RETHINKING MICROFINANCE DEVELOPMENT IN INDONESIA

MEMIKIRKAN KEMBALI PEMBANGUNAN SEKTOR PEMBIAYAAN MIKRO DI INDONESIA

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ABSTRACT

This paper analyzes the microfinance policies in Indonesia, focusing on two issues: the extent to which the microfinance system in Indonesia had been liberalized and whether liberalized financial policies alone is a sufficient condition for microfinance development. In the attempts the financial policies with relevant implications to microfinance development (introduced from 1983-2000) in Indonesia were reviewed and the likely impacts of the financial liberalization were explored. The analysis shows that most of the repressive elements of the previous policies on the microfinance system has been abolished. In spite of that, the number and the scale of credit programs remained substantial. The linear reasoning of the financial liberalization proponents' expectation might not realize as there are also other factors that affect the dinamics of the microfinance market. Among these factors are the characteristics of the finanscal institutions and the households, the economic condition. Thus, financial liberalication is an insufficient condition for microfinance developmen. Microfinance development should be done in tandem with economic, tecnical, institutional, and infrastructure development. The formulation of financial policies should take into account information from both the demand and supply sides of the microfinance market.

ABSTRAK

Paper ini menganalisa peraturan-perundangan dan kebijakan pembiayaan mikro di Indonesia, dengan menitikberatkan pada dua issu, yakni: sejauh mana sistim pembiayaan mikro telah diliberalisasi dan apakah perbaikan perbaikan peraturan-perundangan dan kebijakan saja sudah cukup untuk membangun sektor pembiayaan mikro. Dalam upaya itu, paper ini menganalisa peraturan-perundangan dan kebijakan sektor keuangan yang memiliki implikasi pada pembangunan sektor pembiayaan mikro di Indonesia dalam kurun waktu 1983-2000. Kemungkinan hasilnya dalam mengembangkan sektor pembiayaan mikro juga ditelusuri. Analisis peraturan-perundangan dan kebijakan menemukan bahwa sebagian besar elemen-elemen peraturan-perundangan dan kebijakan yang menghambat perkembangan sistim pembiayaan mikro di Indonesia telah dihapuskan. Meskipun demikian sistim pembiayaan mikro itu masih belum sepenuhnya liberal karena jumlah dan skala credit programs masih relatip besar walaupun kegagalan kredit program acapkali dilaporkan dalam media. Peraturan-perundangan dan kebijakan demikian diharapkan akan meningkatkan skala dan effisiensi pelayanan dari sistim pembiayaan mikro di Indonesia. Hasil demikian mungkin tak menjadi kenyataan, karena terdapat faktor-faktor lain selain peraturan-perundangan dan kebijakan yang berpengaruh seperti karakteristik lembaga pembiayaan mikro. Pembangunan sektor pembiayaan mikro hendaknya dilakukan seiring dengan pengembangan sektor ekonomi, teknologi, kelembagaan dan infrastruktur. Formulasi kebijakan sektor pembiayaan mikro hendaknya mempertimbangkan baik sisi permintaan maupun sisi penawaran dalam pasar pembiayaan mikro.

Key words: Microfinance, Indonesia and microcredit
Kata kunci: Keungan Mikro, Indonesia dan Kredit Mikro

INTRODUCTION

This paper attempts to analyze to the microfinance policies in Indonesia. The analysis focuses on two issues: the extent to which the microfinance system in Indonesia had been liberalized and whether liberalized financial policies alone are sufficient for microfinance development. In the attempts the financial policies with relevant implications to microfinance development (introduced from 1983-2000) in Indonesia were reviewed and the likely impacts of the financial liberalization were explored.

This paper reviews the microfinance policies introduced during 1983-2000 in Indonesia. This period covers policies intended to reform or to liberalize the financial system (commenced in 1983), and to safe the financial system from the deteriorating effects of the recent multifaceted crisis initiated with deep plunge of the currency exchange rates in 1997.

In the review, the paper focuses on two issues. First, to what extent the microfinance system has been liberalized. Second, whether the financial liberalization elimination of policies repressive to the financial system would result in substantial improvement in the provision of microfinancial services in Indonesia. To that end, firstly, the financial policies with particular implications to the provision of microfinancial services are identified and summarized in section 2. These policies are then analyzed against the views of financial liberalization proponents in section 3. The likely impacts of the financial liberalization on microfinance development in Indonesia are discussed in section 4. Finally, a summary concludes this paper.

