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Does Microcredit Facilitate Socioeconomic Development?

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Does Microcredit Facilitate Socioeconomic Development?
A Case Study on the Grameen Bank and Proposition for Impact Assessment

By ARUNDHATI PAL

Introduction

Contemporary poverty alleviation strategies embrace microcredit as the ultimate tool for eradicating poverty. This approach creates a mechanism whereby impoverished peoples can overcome abject poverty and achieve a level of self-sufficiency. While other poverty reduction methods such as food and healthcare aid, and debt forgiveness simply address the temporary side effects of poverty, microcredit presents a bolder claim. Microcredit asserts itself as a preventative strategy for complete poverty extinction and an effective instrument for socioeconomic development: income security, prioritization of health, education and environment, women's empowerment, and political participation.

A major source of poverty is the poor's lack of access to credit as they are typically viewed as a financial risk by commercial lenders. Without credit, the poor are unable to invest economically, leaving them without any form of savings and consequently stranded in the vicious cycle of poverty. By extending credit to the poorest of the poor (those citizens living under $1/day), conceptually, microcredit relies on the belief that borrowers will utilize the money for self-employment, income-generating activities (IGA), and small enterprises. In turn, the financial gains will allow the borrowers to further invest and expand their enterprises, thus perpetuating a sustainable level of income, investment, and savings. If income security is achieved, borrowers will subsequently prioritize the often-neglected aspects of poverty: health, education, women's rights, the natural environment, and political participation.

While microlending appears promising, its actual evidential impact on socioeconomic development of the poor remains uncertain and vastly untested. The importance of such an empirical assessment is crucial in fighting poverty. If microcredit is proven as a solution to poverty, its potential impact on humanity may be astounding. A quantifiable benefit of microcredit, with rigorously tested and verifiable results, is necessary to assess this impact on humanity. Microcredit has gained its success on the platform that *access to credit* is a human right, regardless of the socioeconomic background of an individual, and thus no one shall be denied this right. Proponents of this view assert that a person's worth should not be simply measured by wealth and assets. Wealth encompasses more than just income and ownership while poverty encompasses more than the mere lack thereof.

Under chronic poverty, individuals not only lack a source of income, but are unable to enjoy even the most basic of human freedoms and rights – food, shelter, clothing, healthcare, education and political participation – freedoms that are necessary for human and societal development. Noted economist and Nobel laureate, Amartya Sen argues that development must be included as a human freedom, and it "requires the removal of major sources of *unfreedom*: poverty…poor economic opportunities as well as a systematic social deprivation, neglect of public facilities…"[1] Furthermore, Sen correctly understands that these aptly named *unfreedoms* to "relate directly to economic poverty, [robbing] people of the freedom to satisfy hunger, or to achieve sufficient nutrition, or to obtain remedies for treatable illnesses…" and what individuals can "positively achieve is influenced by economic opportunities, political liberties…and the enabling conditions of good health, basic education, and the encouragement and cultivation of initiatives".[2]

In order to assess the effectiveness of microcredit on socioeconomic development, one must evaluate current microcredit loans and practices. The question that must be asked is to what extent are socioeconomic opportunities expanded through supplemental income from microcredit loans? To answer this question, measurable indicators that display characteristics of socioeconomic development need to be utilized. The following indicators are often used in impact assessments as representative of such development: investment in higher education, socioeconomic empowerment of women, access and utilization of health services, and prioritization of savings and investment. This paper will identify the observed deficiencies of the aforementioned indicators through a case study of a premier microfinance institution, the Grameen Bank of Bangladesh, and conclude with a reemphasis on the absolute need for gathering extensive empirical data and adequately utilizing it to provide a quantifiable impact of microcredit on sustained socioeconomic development. It is necessary to note that valuable progress has been made in the application and assessment of microcredit. However, limitations on funding, research, appropriate data collection and various other complexities (which need to be discussed further in separate research) have restricted the pace of progress.

