

# Micro-credit and Poverty Reduction

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# **Micro-credit and Poverty Reduction**

## **Introduction:**

Micro-credit refers to programs that are poverty focused and that provide financial and business services to very poor persons for generation of self-employment and income. Credit is a powerful instrument to fight poverty. The role of micro-credit in reducing poverty is now well recognized all over the world. It is no longer the subject matter of micro-credit practitioners alone. Governments, donors, development agencies, banks, universities, consultants, philanthropists and others have increasing interest in it.

With the advent of Grameen Bank and other such programs micro-credit obtained a new identity, a new meaning and a place in development literature. It is no more a mere concept. It is now a worldwide movement. The total outreach of Micro-credit Programs (MCP) as compiled by the Micro-credit Summit (MCS) is 54.9 million clients including 26.8 million very poor when they started with the program. According to a guess estimate of Muhammad Yunus, however, the number of poorest clients families reached by MCPs would be at least 35 million by the end of 2002. This includes those who have not been reported by the MCS.

Credit creates opportunities for self-employment rather than waiting for employment to be created. It liberates both poor and women from the clutches of poverty. It brings the poor into the income stream. Given the access to credit under an appropriate institutional structure and arrangement, one can do whatever one does best and earn money for it. One can overcome poverty. One can become the architect of one's destiny and the agent of change not only for one's family but also for the society.

## **Poverty :**

Poverty is a global issue. Despite changes in development paradigms in the last half of the 20<sup>th</sup> century, the promise to bring wellbeing to all human being remained unfulfilled. As it stands, more than 100 million children of primary school age have never stepped inside a class room, about 29000 children die each day from largely preventable malnutrition and disease and more than 1.2 billion people in the world are struggling to survive - at the margins of human existence – on under a dollar a day.

Poverty is a problem for all the countries irrespective of their level of development. It can be observed in many forms. It has both income and non-income dimensions. It may be a lack of income or resources, a lack of coping capacity, a lack of basic human capabilities, a lack of institutional defenses or in extreme cases a lack of all of these. In a wider sense, it may be a combination of economic, social and political deprivations.

In consideration of poverty line, people in each country can broadly be divided into 2 categories namely poor and non-poor. The non-poor are living above and the poor are living below the poverty line. The poor may be divided into destitute (bottom 10 percent below the poverty line), extreme poor (those in the bottom 10 to 50 percentile of households below the poverty line), and moderate poor (the top 50 percent of households living below the poverty line). A further category of vulnerable non-poor may also be recognized who may slip into category of poor anytime.

### **Poverty and Women:**

Poverty has a woman's face. There are more women than men who suffer from abject poverty. They live in severe deprivation and despair. In fact, hunger and poverty are more female issues than male issues. According to an estimate, of about 1.2 billion people in absolute poverty in the world, the majority are women. Traditionally they have to manage the family with virtually nothing to manage with. If any one has to go hungry in the family, it is usually the mother. In the words of Muhammad Yunus, "Mother has to go through the traumatic experience of not being able to feed her children during the days of famine and scarcity".

Despite progress in some areas like life expectancy, education, fertility rates, maternal mortality rates etc. in different countries, women still face many barriers to economic, social and political opportunities. In many countries, women are facing continuing legal discrimination. They are not treated as equal to men - 'whether in property rights, rights of inheritance, laws related to marriage and divorce, or the rights to acquire nationality, manage property or seek employment'. For many women, life is shadowed by a threat of violence - both physical and psychological. For all these reasons, credit is much more significant for women than men. With credit, poor women turn out to be better fighters. They have immense potential to move up. They are hard working. They are concerned about their human dignity, and about the future of their children. They are ready to make personal sacrifices to increase benefits to their family and for building a brighter future for their children. They do not like to see their children suffer from poverty as they have suffered through out their own lives. Once they have access to credit they are better equipped to maneuver the forces around them to their best

advantage. They try their best to earn more, to build and expand their capital base and improve their quality of life. They are empowered. They are able to enjoy their human right which is definitely a difficult and challenging task but which is achievable.

### **Poverty and Micro-credit:**

There is an on going debate whether credit alone or credit plus is needed for poverty reduction. There are views that credit alone on its own is inadequate to fight poverty. The need for other services is also important in this respect. Such views, although, do not negate the role of credit, fail to appreciate the role of credit on its own merit.