FINANCIAL POLICIES WITH IMPLICATIONS TO MICROFINANCE DEVELOPMENT IN INDONESIA (1983-2000)

The major financial policies introduced during 1983-2000 with relevant implications to microfinance development in Indonesia can be classified into three, namely: the major policy reforms (1983-1992), the policy responses to the crisis (1997-2000), and the major credit programs.

The Major Financial Policy Reforms

The major financial policy reforms aimed at liberalizing the Indonesian financial system include a series of policy reforms initiated, which were synthesized in the 1992 new banking law.

Policy Reform Package[1]	Relevant Substances
PAKJUN 01 1983	Rising interest rate ceilings Reducing the liquidity credit programs Promoting domestic saving mobilization
PAKTO 27 1988	Opening the market for competition Simplifying the structure of the banking system Easing requirements for bank opening Defining operational areas of the banks
PAKJAN 29 1990	Directing the allocation of commercial banks' credits under the small business credit scheme, *Kredit Usaha Kecil* (KUK) (discussed below). Reducing liquidity credit programs
Banking Law No. 7/1992	Synthesizing the major elements of the reform packages Adopting prudential banking supervision Opening the opportunity for establishing Islamic banks

[1] The policy packages introduced which then synthesised in Banking Law No. 7, 1992 were commonly referred to by acronyms built from *Paket* (policy package) and the issue date year, i.e., PAKJUN 1 1983 stands for policy package issued on June 01, 1983.

The Financial Policies in Response to the Crisis

Following the recent crisis, the government's main agenda has been to prevent the banking system from collapse while continued to reduce repressive elements of the banking policies whenever it is possible.

Policies - Years	Relevant Substances
Presidential decision: 1998	Government guarantee on savings-deposits with commercial banks
Presidential decision: No. 26 & No. 193/ 1999	Government guarantee on savings-deposits with rural banks
1998	Introducing three liquidity credit schemes for microfinance institutions: *Kredit Pengusaha Kecil dan Mikro* (KPKM) , *Kredit Modal Kerja BPR (KMK-BPR)* , and *Kredit Modal Kerja Usaha Kecil and Menengah (KMK-UKM)* (discussed below)
Banking Law No. 10/1998	Increasing capital requirement for bank opening Shifting the liquidity credit administration from the central bank to a new institutions, *Permodalan Nasional Madani* (PNM) Providing procedure for bank merger
Central Bank Law No. 23/1999	Autonomy of the central bank as monetary regulator

Major Credit Programs in Indonesia

This section summarizes the major credit programs in Indonesia. The summary is divided into three, namely: credit programs primarily financed by the government (liquidity credits), credit programs involving donor and aid agencies, and credit programs mainly financed by banks.

Liquidity Credits

Kredit Usahatani (KUT)	Credits for farming activities at 14% interest rate of which 5% for the channeling banks and cooperatives
Kredit Kepada Koperasi Primer untuk Anggotanya (KKPA)	Credits to members of primary cooperatives for small enterprises, at rate maximum 30%
Impres Desa Tertinggal (IDT)	Loanable funds to groups of people in backward villages, up to IR 20 million a year per village for 3 years. Groups decided lending terms to members
Kredit Penerapan Technology Tepat Guna (PTTG)	Investment credits to groups of small industries, up to IR 50 million per group for 1-3 years at 12 % interest rate
Kredit Pengusaha Kecil dan Mikro (KPKM)	Loanable funds to banks, IR 5 million for a BPR and IR 30 million for a commercial bank, at rate of 10 percent, to be lent to small and very small enterprises at 16 %.
Kredit Modal Kerja BPR (KMK-BPR)	Loanable funds to rural banks at 15% interest rate, up to IR 15 million per borrower at less than 30% interest
Kredit Modal Kerja Usaha Kecil and Menengah (KMK-UKM)	Working capital credits to cooperatives and small-medium enterprises at 16% interest rate

Credit Programs with involvement of donor agencies

Proyek Peningkatan Pendapatan Petani (P4K)	Income generating credits for small farmer families at 12% interest rate. Funds provided by IFAD and the government
Proyek Kredit Mikro (PKM)	Micro credits up to IR 5 million per borrowers at rate 24-36%. Funds at 16.5% interest rate were provided by Asian Development Bank and the government and disbursed through banks.