Case Study: The Grameen Bank Project

Background

Modern-day Bangladesh continues to rank as one of the most impoverished countries in the world since its independence in 1971. Alarming combinations of political instability, exponential population growth, and natural disasters continue to stifle Bangladeshi socioeconomic standing. Currently 84% of the population earns less than $2/day, with 29% of that portion living on less than $1/day.[3] Furthermore, poverty is concentrated in rural Bangladesh, where 117 million people, approximately three fourths of the total population, reside. Such abject poverty and economic challenges provide an ideal backdrop for the discussion and application of microcredit.[4] In 1976, Dr. Muhammad Yunus (then a professor of economics), armed with the belief that poor people were credit-worthy and that access to credit was a human right, created the Grameen Bank with the hope of alleviating poverty.[5] Understanding the creative and entrepreneurial potential of individuals, the Grameen Bank began as Yunus' experiment, loaning small sums of money to very poor individuals; this loan would be used for income generating activities. Since 1976, the Grameen Bank has become a formal, profitable banking institution, disbursing over $7.43 billion in loans to its 7.61 million borrowers, 97% of whom are women, helping them rise above the poverty line.[6] The bank provides a number of products (loans) including the Basic, Housing, Higher Education, and Microenterprise loans, as well as other financial services such as mandatory savings, pension, and life insurance. The loans are provided on a collateral-free basis, and accrue a flat simple interest versus the traditional compound interest. A detailed guideline of eligibility for loans can be found in Appendix A. The evaluation methodology used by the bank for measuring the level of socioeconomic progress, is composed of both income and social indicators, including the 10 Indicators and the 16 Decisions (found in Appendix B).

The lending practices of the Grameen Bank, with is extensive outreach and clientele, has earned the institution noteworthy accreditation. In October of 2006, Dr. Yunus and the Grameen Bank were formally recognized for their impressive achievements by sharing the Nobel Peace Prize. Despite their newfound success, the impact of their microcredit practices on the socioeconomic development of their borrowers remains uncertain. The Grameen Bank has succeeded in assisting 68% of its borrowers' families in successfully crossing the poverty line, while an unaccounted subsection of this population, has gradually progressed from earning less than $2/day to enjoying a relatively comfortable income.[7] However it is unclear whether this group of borrowers is experiencing the key elements necessary for socioeconomic development: income security, prioritization of health, education and environment, women's empowerment, and political participation. The following evidence is based on personal observations conducted during a two-month internship with the Grameen Bank and expresses these uncertainties. While these observations may not reflect a general trend, their existence alone, necessitates further investigation.

<u>Investment in Higher Education</u>

"My sister wanted to go to high secondary and university, but my parents had to marry her off due to pressure from society…" – Rickshawala, whose mother is a Grameen borrower

While general education in Bangladesh has shown vast improvement upon implementation of the "Education for All" policy in 1990, secondary and tertiary education, particularly for women, remains underutilized. Less than half of the 89% of children who attend elementary school enroll in secondary school (grades 6-10).[8] Of the fraction of men and women who attend secondary and higher secondary schools (grades 11-12), a mere 12% of men and 9% of women seek college education.[9] In rural Bangladesh, parents generally place a low value on schooling their children for two reasons: the cost of education and the opportunity cost of child labor. Educational costs to families typically include "direct cost of fees and books, [and] indirect costs of higher nutrition…"[10] A greater burden on families is the lost opportunity cost that productive child labor adds to the family income. The schooling of girls poses the highest financial and social burden. With the average age of marriage for girls being 13-16 years, investment in their education seems irrelevant and insignificant to most households since girls leave their parental homes after marriage and no longer contribute to the family income.

