exchange Rate: The Jordanian dinar has remained stable with the elimination of foreign exchange controls, even though the currency has been supported by high foreign assistance levels and debt forgiveness[11]. A decision to devalue will aggravate inflation and adversely impact the MSE sector.

e. Subsidized Credit: Subsidized credit on the part of the Development and Employment Fund (DEF) and the Industrial Development Bank (IDB) is a major policy concern.

1. DEF: The DEF was established in 1989 and initially housed in the IDB. Its funding came from contributions by the Government of Jordan, Kfw of Germany and the European Union. These funding lines carry no preconditions for on-lending, only that funds be lent according to the by-laws of the DEF. Until 1992 funding was channeled through NGO-type intermediaries with grants and interest free loans. However, due to poor performance and at the insistence of the World Bank it became an autonomous institution in 1993. The incorporating 1992 Law No. 33 states that the DEF will "provide directly or indirectly, *with soft conditions,* the necessary funding for the beneficiary, individuals, families and groups."

At that point a direct lending window was opened. The government and The World Bank agreed that the direct lending interest rate would be fixed at 6.5 percent. That same 6.5 percent direct lending rate remains in effect today with market rates at 14-16%, apparently to meet the requirement that funds be lent *with soft conditions.* Lending to NGOs and Voluntary Societies are interest free with a two-year grace period.

There is considerable pressure from the World Bank, which is working with the government, to change these policies. Reportedly, a plan to do so is under discussion. Interestingly, DEF representatives stated that they are most anxious to work with

[11] USAID/Jordan, Strategic Overview, 1997-2001, February, 1998

commercial banks to expand credit to the MSE sector, but that the institution can only lend at the fixed on-lending rate to the borrower of 6.5 percent. Again, this is apparently in response to the social charter of the DEF.

The Government of Jordan contributions are indefinite, with a commitment of about JD 4.0 million per year. The Kfw committed JD 7.0 million, which has been fully disbursed, and the EU provided JD 4.0 million, which has not been fully disbursed but is internally allocated for future disbursement. The average loan size of the direct lending program is JD 5,000. Due to monitoring problems, the DEF cannot confirm the average loan size through its intermediaries; however, it is assumed to be in the JD 500 to JD 2,500 range.

2. IDB: The IDB was established in 1965. It does not operate under the Banking Law, but its own IDB Law and has to comply with the prudential banking standards of the Central Bank. Year-end 1997 it had assets of JD 143.5 million, with an outstanding loan portfolio of about JD 125.0 million.

Its general loan portfolio includes medium and long-term loans, equity investments, and guarantees for industrial development. However, the bank has managed a Small Scale Industries and Handicrafts (SSIH) program since 1975. The objective of this program is to create jobs and alleviate poverty. Funds come through the Central Bank as soft loans from a variety of donors such as Kfw and Arab development funds. The IDB pays an average of 6.5 percent on these loans to the Central Bank.

Discussions with IDB management revealed that the bank meets its social objective by taking the initial risk in providing financing to small businesses in order to graduate these enterprises to the commercial bank sector. This is currently pursued by offering rates of 11.5% for working capital and 11% for fixed assets on loans over JD 10,000, and 9 percent for borrowers qualifying under the SSIH program. The average SSIH loan size is JD 7,000.

Policy Impact: The major policy concern here is that the Government of Jordan continues to support subsidized lending for micro and small enterprises through the DEF and the IDB without any indication of changing those policies. The case of the DEF is particularly worrisome since its subsidized lending programs will offer direct competition to any new programs established through commercial banks or NGOs using market rates. The case of the IDB appears less serious since its average loan size is JD 7,000; however, its subsidized interest rates still cause a distortion in the market.