Nobody says that credit alone is cure for all. Most of the practitioners believe that credit plays a vital role as an instrument of intervention for a poor person to discover her potential and to stride for better living. Muhammad Yunus advocates that Credit is a human right. Once this right is established, the entitlement to other rights for leading a dignified life becomes easier. It empowers to break the vicious cycle of poverty by instantaneously creating self-employment and generating income. When in the ultimate analysis nothing can be said to be panacea, by overemphasising that micro-credit is not a panacea is in a sense overreacting and underestimating the role of credit as an instrument to combat poverty. Micro-credit is itself a very powerful tool. But if it is combined with others, it is definitely more empowering.

How micro-credit can reduce poverty may better be understood by understanding conceptually the mechanisms by which financial services can affect the lives of the poor. It is important to consider the fulfillment of basic needs (food, clothing, shelter, health, education and psychological well-being), the means to achieve welfare at present and in the future, social networks and empowerment and vulnerability to risk.

It is known that poor people live in a high risk and vulnerable conditions. Their ability to take advantage of opportunities that will lead to increasing their income or economic status, to protect themselves against risks of crises, and to cope with these when they occur is very important. Reduction of poverty is partly a process of increasing income and economic stability which enables fulfillment of basic needs and access to different kinds of services. This may also be understood in the form of developing a range of assets that will reduce the vulnerability of the poor to physical, economic and social shocks. These assets may be defined as financial (income size, regularity and security, savings, loans or gifts), human (skills and knowledge, ability to work, good health, self-esteem, bargaining power, autonomy

and control over decisions), physical (housing, land, productive and non-productive possessions etc.) and social (networks, group and centre membership, trust based relationship, freedom from violence and wider access to society and social institutions).

Poverty reduction may also be considered from both short term and long term perspectives. In the short term it can be understood with reference to individual borrowers, their households and also the society at large. Different studies conducted in Bangladesh and elsewhere show that there is positive correlation between micro-credit programs and their accrued benefits in terms of employment, income generation and promotion of social indicators.

### **Micro-credit Impact:**

A recent study concluded by the Bangladesh Institute of Development Studies and the World Bank in Bangladesh provides a strong indication that Micro-credit do help the poor in consumption smoothing as well as in asset building. The study also suggests that micro-finance programs promote investment in human capital like schooling. It raises awareness to reproductive health and increases both individual and household welfare.

While the short run impact of micro-credit has been widely acknowledged, the questions are raised about its long run and aggregate impacts. Is it sustainable overtime? Given the high incidence of poverty in countries like Bangladesh where micro-credit programs are widespread and successful, critics argue that this reflects the limitations of micro-credit as an instrument for poverty reduction. The question, however, remains whether high incidence of poverty is a result of failure of micro-credit movement or it is an outcome of a low economic growth rate. It may be argued if significant poverty reduction is mainly a function of sustained high economic growth, what is then the net over all contribution of micro-credit movement? These and so many other questions may be raised in connection with impacts and effectiveness of micro-credit programs but the fact remains that it helps the poor participants to overcome their poverty and also benefits the non-participants because of its externality at the micro level.

If one considers the benefits of micro-credit programs enjoyed by different categories of poor one gets mixed feelings. The ongoing debate whether micro-credit programs benefit the extreme poor deserves critical evaluation. While many argue that the extreme poor get little benefit from it as they are mostly excluded, a recent World Bank study in Bangladesh has come with encouraging results. It reconfirms that micro-finance matters a lot for the very poor borrowers and also

for the local economy. It helps reduce extreme poverty more than moderate poverty.

Many MCPs ignore their commitment to the bottom poor on the grounds that sustainability cannot be attained by providing financial services to the extreme poor. They forget that sustainability is a directional goal. The immediate non-negotiable goal is to reach the poorest and enable them to lift themselves out of poverty, which is the ultimate goal. One should not run for attaining sustainability overnight at the cost of those who are very poor. Evidences also show that serving the poorest and at the same time attaining sustainability are not contradictory goals. It needs appropriate planning. For a well designed program it is a matter of time. Though it has a waiting time it is highly rewarding.