Credit Program Financed by Banks (Directive Credit program)

Kredit Usaha Kecil (KUK)	Credit program for small-medium enterprises financed by commercial banks and state enterprises. Commercial banks have to allocate 20% of their credits to small-medium enterprises while State enterprises have to allocate 5% of their profits to the program
Proyek Pengembangan hubungan dengan klompok swadaya masyarakat (PHBK)	Credit programs, as a part of the KUK, linking self-help groups with banks
Kredit Ketahanan Pangan (KKP)	Credits for farming activities and small enterprises of primary cooperatives' members (merging KUT & KKPA) where banks provided the funds at market rate and government subsidized the rate by 6-10%

THE MICROFINANCIAL POLICIES IN THE CONTEXT OF FINANCIAL LIBERALIZATION: AN ANALYSIS

This section analyzes the microfinancial policies in Indonesia against the financial liberalization framework, that is, elimination of the repressive elements of the previous policies to the financial system. These elements are interest rate ceilings, entry barriers for private financial institutions into the financial system, and credit programs. The discussion (below) is organized accordingly.

Elimination of Interest Rate Ceilings and Discrimination against Private Financial Institutions

Low interest rate ceilings (usury law) and discriminatory policies against private banks are two among several elements of early financial policies heavily criticised for their repressive impacts on the financial system and preventing the financial institutions from evolving. In line to this, the liberalisation (Law No. 7, 1992) eliminated the interest rate ceiling imposed on banks in Indonesia in 1992, after raising it to 30 percent per annum in 1983 (PAKJUN 1 1983), well above the inflation rate of the same year, 12 percent.

Elimination of the interest rate ceiling policies (usury laws) is generally seen as one condition for the financial development, motivating financial institutions to improve its service outreach and efficiency as they can charge market rate of interest on their services. Market niches previously under served, e.g., small-scale financial services, due to high transaction costs (relative to the interest rate ceilings) can be served cost-effectively by the financial institutions as they can charge interest rates to cover the full costs of the services. Financial institutions can not charge usuriously high interest rates on their services because the competitor charges lower interest rates. Borrowers with low returns on investments are not financed so that higher efficiency of funds allocation would result.

The financial liberalisation also abandoned two elements of the 1967 Banking Law (No.14/1967) discriminative against private banks, namely: (1) the prohibition of private financial institutions' operations in rural areas and (2) the exclusion of private banks from government guarantee on bank savings. The former was eliminated in 1988 with the introduction of PAKTO 27 1988 while the latter was abolished in 1991 (PAKFEB 28 1991). Moreover, the equality of state and private banks' footing was confirmed in the 1992 and 1998 banking laws (Law No. 7/1992 & Law No.10/1998).

Such discriminative policies unnecessarily limited the extent (outreach) and the efficiency of the financial system. Prohibition, or restraint of private financial institutions' operations implied that existing private financial institutions could not extend their operations to rural areas, that new private financial institutions could not operate in rural areas, and that state/public financial institutions monopolised the rural commercial banking financial market. As a consequence, there were fewer financial institutions, smaller service coverage, and less efficient (monopolised) financial system (financial institutions). Furthermore, private financial institutions were generally more efficient than the public/state ones, although there were contrary cases.

Abolition of Bank Entry Bans

A bank entry ban is another element of policy environments repressive to the financial system as it limits competition, which is regarded as the natural mean to ensure efficient allocations of financial resources in the market. In line to this neo-liberal (perfect market) view, the Indonesian government had done several attempts to develop the financial system by promoting new bank entries (opening the entrance for new entries) during the independence (McLeod, 1994; Nasution, 1994). The first was during the first few years of the independence (1945-1959), while nationalizing the foreign banks, local-indigenous people were encouraged to open banks, before the banking system was centralized, fully controlled by the government in 1965 and then ended with financial recession. The second was during the last few years of the 1960s, as a part of the economic recovery policy, during which the provincial government banks and many private banks along with branches of the state banks were established, before closing the entrance again in 1970.

The most recent opening was initiated in October 1988 (PAKTO 27 1988), as one of the major policy reform packages introduced to promote domestic saving mobilisation, before tougher requirements for new banks and branches were imposed again in 1998 (Law No. 10 1998).