2. Regulatory Controls

a. Financial Intermediary Regulation and Supervision: Over the past few years Jordan's financial markets underwent a transformation through the introduction of a number of legislative measures to liberalize, strengthen and consolidate the capital and banking markets[12]. The Central Bank has let market forces determine the levels of deposit and lending rates, although it can influence both through market operations. The Central Bank will take corrective action only if it determines that a bank's lending rates are substantially off-market. Supervision has strengthened, and financial institutions closely follow Central Bank regulations and directives.

Even with this admirable record in financial liberalization, certain government policies still constrain financial intermediary expansion and competition. They include:

1. Security on Movable Assets: For the most part, banks in Jordan only accept real estate and personal guarantees as collateral for loans[13]. Only loans for automobiles use the asset as collateral. Inventory, accounts receivable, industrial equipment or livestock are not accepted. This is because current Jordanian laws do not provide adequate legal remedy whereby banks can use movable assets as security for loans.

Policy Impact: Under existing conditions it is difficult for anyone without real estate to finance the purchase of equipment, inventory or livestock. This restricts lending by banks to micro and small enterprises, commercial and trade businesses, and leads to unnecessarily high interest rates.

2. Non-Governmental Organizations (NGOs): Foreign and local NGOs are registered through the Ministry of Social Development. There are two types of organizations that can be established, both on a non-profit basis. One is a charitable association to offer social services, and the other is a social organization that provides training and other general services. Special laws or Royal Decrees establish some NGOs. NGOs are not authorized by law to provide financial services.

Policy Impact: NGOs are currently providing financial services without the legal authority to do so. Although this practice may be overlooked by the government at the present time, it will eventually stifle any NGO's expansion plans beyond what is possible from limited donor funds. To do this they must transform themselves from donor-driven programs into formal financial institutions.

3. Reserve for Bad Debts: Central Bank regulations require banks to allocate reserves in stages to cover any unpaid loans. When such delinquencies exceed 180 days, the bank is required to stop accruing interest on the loan and allocate 100% of the value of the loan to a reserve account. However, this requirement applies only to uncollateralized loans.

[12] Backer, Patrice, Institutional Analysis of Commercial Banks Involved in CHF's South Jordan Access to Credit Program, May, 1998
[13] See Annex V, Ali Sharif Zu'bi & Sharif Ali Zu'Bi Law Office, A Review of The Laws and Regulations Related to the Provision of Financial Services to Small and Micro Enterprises in Jordan, June, 1998

Policy Impact: This regulation relieves banks from considering uncollateralized loans and encourages them to require full collateral in order to be exempted from the potential reserve requirement.

4: Credit Bureaus: There is no credit bureau information available for loans under JD 30,000, and even at that level the data is not considered by banks to be completely reliable.

Policy Impact: Banks cannot accurately evaluate the creditworthiness of a new client. Consequently, most banks only lend to customers they know or require loans be fully collateralized.

5. Loan Origination Fees: This is a subject of confusion in the market. Commercial banks state that government regulations prohibit banks from charging more than a one percent loan origination fee. The Central Bank insists that there is no ceiling and that banks are free to charge whatever they want in a competitive market. It appears that banks do limit their loan origination fee (or commission fees) on loans to one percent based on historical practice. Before liberalization policies were implemented there was a cap on commission fees, and in an effort to project a less capitalistic image banks still maintain the practice.

Policy Impact: This practice restrains the banks' ability to structure higher-yielding products.

6. Othmani Murabaha Law: Current Central Bank regulations implement this law. The law restricts banks from structuring loans where total interest payments will exceed the value of the loan principle.

Policy Impact: Under this regulation banks are unable to make long-term loans at market rates.

7. Islamic Banking Products: Commercial banks must obtain a special Islamic banking license in order to offer these products to their clients. In turn, Islamic banks cannot offer traditional commercial bank lending. This lending practice was established in response to adverse religious views concerning the charging of interest on loans. However, to overcome this impediment an Islamic bank will, for example, approve a business loan and at the end of the year share in the profit of the business, rather than charging interest on the loan.