In order to meet the clients needs and satisfaction, it is important that MCPs should have considered appropriate product development that will serve different needs of clients and enables them to improve the quality of their lives. Given the assumption that at the entry point all clients should come from the poorest, the need for developing different products for different levels of borrowers (1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup> time loanees and so on) is also important. Once this, as well as, appropriate mechanism for credit delivery and recovery are in place, it will not only reduce individual and aggregate poverty (may not be very significant) but will also help create a strong foundation for sustainable operation of MCPs.

How micro-credit programs impact the lives of the poor, can be learnt from the impact studies of Grameen Bank (GB), its partners and others who are poverty focused.

### **Grameen Bank :**

Grameen Bank, the pioneering institution in the field of poverty finance is now serving 2.6 million borrowers with 95% as women. All its clients at the time of their first loans were among the poorest. Given the access to credit, they have an enabling environment to strive for better life to cross poverty line and to continue to improve. The Grameen Generalised System (Grameen Bank II) provided them more options and flexibility. It is tailor-made and tension free. It takes care of many dimensions of poverty reduction. Its impact on the lives of its borrowers may be examined from the economic, social and political points of views.

## **Economic Effects :**

Grameen has been widely researched and recognized for making a difference in the lives of its members. Studies show that the borrowers of Grameen Bank are steadily moving out of poverty. One such study shows that it is at the rate of 5% a year. According to another study based on a household survey in an area where Grameen has been operating for more than a decade, about 50% of the Grameen households have crossed the poverty line. Another 25% were about to cross it and the rest was struggling mainly because of health reasons.

A study examining the economic effects of Grameen on the life of its borrowers, compared the situations 'before' and 'after', 'with' and 'without' Grameen. It considered the effects of Grameen operation on capital accumulation, employment, income and poverty alleviation. The study found that without any capital base at the beginning, the Grameen borrowers started accumulating capital as they joined Grameen which has not been possible by others. Grameen loan is required to be paid back in small installments as per agreement. The borrowers pay the installment from generated income, leaving the original capital intact. Their capital base usually increases in large amounts as they go for subsequent loans that enable them to go for medium and long-term investments.

The study also found that 31 percent of the borrowers reported themselves as unemployed before joining Grameen. Grameen created new employment for them and especially for the female members who were earning nothing before. The effect of Grameen loans on reducing unemployment is impressive. The borrowers were found less underemployed than before. More than 91 percent of the borrowers in the survey area reported that Grameen had made a positive contribution to their standard of living. The bank has been able to lift a significant proportion of its borrowers and their household members out of poverty. A World Bank study found that profits from Grameen-financed businesses were increasing borrowers' consumption by 18% per year, and that the percentage of Grameen borrowers living in extreme poverty was reduced by 70% within 4.2 years of joining. According to a recent survey conducted by Grameen Bank the cumulative percentage of borrowers who have crossed the poverty line until 2002 is over 46%. Such findings of the above mentioned studies are corroborated by many other studies conducted in different areas and at different points of time.

Grameen is contributing directly and indirectly to the gross domestic product of Bangladesh. During the period 1994-1996, its net contribution to GDP as a percentage of total GDP in current prices has been more than one percent.

Grameen borrowers have been found to improve their conditions in terms of housing and clothing too. They can afford more and warm clothes during winter seasons. Till the end of April 2003, they have built 566333 houses with housing

loans from Grameen. Women are the owners of 95% of these houses. They hold the title for the land of these houses. This was unthinkable for them before they joined Grameen.

## **Coping Capacity**

If an increasing capacity to cope with calamities is considered to be an indicator of improving poverty situation, the experiences of micro-credit programs show that micro-credit members are in better positions to cope with such situations. During two and a half months of devastating floods that hit Bangladesh in 1998, it was found that Grameen borrowers were relatively less vulnerable and more capable to deal with the situation both during and after the flood. They had their savings, institutional back-up and peer support. They were able to go for rehabilitation immediately after the floodwater receded.

Grameen, as a provider of micro-credit, had a key role in ensuring not only the survival of its borrowers and their family members during flood but also during their rehabilitation after it. The crisis management capacity of Grameen borrowers was found to be higher than others.

In fact, the severe flood provided both a challenge and an opportunity for the micro-credit program in Bangladesh. The challenge was to recover from the losses caused by the flood and to bring the poor back onto the path of sustainable development. The opportunity was to consolidate and improve upon the existing modalities in order to bring the most affected families within the fold of the MCP and to have more impact on the socio-economic condition of the poor. Grameen and other MCPs could do more under such disastrous situations if they had access to more funds. Such funds are needed to replenish their cash flow which gets depleted due to withdrawal of savings by members, fresh loans to old borrowers, new loans to new borrowers and non-recovery of loans from flood affected borrowers.