More and more girls have started enrolling in primary and secondary education, however this is largely due to government subsidies to families for girls' education up to grade ten. Therefore, only a minute fraction of women pursue any sort of higher secondary and/or tertiary education that is necessary for the economic development of households and nations alike. Societal pressures in rural communities also limit girls' education to secondary schooling. Younger girls attract a larger dowry and better prospects for marriage, and higher education is merely another marketable asset. Although the Grameen

Bank promotes elevated cultural expectations of their borrowers, such as number 11 of the 16 Decisions (see Appendix B), "We shall not take any dowry at our sons' weddings, neither shall we give any dowry at our daughter's wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage." Despite this edict, the practice is still very common. Economically these borrowers still see the sale of their daughters as both a relief from financial burden and an economic benefit. This practice exists in most places where microcredit operates, and selling of girls into marriage continues to be a significant source of income for families.

The negative view of investment in higher education is also demonstrated by the low rate of participation in Grameen's Higher Education Loan Program. An in depth interview in May 2008 with the Lakshampur local Grameen Bank manager revealed that out of more than 4000 borrowers, the majority of whom were eligible for the Higher Education Loan Program, only six borrowers took advantage of this product in the four years of their operations at that village. Only a small fraction of Grameen borrowers are beginning to understand the value of tertiary education, regardless of the gender of their children. These families have utilized a substantial portion of their loans to facilitate this higher education. A shift in mentality toward prioritization of, and investment in, higher secondary and tertiary education for both men and women alike, is crucial for socioeconomic development. This advanced mentality is indicative of understanding the correlation between higher education and the benefits it has on income security. Ultimately, income security is the steady state that poor people seek to acquire.

Socioeconomic Empowerment of Women

"I sell these eggs and milk from my home…we are not allowed to go to the market to sell things." – Female Grameen borrower

Socioeconomic empowerment of women begins with their access to economic tools as well as improvement of their social standards. It is indisputable that the Grameen Bank has made an incredible impact on the economic capacity of women by recognizing their prudent fiscal managerial skills and the priorities that women give to their children and family. For this purpose, Grameen loans are specifically given to women. In a patriarchal family structure, where women are traditionally subordinate to their male counterparts, having control of the household income has significantly improved the female borrowers' position in the home. Furthermore, when a female borrower is granted a Housing Loan, the Grameen Bank legally places the deed to the home in the woman's name. This allows her to own property and safeguards her future against divorce and being left assetless.

However, in Islamic Bangladeshi society, governed mostly by Sharia law, women receive very little status and importance, especially regarding economic matters. Constrained to their homes, women who seek employment outside of their homes are portrayed as "morally lax and the cause of disintegration of the family, of social values, and of society in general".[11] Such societal stigmas limit rural women's employment options, especially when it comes to any commercial activity. While the Grameen Bank encourages entrepreneurial activities of their female borrowers, such activities are bound to the home. For example, a woman may borrow money to buy some cows, but she can only sell the milk from home. This confines her sales, as she cannot go to the market to sell milk to a larger base of consumers. Due to the fact that women have little to no market access, both in physical and economic terms, the loans they take are primarily used to support their husbands' and/or sons' employment. A major critique of this type of microcredit scheme asserts that women are only money collectors, instead of money managers and entrepreneurs able to direct their own finances. Therefore women's economic potential through microcredit is being vastly underutilized and neglected. Furthermore, while women contribute heavily to the overall labor force in Bangladesh, their work is mostly unpaid, reinforced by the fact that only 26% of paid adult employees are women.[12] The lack of wages has been documented particularly in agriculture and manufacturing, where women work most often as uncompensated "family helpers" as opposed to wage earners. 56.4% of unpaid family helpers are women, along with 74% of day laborers.[13]

Therefore, encouraging the socioeconomic progress of women, where women are genuinely engaged in compensated commerce, entrepreneurship, and trade that goes beyond the selling of a dozen eggs from the home, is crucial for socioeconomic development. If a woman is allowed and encouraged to participate in the economy as equally as a man, total household income would increase significantly, leading to greater income sustainability.

Access and Utilization of Health Services

"We don't have hospitals or clinics in the villages because doctors do not want to go and live there…" – Grameen Bank official

It is a logical deduction that once an individual experiences income growth, he or she begins to focus on healthcare needs. Such essential needs of individuals are deferred or ignored when income is insufficient. An element of socioeconomic development is the emphasis on reliable and accessible healthcare, which in economic terms increases productivity and life expectancy, thereby allowing individuals to earn more for a longer period of time. Key to improved health is the recognition of important hygienic and sanitary behaviors, such as using proper latrines, drinking only potable water, bathing in sanitary water, etc.