Policy Impact: Discussions with two Islamic banks suggest that in many cases small entrepreneurs prefer Islamic lending procedures. Commercial banks indicate that the ability to offer Islamic loan products to MSE borrowers could make some transactions easier for both the bank and the borrower.

8. Foreign Banks: The Central Bank is flexible in issuing a license to a foreign bank to establish a branch. The minimum capital requirement for local banks has increased over the past few years to JD 20 million, and the larger banks are in the JD 30 to 40 million range. The capital requirement for the establishment of a foreign bank branch is JD 10 million. This amount is lower since the government would have recourse to the foreign corporate headquarters in the case of a problem. The Central Bank must consider whether the foreign bank would provide unfair competition and through this mechanism seeks to avoid overbanking the market. With the current restructuring and consolidation of some local banks, this policy seems rational. Furthermore, it appears that the current domestic market does not offer enough incentive for foreign bank entry. Therefore, at least for the time being, there appears to be no negative impact from this policy.

9. Encouragement of Investment Law: This law was promulgated in 1995 to encourage local and foreign investment through an improved investment climate. The law offers investment incentives to projects in certain sectors, including industry, agriculture, hotels and others; however, there are no incentives to help establish a micro/small business industry.

Policy Impact: Formal financial institutions will have difficulty considering MSE lending without some incentives from the government. For example, the Investment Law does not lower or exempt **stamp fees** collected on MSE transactions. These fees are set at .03% on each agreement, guarantee and other legal documents in connection with all transactions that exceed JD 100. Therefore, the total amount of stamp fees could be an obstacle for banks to provide micro and small size loans.

b. Enterprise Licensing and Regulations: Discussions with the Ministry and Trade and Industry and small enterprise owners confirm that the business registration process was streamlined with the new Law No. 22, which was enacted in 1997. All new companies must register at three levels: the Ministry of Trade and Industry, either the Chamber of Commerce or Industry and at the municipal level. Actually, the applicant need only sign the forms in the Companies Department of the Ministry and a local lawyer can then certify and file them with the government. The registration fee is JD 3 per JD 1,000 in company capital. Registering with the appropriate Chamber is a formality.

Registering with the municipality is more difficult and time-consuming, and the business cannot legally operate until it has its municipal license. Several departments must approve the application in order to satisfy health, safety and zoning requirements.

Policy Impact: It appears that the licensing process at the municipal level can be erratic, lengthy and sometimes costly, depending on the permits required. For example, one small business borrower stated that the municipality wanted to charge her JD 25,000 to allow six parking spaces in front of her restaurant. She would not pay and after long negotiations the fee was reduced to JD 400.

c. Tax Policies: Many micro and small entrepreneurs currently operate in the informal sector and pay no taxes. Business registration is required for formal financial borrowing, and, consequently, these businesses would not be able to further circumvent the taxation system. Hence, the subject of reasonable tax rates was investigated. Discussions revealed that the amended Tax Law of 1997 increased the amount allowed for deductions for the head of household and other family members. Based on the new taxation formula, a family of five (below the national average) pays no income tax on annual earnings of JD 6,000, just with family deductions. Other deductions such as rent and medical bills result in further decreases to taxable income. Therefore, an annual total income of up to JD 10,000 most likely will not be taxed, and this income level is considerable for most micro and small entrepreneurs in the market.

3. Legal Environment

a. Court System: Enforcement of claims made by formal and informal financial intermediaries against micro and small enterprise borrowers can take from two to four years before a final judgment is rendered. Legal proceedings can advance through an appeal system from Magistrate (Small Claims) Courts to the Court of Appeal to the Court of Cassation (Supreme Court). The Supplementary Execution Law of 1965 provides creditors with the right to prosecute small claims through the Execution Office in the Ministry of Trade and Industry. However, at that level the borrower has the right to deny the existence of the debt and the case then enters the court system.