PAKTO 27 1988 abolished the bank entry ban and eased the requirements in order to attract greater participation of private banks in the banking system, including in rural areas. Two types of banks were recognised, namely: commercial banks (*Bank Umum*) and rural banks (*Bank Perkreditan Rakyat*, BPR). Commercial banks provided general banking services with access to the inter-bank money market, the payment system, and might also provide foreign exchange service while rural banks only provided savings and credits. The minimum capital requirement for bank opening was low: Indonesian Rupiah (IR) 10 billion for a commercial bank and 50 million for a rural bank. The minimum reserve requirement for commercial banks lowered from 15 percent to two percent. While there was no restriction on operational areas of commercial banks, rural banks were restricted at the sub-district level. The geographical restriction was abolished in 1993 (PAKMEI 29, 1993).

A financial institution has to have a company legal status, either as limited liability (P*erseroan Terbatas,* PT), cooperative (*Koperasi*), or public enterprises owned by local governments (*Perusahaan Daerah*, PD). The granting authority is the Ministry of Finance for limited liabilities, the Ministry of Cooperative for cooperative institutions, and the local governments for local government enterprises. The ministry of finance was the authority of bank license, based on the central bank's recommendation. The central bank then assumes the full responsibility of bank licensing and supervision since 1998 (Law No. 10, 1998).

Motivated by the growing public interest in microfinance but given that many are unable or unwilling to meet the requirements of rural banks, the government opened the opportunity to establish rural cooperatives engaging in micro financial services, referred as *Koperasi Simpan Pinjam* (KSP) in 1995 (Regulation No. 9/1995). In theory, KSP is differentiable from BPR in terms of the clientele. A KSP should serve only its members while a BPR serves the general publics willing to use its services. Nonetheless, the KSP regulation describes that KSP not only can serve its members, but also prospective members, other cooperatives and their members (article 1). This opens the opportunity for KSP serving the general publics as rural banks do.

Scaling Down the Credit programs

The financial liberalization also attempts to scale down the government directed credit program. Prior to the liberalization, the scale of the credit programs was massive. In 1983, for instance, the liquidity credits accounted for 56 percent of total bank credit amount (Steinwand, 2001). The common setting of the liquidity credits was that the government assumed the administration, provided the funds, and bore the risks. Banks might or might not be involved in the disbursement of the liquidity credits. When involved, banks disbursed the credits on commission or fee basis with no responsibility for the credit risks.

The failure of such credit programs has been widely noted in the literature (Adams, Graham, & Von Pischke, 1984; Hoff, Braverman, & Stiglitz, 1993; McKinnon, 1973; Robinson, 2001) with respect to reduction of interest rate and informal finance' role, fund recovery, moral hazard (corruption), and financial development. Major changes in credit program policies in Indonesia during the financial liberalization period are discussed, below.

Reduction of Liquidity Credits

Prior to the liberalization, among the large liquidity credits were those for the green revolution (BIMAS) initiated in 1969, and for the working capital (*Kredit Modal Kerja Permanen*, KMKP) and the investment (*Kredit Investasi Kecil*, KIK) of small-medium enterprises through commercial banks (on commission/fee basis) initiated in 1972. These schemes, however, made banks dependent on the government's funding for their lending activities, undermined mobilization of household savings, resulted in high inflation, and opened the opportunity for misuse of funds (Nasution, 1983).

The reform (PAKJAN 29 1990) reduced the liquidity credit schemes for priority sectors from 16 to only four, including KUT, KKPA, credit for food and sugar procurement, and credit for plantation, transmigration and low-cost housing. These schemes continued to adopt the conventional policy setting of liquidity credits (noted above).

From Direct Finance to Directive Finance

Like in other places, the liquidity credits in Indonesia were not exception, they also faced problems, such as: low fund recovery, credit misuse and corruption problems. These reflected in recent media news:

"Seventy three percent (73%) of IR 8.412 trillion total KUT credit disbursed in Indonesia in 1999/2000 was bad. Of the bad loans, 72% were in KUD and NGOs, 23% in banks, 3% the Regional Office of Department of Cooperative, and 2% in other institutions" (Kompas, 2001). Similarly, "Of IR 149.5 billion total KUT credits disbursed in NTB province during 1998-2000, IR 82.9 billion (55.45%) was not recovered. This was small compared to IR 1.9 (90.48%) of IR 2.1 trillion total KUT credit disbursed in West Java province during the same period. Of IR 77.3 billion total KUT credit disbursed in NTB province in 1998/99, IR 77.3 billion, IR 7 billion lost at NGOs and IR 42.4 billion lost at cooperatives and KUDs" (Kompas, 2000b).