However these logical and seemingly common sentiments are not apparent in majority of rural Bangladeshi households. Access to a physician or trained medical expert is often limited due to proximity to larger cities and towns. More often, the closest clinic is located forty to fifty miles away, and an emergency medical facility may be even further. Furthermore, absenteeism among physicians and trained medical staff has risen by over 40%, making access to healthcare unreliable and cumbersome.[14] In terms of maternity care over 70% of women acquire prenatal care from untrained individuals, including relatives. Most rural families continue to avoid getting medical help when needed. When medical facilities are within reasonable access, the habit of not going to see the doctor outweighs the need for proper medical attention. As medical attention continues to be neglected by a majority of rural households, the overall health of the population remains grim, thereby contributing to inefficiencies and decreasing productivity in the workplace.

In larger cities, the Grameen Bank has designed a medical welfare program. Poor individuals can receive discounted medical services, while the Bank subsidizes medical providers for their low-priced services to the poor. Even with the existence of such programs, the Bank's borrowers vastly underutilize these medical services. Again, emphasis on good health as an investment is lacking, as most borrowers view it as money they will never see again. They would rather wait out their ailments and illnesses than pay to receive medical attention, unless absolutely necessary.

In regard to sanitation, while 97% of the rural Bangladeshi population has access to clean drinking water, only 33% of enjoy access to sanitary latrines. Customarily, peoples of rural Bangladesh used the toilet outside of their homes, usually in a field or in ponds and lakes, because they deemed this practice as more sanitary than having a latrine in their homes. With natural disasters, especially floods, abundant in Bangladesh, human excrement in ponds, rivers, and lakes caused severe public health concerns. To eliminate these health concerns for the future, the bank undertook the "pit" latrine project, providing these latrines to every borrower household. The Grameen Bank subsidizes the purchase of these sanitary latrines in a massive effort to increase public health in rural communities. However, in a society where culture and daily way of life supersede public health concerns and hygiene, such sanitation services are limited and largely ineffective. Therefore, while the risks from 30 years ago may have declined, they have not been eliminated due to lack of public health education and a cultural transformation from aversion to awareness.

Emphasis on Savings and Investments

In general, the majority of Bangladeshis are deficient of the fundamental knowledge of savings and investment. The most obvious reason, besides the low income of the impoverished individuals, is the lack of proper financial education and the lack of property rights and ownership. However, even in the most simplistic terms, once income becomes sufficient, economic rational behavior reveals the inclination of individuals to save for their future to compensate for any unexpected loss of or decrease in consumption. Such "rational actor" sentiment is clearly absent in rural societies of Bangladesh, the areas where the Grameen Bank operates. Perhaps from repeated experience in losing one's hard earned assets, the attention of rural Bangladeshis remains on immediate consumption and minimizing risks from external shocks, rather than savings and future consumption. There is always a sense of urgency to use the income to generate even more income as opposed to a combination of income generation, savings, and investment. Outside of the mandatory savings required of Grameen borrowers (see Appendix B), these affected groups have no other form of savings.

Investment is also a problem and shares a similar experience with the lack of savings. Losses of homes and livelihoods on a relatively frequent basis leave the borrowers feeling unsettled. They do not believe in investment because their experiences often do not allow them to forecast for their futures. If a farmer has repeatedly lost his crops and land to floods, his focus becomes the regeneration of income to the previous level, instead of investing for future expansion. However, losses and investments are part of a cyclical process. If the farmer had set aside a lump sum for the future on a regular basis, then even if he did undergo a severe natural disaster, he would still retain a part of his previous income instead of having to start fresh with nothing.