Lending banks cannot recover more than JD 500 in attorneys fees incurred in the process of prosecuting the bank's claim. Even when a settlement is reached in favor of the bank, the borrower can propose a settlement of very low monthly payments (JD 20 or 30), which the court usually accepts.

Court fees can also add up quickly. According to the size of the claim, pursuing a claim at three different trial levels can cost hundreds or thousands of dinars in court fees.

Policy Impact: It is evident that the court system in Jordan is a serious impediment to the growth of the MSE finance industry. The length of the court settlement process is never less than 24 months, the bank's attorney fees will always be more than the amount granted by the court and court fees add further expense. Thus, with these obstacles banks are reluctant to provide financing to micro and small enterprises.

b. Labor Laws: "The Labour Law No. 8 for the year 1996" defines employers' and employees' rights. Review by local legal counsel determined that the law is equitable for both parties, and, overall, it is not a constraint to MSE development. Nevertheless, isolated cases sometime surface that require special attention. Such is the instance of fraud vs. libel.

In a case where the employer terminates an employee for fraudulent actions, under the Labour Law the employee may challenge his termination in court. The employer then must prove that the employee committed such actions. Based on the evidence submitted by both parties, the court will rule for dismissal or rightful compensation to the employee.

The employee may also file a criminal case against the employer for slander and defamation of character. The employer can then file a criminal case against the employee for breach of trust, which is a criminal offense. Again, based on the evidence, a ruling is made.

From this legal review, it appears that the burden of proof and sufficient legal protection exist equitably for both parties. Bonding of employees working directly with financial assets could possibly address the problem; however, this type of legal problem seems rare and is not considered a serious constraint to the development of MSE finance programs.

4. Institutional Constraints

Although outside the general framework of governmental regulatory and legal constraints, overcoming institutional and market obstacles is a key ingredient to the long-term sustainability of MSE financing. Rather than identifying these constraints as having a **negative policy impact** at the governmental level, they are classified as **operational issues** that should be addressed as part of program design. The most critical are:

a. Lending Practices: Both formal and informal institutions will have to dramatically change their lending methodologies and financial products in order to operate on a self-sufficient basis. Formal and informal sector intermediaries view their constraints differently.

1. Commercial Banks: The critical issue with commercial banks is collateral; second is the high administrative costs for small loans. It comes as no surprise that their initial reaction was that they would expect to have 90% of their risks covered through personal collateral or guarantees. Several categorically stated that no loans would be approved for clients they do not know if no collateral is available. During our discussions, it was apparent the banks have little or no familiarity with microbusiness lending methodologies or best practices terminology. Also, the image of the micro/small entrepreneur is not favorable in that most banks expect that such loans would not be used for their intended purpose.

2. NGOs: In most cases NGOs are already making uncollateralized loans to microentrepreneurs through group lending mechanisms. Others require promissory notes, bank checks or some type of family collateral. One NGO stated that its lending operations are seriously hampered in rural areas by overt religious bias because most of its loan recipients are women. Whatever the constraint, virtually all of these programs would have to be restructured in order to achieve long-term self-sufficiency. The DEF even admits that its image among micro/small entrepreneurs is one of an institution that does not require repayment of loans.

Operational Issue: The Jordan Loan Guarantee Corporation. Many MSE finance programs have begun initial operations with the assistance of guarantees or insurance on their loan funds. As programs demonstrate their capacity to perform profitably, operations then continue on an unsecured basis. Some of the newer programs that have achieved efficiency have quickly implemented this methodology[14]. The JLGC appears to be an underutilized institution that is eager to play a major role in any new MSE finance program. This is an important issue to be considered in program design.

b. Market Demand: The structure of markets is a crucial aspect of MSE finance that is most times not well studied. For example, a common observation was reported by lenders questioning just how much embroidery can be marketed from rural areas or how many groceries can survive in one neighborhood. It is human nature to copy apparent success rather than try something new. However, any micro/small enterprise that sells its product or service in a competitive market should be small enough in relation to the market to avoid oversupply and a resulting decrease in price. This supply/demand principle seems simple, but credit programs often founder due to overconcentration of funding in the same sector.