Due to the low fund recovery problem, among others, the liquidity credits for the priority sectors (noted above), except for low housing, were abolished and replaced with a new scheme, described as food maintenance/self-sufficiency credit (KKP) in 2000. Nonetheless, banks showed little interest on financing KKP (Kompas, 2000a, 2001) because they the risks of such credits was historically very high.

In spite of that problem, it is noteworthy for the purpose of this section to look closer on elements of the KKP policy. The policy setting of KKP was different from the common policy setting of the liquidity credits: the government as the funding provider and the risk bearer (noted above). Under KKP, the participating banks provided the funding at market rate – the funding providers—while the government shared the costs and risks of the credits.

A similar line of (directed finance) policy setting had been implemented earlier in 1990, the small enterprise credit (KUK) program.[2] Banks and state enterprises could disburse the directed funds to small enterprises by either direct lending to small enterprises, by lending to rural banks, or by issuing particular money market instruments.[3] Thus, KUK program implemented a rather different policy setting than that of the liquidity credits, namely: directing the allocation of commercial banks' credits and state enterprises' profits to financing small enterprises, rather than directly financing the target groups with the liquidity credits.

While the state enterprises tend to channel their funds through line agencies (e.g., the post office) at low interest rates, generally 6 percent per year (Steinwand, 2001), the commercial banks tended to follow commercial arrangements, with market interest rates. One arrangement between commercial banks and rural banks supported by the central bank and GTZ was the linkage project (PHBK). In this linkage project, banks provided 100 percent of funds while GTZ gave assistance in linking self-help groups to the banks (McGuire, Conroy, & Thapa, 1998). Nonetheless, several observers were skeptical about the claimed success of the linkage project.

Steinwand (2001: p. 78) commented that:

"It is noteworthy that some 90 years after these first experiments, BPR started again with group-lending on a larger scale under Bank Indonesia's Linking Banks and Self-help Groups (PHBK) project but still faced the very same problems [failure]. [the] main difficulty with group approach was: to install a [group] management reliable in the eyes of the BPR and capable to fulfill its tasks".

Lont (2001) argued that one fundamental aspect potentially led to the linkage project failure, as follows. The widely shared values among Javanese community: "feeling of shame and fear for loss of face" (*rasa malu and takut kehilangan muka*) limited the use of group

[2] The definition of a small enterprise credit was revised several times. In 1993 (Central Bank Decision No. 26/20/KEP/DIR/1993), small enterprise credit was raised from previously loans up to IR 200 million to loans up to IR 250 million for enterprises with maximum assets of IR 600 million (excluding land and building). In 1997 (Central Bank Decision No. 30/4/KEP/DIR/1997), it was raised once again to loans up to IR 350 million for enterprises with maximum assets of IR 1 billion.

[3] The money market instruments included *Surat Berharga Pasar Uang* (SPBU) and *Surat Bank Indonesia* (SBI).

lending to effectively enforce repayment, rather prevented younger members from putting pressures on senior defaulters.

From Commission Agents to Risk Bearers

A few months after the recent crisis erupted, in 1998, the government introduced two liquidity credit schemes through rural banks intended to provide loanable funds to rural banks for lending to micro-small entrepreneurs. The schemes were KPKM, and KMK-BPR, described above. With respect to the responsibility of the disbursing banks (rural banks) these schemes resembled the PKM, where banks bore the risks of the credits.

The introduction of these liquidity credit schemes should be viewed as an emergency measure (short term) to safe the rural banks from stressful distortion arising from the crisis. In the same time, the liquidity credits provided loanable funds to rural banks for lending to their micro entrepreneur clients (engaging in the informal sector of the economy) for their working capital loans.[4] A part from the short-term intention, these liquidity credit schemes were different from their conventional counterparts with respect to bank responsibility towards loan non-repayments, evidence in the earlier liquidity credits (e.g., KUT). Under these recent schemes (PKM, KPKM and KM-BPR), prudential lending principle was highlighted in the selection of qualified rural banks, on-lent interest rate was higher, and most importantly the responsibility for non repayments of the target groups was fully assumed by the banks.

