

# Microcredit, NGOs and poverty alleviation

Mritiunjoy Mohanty

**T**HE MICROCREDIT movement, of which Muhammad Yunus and the Grameen Bank have been leading pioneers, makes two important contributions to development practice: first to demonstrate that creditworthiness and collateral do not go hand in hand and therefore it is possible to delink the two; and secondly, it is possible to use a collectivist ethos and group solidarity (and implicit joint liability) to minimise the risk of loans being made to persons with high-risk propositions (adverse selection) or of their being utilised for purposes other than that for which they are contracted (moral hazard), and to use peer pressure to ensure that repayment schedules are met.

Therefore it has established that lending to the poor who have little collateral but their labour is a viable practice; that providing even a modicum of access to financial resources, by lowering under-employment of labour and diversifying their sources of income generation, makes a difference to the ability of poor households to cope with some kinds of adverse shocks; and that for very poor households this additional income and diversification are a precious buffer in remaining out of poverty. Therefore, given that formal credit channels are lumpy and overly conservative in their risk assessment procedures, it is possible to argue that provision of micro-credit may be a useful complement to the overall strategies of employment generation and poverty alleviation, helping to improve the stability of consumption levels and income flows of poor households.

Perhaps an unintended consequence of the microcredit movement, which, for practical reasons was designed to be delivered through women's groups, has been its impact on the status of women. In Bangladesh in particular and in other countries where microcredit has been successful, it has given poor women, particularly in rural areas, a sense of agency they lacked before. A sense that they have the capability of influencing

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some of the decisions affecting their and their families' lives and livelihoods. In a world where institutional structures tend to perpetuate the inequalities of class, caste, race and gender and as a result women are invariably left holding the short end of the stick, even this small step is not to be dismissed or sniffed at.

However, it is equally important to note that whereas access to microcredit serves as a useful complement to the survival strategies of poor households, it is not a strategy of poverty alleviation and growth. When it comes to sustained growth and poverty alleviation, its main strength — small loans made available for relatively short periods of time with tight repayment cycles — becomes its main weakness. Microcredit loans are simply too small to make a difference in terms of sustained growth and poverty alleviation.

## 'Livelihood finance'

As Vijay Mahajan of BASIX, one of the pioneers of India's microcredit movement, has noted, "microcredit pales into insignificance as a "solution" for poverty alleviation and promotion of livelihoods" (*Economic and Political Weekly*, October 8, 2005). This is because poverty alleviation and sustained increases in income-generating capabilities have to do with accumulation of assets — physical, financial or human. And microcredit is simply far too small and far too narrow (in terms of the risks it seeks to mitigate) to aid significantly in that process. This is why Mr. Mahajan wants a strategy that targets what he calls "livelihood finance" that will aid the process of asset accumulation, in

which provision of financial services broadly defined (including insurance) forms an integral part.

If microcredit loans are too small to make a dent in poverty alleviation and growth, it is not as if it is a strategy that comes cheap either. Indeed, it is now widely accepted in development finance circles that in both absolute and relative terms the rates of interest (in nominal and effective terms — they were 15 and 30 per cent in Bangladesh in 2004, and in India the nominal interest is around 24 per cent) charged on microcredit loans are very high. Whereas there might be a monopolistic element in these rates, there are also structural reasons why they tend to be high. The one aspect of microcredit that attracts conventional bankers is the extremely high repayment rate (or low default rate). One of the reasons for high repayment rates is close supervision of loan portfolios. Supervision being expensive, the transaction cost of microcredit lending is high, leading to structurally high interest rates.

All this is to say that in the context of generating employment, sustainable livelihoods and the fight against poverty, microcredit is a palliative and not a panacea that multilateral agencies, international development NGOs and donor governments would make it seem. For sustained growth and poverty alleviation the answers are still old-fashioned — asset accumulation and employment generation. Even mainstream development finance is slowly coming to grips with this relative ineffectiveness of microcredit-led strategies, and to that extent microcredit is yesterday's story.

Be that as it may, as we join the Nobel

Committee in noting the pioneering work done by Mr. Yunus and the Grameen Bank, it is worth recording that neither is the only pioneer in Bangladesh in providing the poor with a modicum of access to financial resources. There are other NGOs that have walked, struggled and prospered down the same path, most famously Grameen's contemporary from the 1970s, the Bangladesh Rural Advancement Committee or BRAC. To draw attention to the role of other NGOs involved in microcredit is not to take away from the catalytic role Mr. Yunus and the Grameen Bank played both at home and abroad in furthering the microcredit movement. It is however to situate this role in particular and that of NGOs in general in the specific developmental context of Bangladesh.

## Burden of reform

If Bangladesh's political birth was difficult, institutionalisation of democratic politics has perhaps been even more so, the country having had to carry simultaneously the burdens of political and social reform. Burdens under which it frequently collapsed only to rise up, dust down the most recent failure and slowly move forward to reach a point where today it has a reasonably functional political democracy, even though of late it has appeared fragile, seemingly unable to chart a path from political confrontation to dialogue. In such a politically charged atmosphere, coping with myriad challenges, both natural and man-made, and the lack of administrative capabilities and delivery mechanisms that Bangladesh started out with were even more keenly felt.

This meant that the provision of what are normally regarded as public goods often fell through the cracks. It is this lack and vacuum that the NGOs filled, in a very diverse range of areas, from microcredit to education and from health to agricultural extension, aided in no small measure by reasonably steadfast international donors. If Bangladesh has moved from being an international basket case to a resilient economy, capable of coping with adverse environments and slowly but steadily climbing the human development ladder, some credit should go to its myriad NGO sector.

If the NGO sector in general has played a salient role as a delivery mechanism for public goods in the Bangladeshi context, it has raised important questions as well for both the country and development strategy. How sustainable (except for the super-large ones like BRAC and Grameen) is NGO intervention without international donor support? Are the NGOs to be seen purely as delivery mechanisms or are they vehicles of accumulation as well? Does NGO intervention shape in some ways the accumulation process? In the context of democratic political and economic governance structures how accountable are they? And if they are, who are they accountable to? Is NGO intervention in Bangladesh a particular response to a particular situation or are there generalisable aspects? And if there are, how cost-effective are these?

These are questions Bangladesh is slowly beginning to ask itself. Other economies and societies would do well to ask themselves the questions before emulating either the microcredit strategy or the NGO strategy or both unquestioningly. As the adage goes, only fools rush in where angels fear to tread ...

[Mritiunjoy Mohanty is an Assistant Professor of Economics at the Indian Institute of Management Calcutta in Kolkata. He is currently on leave and associated with Institut d'études internationales de Montréal (IEIM) of the Université du Québec à Montréal (UQAM), Montreal, Canada]