Operational Issue: The basis for most MSE finance programs is that a lack of credit is *the* major problem for the sector. However, credit is also debt. In the rush to meet program objectives, financial intermediaries must also take care to understand the debt/credit issue. Burdening micro and small entrepreneurs with unnecessary debt in the face of unfavorable market conditions can quickly result in a negative public perception of the program.

c. Preparation: Both of the operational constraints outlined above must be effectively addressed with technical assistance and training for the lender and the client. Continued support for widespread transfer of knowledge and technology will provide the foundation for the long-term success of the programs.

Operational Issues: Within the institutions operational preparation must begin with the commitment at the highest levels of management to make MSE finance programs work successfully. Staff training, remuneration and incentives should at least be equal to that received by the existing corporate staff. One bank stated that one and one-half percent of its administrative budget is allocated for staff training. Therefore, *additional* funds will be required to establish microlending methodologies and to meet the training needs associated with a new lending program and different products.

Preparation of the client to take on the responsibility of incurring and repaying debt is one of the most important elements of the MSE lending cycle. Management skills

[14] Christian, Robert Peck, et al

training, networking, entrepreneurship training and business advisory services are some of the approaches used at the MSE level. This effort will require long-term funding in order to reap the rewards of program self-sustainability, and should be further investigated during program design. The U.S. Small Business Administration was often described by those interviewed as the best model to study.

d. Savings Mobilization: Taking deposits from clients immediately surfaces the specter of governmental regulation. Nevertheless, deposits potentially provide the most important source of funds for MSE lending. Most micro and small entrepreneurs already save at home in order to meet the family's cash demands. Offering clients security, liquidity and better returns on their savings will be the key elements of a savings program.

Operational Issue: Only financial institutions regulated by the Central Bank can take deposits. However, informal sector financial intermediaries can still induce clients to save, for example, through conveniently located commercial banks involved in the program. This issue requires further investigation in relation to the cultural expectations of the clients, and the capability of the lending institution to promote and manage deposit services. Even longer-term it will be necessary for the government to restrict savings accounts only to those institutions meeting stringent management criteria.

C. Program Coordination

Clearly, any new micro/small enterprise program must be closely coordinated among the Government of Jordan, the International Finance Corporation (IFC) and USAID, who are the major players. A brief review of the current situation is as follows:

1. The Ministry of Planning: The Small and Micro Enterprise Unit, which is a component of the Social Productivity Program, has major plans over the medium term to enhance the growth of the MSE sector. A major government study in 1996 made the recommendation to establish the unit. The four objectives of the unit's work include:

a. Provide technical assistance to support the development of NGOs.
b. Develop commercial bank capacity to provide small finance lending.
c. Develop business support services for micro/small entrepreneurs.
d. Modify the policy and legal framework to facilitate the growth of the sector.

2. International Finance Corporation: The IFC is discussing with commercial banks the viability of undertaking a project for micro and small business finance. The general scope of the program is to invest matching funds with the banks and to share the risk according to a negotiated percentage. Technical assistance will also be part of the package in order to assist the banks with their training needs, hardware/software requirements and to establish procedures for the lending program.

3. Cooperative Housing Fund: In late 1997 the CHF South Jordan Access to Credit Program was approved by USAID, which includes approximately $4.0 million in loan funds and $3.0 million in technical assistance. MSE loan funds will be disbursed through commercial banks with CHF contributing 80% of the capital and assuming 80% of the portfolio risk.

Operational Issues: The potential exists for competition rather than collaboration between USAID and IFC programs. This should obviously be avoided through close coordination, particularly concerning the crucial element of risk sharing between international agencies and financial intermediaries. The CHF program has set a precedent in the minds of some bankers that should be quickly dispelled if a more equitable sharing of lending risks is anticipated under new programs.