In short, there had been a shift in the government directed finance policies, with regard to responsibility of banks participating in the directed credit schemes. Prior to the reform, the policy settings dominantly use financial institutions as the channeling agents while the government bore the credit risks (e.g., KUT scheme). In contrast, beginning in 1990, the government directed the allocation of financial institutions' credit portfolio to priority groups—banks as the funding providers and also the risk bearer (e.g. KUK and KKP). A rather different policy setting of credit programs was initiated in 1998, namely: while the government continued as the funding provider, the qualified banks were responsible for the credit risks (e.g., PKM, KPKM and KMK-BPR).

LIKELY IMPACTS OF THE FINANCIAL LIBERALIZATION ON RURAL FINANCIAL DEVELOPMENT – CONCEPTUAL REASONING

The key elements of the financial liberalisation policies, discussed in sections above, include elimination of interest rate ceilings, abolishment of ban for financial institution entry, and reduction of government direct credits. The linear reasoning generally shared by the proponents of financial liberalisation suggest that the likely impacts of these elements of financial liberalisation on the extent and efficiency of the financial system are as follows.

The abolition of the interest rate control (by the government) provides a scope for the existing financial institutions to extend their financial services to households previously infeasible to serve, on cost-effective basis due to low interest rate ceilings. Low-income households in developing countries are generally regarded as this group of population. Accordingly, it is expected that the abolition of the interest rate would lead to greater supply of financial services to the low-income households, and, hence, the service outreach of the existing financial system. This also means greater access of the households to financial services. The abolition of the interest rate ceilings is also expected to increase the efficiency of the existing financial institutions as they can charge interest rates fully cover the costs and generate profits. This and greater service outreach lead to higher profits (or efficiency) of the financial institutions.

The elimination of the barriers (or easy entry policies) for opening new banks and branches (public or private are alike) motivate establishments of new financial institutions. It is evident that there has been a vast increase in number of financial institutions, commercial and rural banks, in NTB province following the liberalization. This increase in number of financial institutions is expected to result in greater service outreach of the financial system or access of the rural households to financial services. The increase in number of financial institutions also means increasing competition in the rural financial market that, theoretically, is expected to bring higher market efficiency (e.g., lower transaction costs as competition forces the financial institutions to find cost reducing instruments). Since access to financial services may induce greater households' incomes (generally argued by the proponents of financial system perspectives), the further increase in service outreach (access) may result,

[4] It was widely believed that economic activities in informal sector could better survive (profitable), relative to those in formal one, the crisis.

due to increase in demand for financial services. The same line of argument can be used to estimate the impacts of the reduction of the government direct credits.

However, taking into account the dynamic relationships of government, financial institutions, households and their environment in the microfinance market (Figure 1), the expectations drawn from the linear reasoning (above) may not fully realize, because of the following reasons. Other than financial policies, there are a number of factors, internal and external to financial institutions and households jointly determine the performances of the financial system, and hence the microfinance development. For example, an initial increase in the supply of financial services, induced by the liberalisation, may not lead to greater outreach if:

1 The features of the financial services are not compatible with the features of financial services they demand (e.g., requirements, procedure or other features).
2 Opportunities for investments (use of loans availed) with reasonable returns (relative to costs of getting the financial services) are not available to the households, e.g., due to high inflation, lacks of demand, lack of productive skills and others.
3 The many microfinance institutions established following the liberalisation are primarily composed of low quality financial institutions (e.g., in terms of management, and assets).

