Is Microcredit <u>the</u> Answer to Poverty Eradication?

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Over 2000 people from nearly 100 countries around the world met in Washington DC for three days in February, 1997 at what was called The Microcredit Summit. The Summit was organized to “launch a global movement to reach 100 million of the world’s poorest families, especially the women of those families, with credit for self-employment and other financial and business services, by the year 2005”.

The presence of many luminaries in the plenaries was an indication of the support garnered by the Summit. For example, from the speech of Ms Hillary Clinton, it was obvious that she was sincerely involved in the field and had visited many microcredit institutions in developing countries. However, for many of the others, it was joining the band wagon, and few raised any issues about the limitations of microcredit. This piece is more aimed at that.

Limitations of Microcredit: Five Fatal Assumptions

1. Assumption that the poorest all wish to be self-employed : Most of the proponents of micro-credit as <u>the</u> strategy for poverty eradication make the explicit assumption that the poor would all like to be self-employed. It is true that a certain proportion of poor people do like to take up micro-scale farming, processing, manufacturing or trading activities, but usually they do so to supplement their income from <u>wage-employment.</u> A majority of poor people, particularly the poorest (such as landless labourers in India) want steady wage-employment, on- or off-farm.

2. Assumption that credit is the main financial service needed by the poor. The Microcredit Summit Declaration did make a token recognition of this assumption when, in a shift from the draft to the final, they added "other financial and business services" to credit. The experience of SEWA Bank in India for example, shows that women, at least, value a safe place to keep their savings as an important service. However, the field in general does not adequately emphasize other financial services, such as savings and insurance.

Savings are particularly important, as they provide the "equity" for borrowing; act as a cushion for sudden demands of cash such as due to illness in the family or natural disasters; and finally, to some extent act as a guarantee for repayment of loans, where savings are deposited with lenders. Insurance is another important financial service for the poor, given their vulnerability to livelihood risks. Here one is not talking so much of life insurance but of crop insurance and insurance for income earning assets such as livestock and irrigation pumpsets. For certain occupational groups such as sea-going fishermen and miners, life insurance is important.

3. Assumption that credit can automatically translate into successful micro-enterprises: This is the familiar debate of "minimalist credit" strategies versus the "integrated" approach to microenterprise promotion. Others, (such as Mahajan and Dichter, *Small Enterprise Development*, Vol 1. No.1) argue that there is no one truth and the approach to microenterprise promotion should be contingent on the requirements of the situation, based on a systematic analysis. Microfinance is a necessary but not a sufficient condition for microenterprise promotion. Other inputs are required, such as identification of livelihood opportunities, business and production training, establishing of market linkages for inputs and outputs, sub-sectoral analysis and policy reform.

4. Assumption that those slightly above the poverty line do not need microcredit, and giving it to them amounts to mis-targeting: This assumption has come from the Grameen Bank experience of successfully reaching microcredit to the poorest, mainly landless women (there is no other example of comparable scale and targeting). However, almost all other programs mainly reach the upper layers among the poor and some, mainly those above the poverty line. Yet this experience is not as well regarded by the field, even though access to credit by those who are not among the poorest is not very much better than for the poorest, and what is more, these people generate much needed wage employment opportunities for the poorest.

5. Assumption that microcredit institutions can all become financially self-sustaining: While one supports the overall move for financial self-sustainability, the assumption that this can be possible for all microcredit institutions, needs to be examined. Even the best cases are either still not there (e.g. Grameen) or have got there by shedding their NGO avatar which needed early subsidies (e.g. Bancosol/PRODEM).

Risks of the Microcredit Strategy

What are the risks of pushing microcredit as <u>the</u> strategy for poverty eradication? As David Hulme and Paul Mosley have shown in their important work "Finance Against Poverty" (Routledge, London, 1996), the increase in income of micro-credit borrowers is directly proportional to their starting level of income - the poorer they were to start with, the less the impact of the loan. One could live with this finding in an imperfect world, but what is really troubling is that a vast majority of *those whose starting income was below the poverty line actually end up with less incremental income after getting a micro-loan, as compared to a control group which did not get the loan.* This should stop converts from offering microcredit as <u>the</u> solution for poverty eradication, since it seems to do more harm than good to the poorest.

A second risk that the poor may suffer, is the drying up of, or at least reduction in other efforts at poverty alleviation, such as the well-tried but less dramatic strategies of investment in human capital through simple primary health and primary education programs. While there is no denying that such programs can be run more cost-efficiently and that they can be better targeted to the poor, the replacement of such programs with microcredit programs will be a double disaster for the poor.

Making Microcredit Work

What needs to be done to make microcredit work?

First of all, its limitations should be as deeply understood as its successes are widely recognized. More studies such as the one by Hulme and Mosley need to be carried out, to find out the income and other impacts of microcredit.

Second, the implicit subsidies to microcredit institutions should be made explicit, not because subsidies are bad per se, but so that everyone understands that microcredit institutions are not, in most cases, fully financially sustainable. Thus subsidizing microcredit programs versus subsidizing social sector programs can become an informed policy choice, rather than be carried out under the mistaken notion that the former will require only temporary and diminishing subsidies (till every NGO becomes a Bank !).

Third, once the fever comes down, microcredit programs can be re-engineered to target not the poorest (whom it can harm) but the poor and indeed some non-poor micro- or meso-entrepreneurs. Why so? Because commercial farmers and meso- entrepreneurs run enterprises which generate much needed wage employment opportunities for the poor and the poorest. There is no harm in supporting the poorest first with wage employment before they become self-employed.

In other words, only when we unshackle micro-credit from "minimalist credit for self-employment for the poorest" and convert it into " financial services and technical assistance for agro- and non-farm enterprises for generating large amount of wage-employment for the poor" can it achieve its full promise.