VI. Regulatory and Legal Changes to Improve Micro/Small Financial Services in Jordan

A. Best Practices Criteria

Micro and small enterprise finance programs exist in a variety of policy settings. An effort has been made in this study to present a top-down approach to identify the most critical policy constraints to the development of this industry in Jordan, and to encompass best practices criteria from successful programs around the world. The most debilitating obstacle to these programs is financial repression. Fortunately, the extent of financial liberalization that has already taken place in Jordan offers a favorable environment to launch a major MSE finance program.

Consequently, USAID and the AMIR Program have the opportunity to deepen policy reforms to sub-category or *second-generation* constraints. Policy reform directed specifically at the MSE sector has been undertaken in very few developing countries. Government policies are almost invariably enacted with other objectives in mind, and many times the impact on micro and small enterprises is negative. The objective then is to encourage policy reform that recognizes the special needs of the sector.

B. Recommended Policy Reforms

Recommendations for policy reforms will follow the sequence of constraints identified in **Section IV, B. Constraints/Impact Analysis**. It is assumed that the favorable monetary and fiscal policies currently in place will be maintained, and only those factors considered having a **negative policy impact** will be further discussed.

1. Financial Policies: Subsidized Credit

a. The Development Employment Fund: The DEF is the largest player in the field of microfinance in Jordan. This status unfortunately allows its subsidized lending rates to distort the market for any program with the objective of self-sufficiency. Under its present mandate, the institution is not viable. An effort to change the culture and orientation of the DEF through internal reorganization would probably not be successful.

Recommendation: The DEF should be completely restructured or possibly closed as is being discussed with the World Bank. A team of government-recruited regulators should have complete authority to vigorously collect arrears on loans in the shortest time possible. All outstanding loans would remain open until completely paid. In the case of closing, the resulting capital base would be transferred to other productive programs.

b. The Industrial Development Bank: Although the IDB also lends at subsidized rates, its threat does not match that of the DEF. It mostly acts as a business-managed social fund, particularly with its lending program to municipalities and voluntary organizations for social development projects. The JD 7,000 average loan size under its Small-Scale Industries and Handicrafts program in most cases would not compete with any new MSE lending program.

Recommendation: The SSIH program does not cover its operational costs. Continued policy dialogue with the government should stress the need for the IDB to move toward market rates in order to cover its costs of lending.

2. Regulatory Controls:

a. Financial Intermediary Regulation and Supervision

1. Security on Movable Assets: In order to help mitigate formal sector lenders' requirements for fixed asset collateral, a "Security Interests in Movable Property Law" has been drafted and submitted to the government for comments. This new law would allow banks to take equipment and other tangible movable assets as collateral for loans and to repossess the asset in case of nonpayment of the debt. This process is referred to as the "registration and self-remedy enforcement system." Currently, under the Jordanian Civil Code and Commercial Code, such claims have to proceed through the court system. The proposed "system" would work as follows:

> A registry system would be established in the Ministry of Industry and Trade where lenders would register all movable assets taken as collateral. In case of default by the borrower, the lender could request the Execution Office in the Ministry to seize the collateral for further disposition by the lender.

This may seem like a normal business procedure; however, bypassing the dreadful court system described earlier to enforce claims on movable assets has never been an option. Consequently, formal sector lenders rarely accept them as collateral.

Recommendation: The "Security Interests in Movable Property Law" should be promulgated as soon as possible. Local banks are reluctant to quickly change lending practices, and getting this law on the books will offer substance to the argument for them to do so.

2. Non-Governmental Organizations (NGOs): The role of NGOs in microlending has grown exponentially in the developing world over the years as the demand for microcredit increased. Unfortunately, the vast majority of these programs do not operate on self-sufficiency basis. This is also the case in Jordan, where NGOs do not even have the legal authority to lend money. Still, successful programs will strive to expand their outreach and to provide more complete financial services to their clients. To do this, they must transform themselves from an informal institution to one that is recognized as a formal sector credit-driven intermediary. Depending on its capabilities, ultimately, the institution should be able to transform itself into a full-fledged financial intermediary based on locally mobilized savings. In most cases, this process can take from five to seven years.