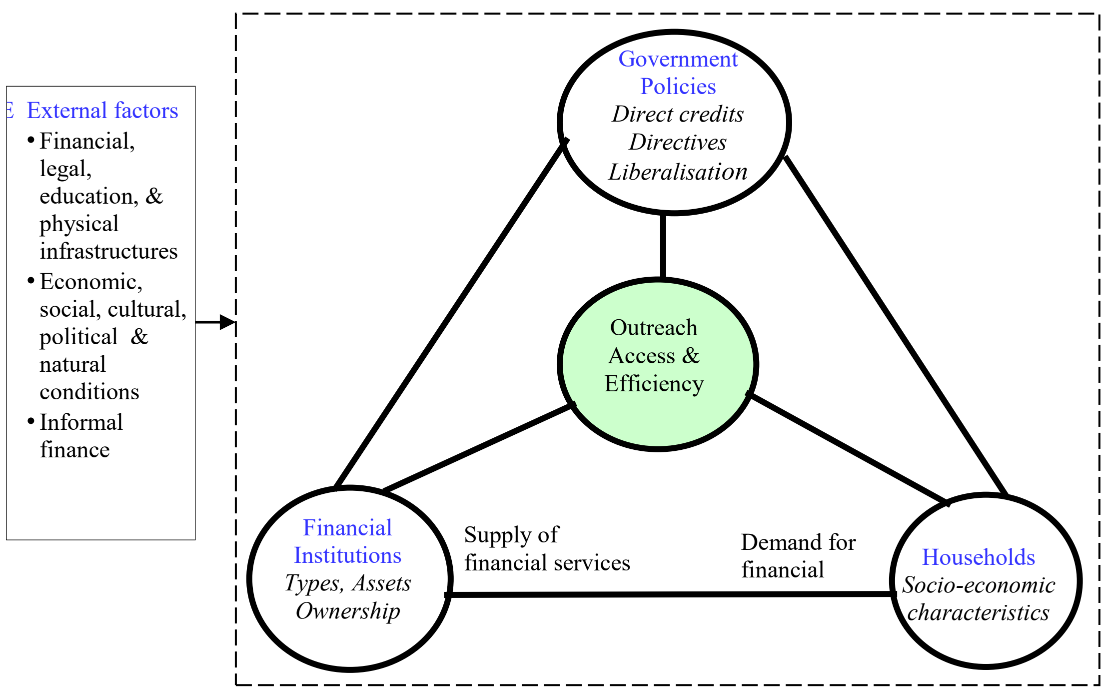

Figure 1. Government, Financial Institutions and Households in Microfinance Development in Developing Countries: A Stylised Model

Performances of individual microfinance institutions, as reflected by their service outreach and viability (efficiency) indicators, are also determined hand in hand by factors influencing both the supply of and demand for financial services. Factors internal and external to the financial institutions that influence their supply of financial services (e.g., ownership, assets, management, regulatory and policy environment, competitors, economic condition, and infrastructure) may also influence the households' demand for the services. This is because the households may take into consideration the characteristics of the financial services available to them, such as: interest rate, size, term, procedure and requirements, in their saving and borrowing decisions.

Similarly, factors influencing the households' demand for financial services, such as: their social economic characteristics, and employment and business opportunities, access to technical and information services, and infrastructures, may also influence the performance of financial institutions. This is because the social economic characteristics of the households determine their saving and credit capacity and (service) worthiness.

CONCLUSIONS

Although, the financial policies introduced during 1983-2000 in Indonesia eliminated many of the previous policies' repressive elements such as interest rate control and hard requirements of microfinance institution opening, the microfinance system was not fully liberalized, yet. The extent of credit programs remained substantial. Many new credit programs introduced in response to the 1997 crisis. Some of them attempted to shift (partly or fully) the funding, administrative, and risk bearing responsibilities of credit programs from the government to the banks (e.g., under KUK and KKP program). Some attempted to improve the delivery systems, but failures of such credit programs were reported in media news

The policy reforms would result in mixed outcomes. The interest rate and entry liberalization would bring about substantial improvements in the extent and the efficiency of the microfinance system while the continuing importance of credit programs would distort the functioning of the microfinance market. This linear reasoning expectation, however, might not fully realize, considering the dynamics of the microfinance market. There are other factors-such as the characteristics of the financial institutions and the households, the economic condition, the demography, and the infrastructure condition-that also determine the extent and the efficiency of the microfinance system, and hence the level of microfinance development.

The financial liberalization policies essentially affects the supply side of the market, such as: interest rate, number, type, and volume of financial services. The characteristics of the households, the economic condition, the demography, and the infrastructure affects the demand side of the microfinance market. Hence, the performances of individual financial institutions are expected to be different as their characteristics (internal factors) are different one another. Similarly, the structure of the households' demand for and access to financial services is expected to be different by types of financial institutions. Thus, financial liberalization is an insufficient condition for microfinance development, and, hence, microfinance development should be done in tandem with economic, technical, institutional, infrastructure development. For the best outcomes, formulation of financial policies should take into account information from both the demand and supply sides of the microfinance market.

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