For an agrarian society such as in Bangladesh, this understanding of savings, investments, and protecting against future losses, is essential and necessary for socioeconomic development. The problem is the lack of institutions or infrastructure available for the poor to invest their limited assets and wealth. Commercial banks will not accept them since the poor are not deemed credit-worthy, so a perpetual downward spiral is created under these circumstances. According to Grameen Bank officials, only half of collected or deposited money is re-circulated into loans, illustrating a lack of both accommodation and infrastructure in commercial banks that does not allow them to accommodate rural customers.

Emphasis on Collection of Necessary Empirical Data

It is uncontested that the Grameen Bank has been overwhelmingly successful in helping millions of their borrowers reach and cross the poverty line. However, the impact of such microcredit programs on socioeconomic development for individuals who have crossed the poverty line remains unknown. There must be reliable evidence to support any claims that microcredit can and will eradicate poverty. Sufficient and reliable data, at an expansive household level will help with the construction of effective econometric models that can better quantify the impact of microcredit on poor households.

For economists, humanists, and donors to microfinance institutions (MFIs) such as the Grameen Bank, the measure of poverty reduction, in conjunction with its social implications, is an important point of discussion and contention. Economists and donors desire concrete evidence in the form of numbers and trends to evaluate the impact of particular interventions and programs. MFIs are not excluded from these expectations. Humanists tend to be more theory and experience based and less concerned with empirical evidence. The three contending groups have led to both critiques and praises of microcredit practices. The obvious problem for deriving the empirical evidence requested by economists and donors is sufficient and reliable data. Many authors and researchers state that MFIs are inadequate at maintaining data that would help build models for an impact assessment of MFIs. Most institutions provide only minimal data to appease their donors, but such data may not be reliable and may be very limited. An institution like the Grameen Bank, which stopped accepting donor funds in 1995, sees no incentive to collect and maintain any sort of data to qualify its claims of poverty reduction and subsequent socioeconomic development.[15] This outlook must be changed if microcredit is to remain a valid tool for socioeconomic development and poverty reduction. The positive long-term impact and capacity of this strategy needs to be determined.

In regard to choosing an appropriate unit of assessment, for institutions like the Grameen Bank which loan to women who are most likely married and part of a family, an evaluation at the household level would be most pertinent since the loan is utilized for the family income. According to Hulme, while using the household as the unit of assessment provides a comprehensive overview, there are definite drawbacks: "complexity, high costs, demands sophisticated analytical skills, and is time consuming."[16] However, a comprehensive overview using the household as the primary unit provides a "relatively easily defined and identified [group], [and] permits an appreciation of livelihood impacts..."[17]

To measure the impact of microcredit on socioeconomic development, proper variables must be chosen. Variables that comprise both economic and social indicators are necessary since these types of variables are the key components of socioeconomic development. In order to measure changes in higher education, socioeconomic empowerment of women, utilization of health services, and emphasis on savings and investment, the following measurable variables should be considered: loan disbursement amount, number and type of loans taken per household, net household income, amount of loan repayment, number of children receiving higher education, number of women participating in the formal economy, number of doctor visits, amount of savings outside of the Grameen Bank, and number of working members in the household, etc. Due to their numeric attributes, combinations of these variables can generate econometric equations, displaying a wide variety of outcomes: links between increased income, increased doctors visits and improved health; correlation between economic participation women and consumption, etc. By populating these specific variables with reliable empirical information, a diverse range of quantifiable results of microcredit, can be established.

Conclusion

While the suggestions are fundamental in nature and require a more rigorous inspection into possible scientific methodologies, scope of data collection endeavors, and overall plausibility, the need to conduct an assessment which quantifies the impact of microcredit on socioeconomic development is of utmost importance. While searching for the appropriate methodology to such a profound social dilemma as poverty, it is crucial to recognize that the management, implementation, and interpretation of any selected would be inherently complex and admittedly not void of potential complications. As suggested earlier, the plausibility of reaching millions of borrowers at a household level is uncertain due to fiscal constraints, rigors of data collection, and development of a sound method of data analysis. Regardless of the possible challenges of assessment, the global community should demand verifiable results of these socioeconomic interventions. If microcredit is empirically proven to lead to socioeconomic development of poor individuals, foreign aid maybe more efficiently allocated to support viable microcredit operations. Furthermore, such impact assessment would also create a more competitive market for microcredit, thereby hopefully eliminating "loan-shark" type credit organizations that tend to simply use microcredit as a profit-making scheme, ignoring the social responsibilities and expectations attached to the traditional microcredit concepts.