The current Charitable and Social Associations Law No. 33 of 1966 does not allow NGOs to provide financial assistance to micro and small enterprises. However, the Banks Law No. 24 of 1971 allows "special institutions" to provide financial services with the approval of the Central Bank. Moreover, nothing in the Banks Law would prohibit NGOs from registering as a special institution that does not take deposits as long as it meets strenuous application requirements.

Recommendation: Procedures for the "transformation process" allowing a NGO to become a special institution under the Banks Law should be issued by the Central Bank.

3. Reserve for Bad Debts: The present Central Bank policy to classify uncollateralized loans as bad debts after 180 days of deficient payment encourages banks to only make fully collateralized loans. This is clearly a disincentive for any MSE finance program. Moving banks toward unguaranteed or partially guaranteed loans will be a laborious challenge, and this creates additional rationale for the rapid approval and utilization of the proposed "Security Interests in Movable Property Law."

Recommendation: Government approval of the 'Security Interests in Movable Property Law."

4. Credit Bureaus: Credit information, albeit inadequate, is only available for loan applications over JD 30,000. Thus, banks cannot accurately evaluate the credit standing of new customers, and, especially for micro/small borrowers, will either refuse to extend the loan or call for full collateral. NGOs state that they have the same problem. Their micro borrowers may have an account with more than one informal intermediary without their knowledge.

Recommendation: Without a centralized data base efforts to expand the outreach to micro and small entrepreneurs will be hampered. All Jordanian citizens have a national I.D. number, which could be used as the basis for one or more data bases accessible to lending institutions. It is recommended that establishing a Credit Bureau be added to the Management Information System component of the USAID micro/small enterprise program. The Jordan Loan Guarantee Corporation has built a client data base that may be helpful in the initial development stage.

5. **Loan Origination Fees:** Central Bank regulations do not require banks to maintain a cap on loan origination fees. Although there may be some cultural resistance, increasing this profit margin will be important in competitively pricing products for micro and small enterprise lending.

Recommendation: On this issue, the Central Bank should clearly state its floating rate policy to financial intermediary institutions, specifically with respect to micro and small enterprise lending.

6. **Othmani Murabaha Law:** Although most MSE loans will be short term, interest on the loans will still equal the amount of the loan principal in a very short period. This regulation also restricts the development of a mortgage market since short-term mortgages would be too expensive for the majority of borrowers.

Recommendation: Banks indicate that discussions are already underway to eliminate this regulation. By extension, it is recommended that USAID require such action as a necessary policy reform for its micro and small finance program.

7. **Islamic Banking Practices:** This appears to be an issue well worth further policy dialogue with the government and banks. Islamic banks state that successful Islamic lending for micro and small enterprises is taking place in Sudan in connection with United Nations-supported training schools. Commercial banks indicate a willingness to consider Islamic lending as an incentive to bridge the cultural gap with MSE borrowers.

Recommendation: Establish a dialogue with the Central Bank and commercial bankers to develop a policy for using Islamic lending mechanisms for MSE borrowers. Encourage Islamic lending institutions to expand their lending to micro and small entrepreneurs.

8. **Encouragement of Investment Law:** The Small and Micro Enterprise Unit within the Ministry of Planning has as one of its program objectives over the next two to three years to develop a "Special Promotion Law for Micro and Small Enterprises." During the interim, effort should be made to modify the Investment Law to allow certain incentives for MSE lending. Since stamp fees are a common complaint from all borrowers, this regulation is a good place to start.

Recommendation: Exempt the collection of stamp fees on all loans categorized as for micro and small enterprises. A clear definition of such loans will have to be provided by the Central Bank.

b. Enterprise Licensing and Regulations: The most difficult licensing impediment to MSE development is at the municipal level. Notwithstanding the importance of zoning, health, safety and other requirements, there is generally financial and bureaucratic harassment that one must overcome. What authority the central government has to intervene in the situation is still unclear; however, the seriousness of the problem warrants further investigation.

Recommendation: Establish a policy dialogue with the government concerning licensing and regulatory constraints at the municipal level.

3. Legal Environment: Legal infrastructure has been a largely unrecognized element in countries where micro and small finance initiatives are operating. However, an effective contract enforcement environment is vital to the success or failure of these programs. In Jordan the Execution Law of 1952 is theoretically the venue for financial institutions to enforce small claims without the need to obtain a final court judgment. Unfortunately, the loophole allowing the borrower to deny the existence of the debt negates the whole purpose of the law.

Recommendation: This enforcement void presents one of the most detrimental constraints to the development of the sector. The objective here is rigorous *contract enforcement* as a sub-category of judicial reform, not overarching judicial reform. Therefore, the following alternatives are recommended as potential policy reforms to address the problem:

a. Delete the provision in the Execution Law allowing the denial of debt. This would be determined by the Execution Office's review of the official loan documentation. No final court judgment would be required.

b. Otherwise, legislate more authority to the Magistrate (Small Claims) Courts by:

1. Increasing the amount of their claims authority from JD 750 to JD 5,000, and,
2. Eliminate the right to appeal, or
3. Maintain the right to appeal, but require payment of the claim awarded at the Magistrate Court level before appeal is granted.

V. Action Plan for Policy Reform Implementation by the Government of Jordan

The Action Plan addresses the USAID/Jordan objective of "Policies Conducive to the Development of a Sustainable Microfinance Savings and Credit System", and it is presented in the "USAID Policy Reform Agenda" format. It is prioritized on the basis of the constraints identified that have the most **negative impact** on the development of micro/small finance services in Jordan. Specific tasks to be accomplished and a reasonable timeframe to complete them are also included.

Objective: Policies Conducive to the Development of a Sustainable Microfinance Savings and Credit System

Constraint	Tasks to be Accomplished	Timeframe
1. Security on Movable Assets	Promulgate the "Security Interests in Movable Property Law".	FY 1999
2. Enforcement of Claims	1. Modify Execution Law of 1952, or 2. Increase authority of Magistrate Courts.	FY 2000
3. Subsidized Credit	1. Restructure or close DEF. 2. IDB: Establish a policy dialogue on its interest rates.	FY 1999
4. Non-Governmental Organizations	Issue procedures defining the "transformation process" for NGOs.	FY 1999
5. Enterprise Licensing	Streamline municipality regulations.	FY 2000
6. Credit Bureau	Establish a credit bureau that includes data on micro/small enterprise borrowers	FY 2000
7. Loan Origination Fees	Issue Central Bank policy statement.	FY 1999
8. Islamic Banking Practices	Establish a policy dialogue with government and banking representatives.	FY 1999
9. Encouragement of Investment Law	Exempt micro/small enterprise loans from stamp fees.	FY 1999
10. Othmani Murabaha Law	Eliminate.	FY 1999

VI. Conclusions

Many constraints and influences can affect the outcome of MSE programs. Fortunately, the best practices criteria now available helps program designers to avoid some of the major pitfalls that have plagued these programs over the years. Policy reform will require an on-going dialogue to effect change and further deepen the process. At the institutional level, critical constraints, including; lending practices, market demand, specialized training and savings mobilization, will require both commercial banks and NGOs to fundamentally change the way they do business in order to operate self-sufficient programs. To facilitate this difficult transition, an essential role for USAID will be to bridge the gap between the financial intermediaries involved in the program and government policymakers and regulators. In Jordan it appears that there is an understanding that the challenge is worth the effort.