As previously mentioned microcredit practices is clearly having an impact on millions of poor people around the world. The Grameen Bank's accomplishments, along with those of similar institutions should be highly applauded. However, these accomplishments must also be investigated, measured, and quantified. The global community cannot afford to lend money practices that have not been tested and proven for success. Poverty alleviation is a serious matter that without sound assessment may have dire consequences at the grassroots level. We need to know that the poor people that we desire to help, whose socioeconomic standings we aspire to improve, are actually feeling experiencing these improvements.

APPENDIX A

Features and Details of Loans Extended by The Grameen Bank

There is an exclusive focus on the poorest of the poor.

Exclusivity is ensured by:

- establishing clearly the eligibility criteria for selection of targeted clientele and adopting practical measures to screen out those who do not meet them
- in delivering credit, priority has been increasingly assigned to women
- the delivery system is geared to meet the diverse socio-economic development needs of the poor

Special loan conditions that are particularly suitable for the poor.

These include:

- very small loans given without any collateral
- loans repayable in weekly installments spread over a year
- eligibility for a subsequent loan depends upon repayment of first loan
- individual, self chosen, quick income generating activities which employ the skills that borrowers already posses
- close supervision of credit by the group as well as the bank staff
- stress on credit discipline and collective borrower responsibility or peer pressure
- special safeguards through compulsory and voluntary savings to minimize the risks that the poor confront
- transparency in all bank transactions most of which take place at centre meetings.

APPENDIX B

Stipulations and Evaluation for Economic & Social Progress

10 Indicators to Determine Crossing the Poverty Line

A member is considered to have moved out of poverty if her family fulfills the following criteria:

1. family lives in a house worth at least Tk. 25,000 (twenty five thousand) or a house with a tin roof, and each member of the family is able to sleep on bed instead of on the floor.
2. Family members drink pure water of tube-wells, boiled water or water purified by using alum, arsenic-free, purifying tablets or pitcher filters.
3. All children in the family over six years of age are all going to school or finished primary school.
4. Minimum weekly loan installment of the borrower is Tk. 200 or more.
5. Family uses sanitary latrine.

6. Family members have adequate clothing for every day use, warm clothing for winter, such as shawls, sweaters, blankets, etc, and mosquito-nets to protect themselves from mosquitoes.

7. Family has sources of additional income, such as vegetable garden, fruit-bearing trees, etc, so that they are able to fall back on these sources of income when they need additional money.

8. The borrower maintains an average annual balance of Tk. 5,000 in her savings accounts.

9. Family experiences no difficulty in having three square meals a day throughout the year, i.e. no member of the family goes hungry any time of the year.

10. Family can take care of the health. If any member of the family falls ill, family can afford to take all necessary steps to seek adequate healthcare.

16 Decisions

1. We shall follow and advance the four principles of Grameen Bank --- Discipline, Unity, Courage and Hard work – in all walks of out lives.
2. Prosperity we shall bring to our families.
3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.
4. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.
5. During the plantation seasons, we shall plant as many seedlings as possible.
6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.
7. We shall educate our children and ensure that they can earn to pay for their education.
8. We shall always keep our children and the environment clean
9. We shall build and use pit-latrines.
10. We shall drink water from tube wells. If it is not available, we shall boil water or use alum.
11. We shall not take any dowry at our sons' weddings, neither shall we give any dowry at our daughters wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage.
12. We shall not inflict any injustice on anyone, neither shall we allow anyone to do so.
13. We shall collectively undertake bigger investments for higher incomes.
14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.
15. If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline.
16. We shall take part in all social activities collectively.

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