## **Savings**

Saving has always been an integral part of the Grameen program. It is designed to address production and other risks as well as market imperfections. If saving is a function of income, a balance of \$ 135 million savings by Grameen borrowers is definitely an indication of their increased income and capacity building.

## **Social Effects:**

The poor have little access to education, health, sanitation and other social services. They are socially condemned, rejected and powerless. In the case of poor women the situation is more deplorable. In many societies including Bangladesh, women are generally confined to their homes. They are not supposed to be seen by other than their family members. Their sphere of work is largely restricted.

Under these circumstances, Grameen provides them a forum, a network where they are organized into groups and federated into centers. They become decision makers, leaders and a social force. They become group and center leaders and also members of the Board of Directors of Grameen Bank, which they own. In the Board of Directors they are nine out of twelve members in total. The Grameen borrowers go for implementation of social development programs under the "16 Decisions" that they have taken. The Grameen borrowers who became village phone ladies by leasing cellular phones for providing village pay phone (VPP) services to the neighborhood do not only earn more, but also enjoy a gracious social status. These women have brought the world closer for themselves as well as for their communities.

Grameen women have become mobile. They are exposed to the outside world and are active participants in social networking and commercialisation process by attending center meetings, workshops, interacting with national and international dignitaries, producing, selling and buying products.

Grameen borrowers become more conscious about their family size and family welfare and are determined to improve their quality of life. Studies show that infant mortality among Grameen families has decreased by 34%, and the adoption of family planning among them is double the national average for Bangladesh. In terms of education, Grameen borrowers' families are also ahead of others. In Grameen families, all school-age children are going to school. After the introduction of the Higher Education Loan (HEL) there are no case of children being deprived access to higher education due to financial constraints.

Whatever indicators such as respect from neighbors and spouses, self-esteem, self-confidence, self-expression, ability to protest social injustice, capacity to solve social issues are applied to measure changes in social conditions of poor women, Grameen borrowers are found better off than others. The process is continuing and progress is visible. This has all been possible because of their access to credit.

## **Political Participation:**

Poverty alleviation does not only mean meeting basic food and non-food requirements but also exercising political rights and enjoying political freedom. Freedom of speech, choice, human rights, casting and seeking votes for public office and other posts are some of the indicators by which it may be measured whether the poor organized under Grameen have a better understanding of their political rights and obligations.

Although it is a modest beginning, it is significant to note that Grameen borrowers and their household members are taking part in larger numbers as voters and candidates in local and central government elections. They are encouraged to discuss their rights at their center meetings before elections and to take decision to vote for candidates who according to their judgement will advocate for and serve their cause.

Many Grameen members contested and were elected during the local government elections held in 1997 and 2003. According to reports, in the 2003 local government elections 6759 Grameen members contested for the post of chairman and members of whom 4179 candidates got elected as members. The percentage of Grameen members in the local Govt. bodies is more than 8%.

## **Grameen Partners :**

Grameen partners worldwide believe in the great power of micro-credit. They are not only interested in providing credit but also in visible and measurable changes that are taking place in the lives of the poor because of credit. Many of the partners have developed their own impact assessment indicators. They conduct case studies. Some of them have made internal evaluation studies of their program and some of them have been exposed to external studies. The studies reveal and reaffirm the fact that poverty is reduced with micro-credit as the input.

An evaluation study of Integrated Development Foundation (IDF) which is working with the poorest women in Chittagong Hill Tracts and Chittagong City in Bangladesh states that 35% of its borrowers have already crossed the poverty line.

A practioner-led impact assessment of Activist for social Alternatives (ASA) which is working in Tamil Nadu, India reveals that its micro-finance services-as a combination of credit, savings and insurance products have provided its clients economic empowerment in terms of increased income, economic security and risk management mechanisms.

An external study conducted to assess the impact of Society for Helping Awakening Rural Poor through Education (SHARE) which is operating in Andhra Pradesh, India states that three out of four (76.8%) of its mature clients have experienced significant reduction in their poverty over the past four years. Half of these are no longer poor. The study also states that nearly four out of ten (38.4%) have moved from being very poor into moderate poverty, while exactly the same proportion have come right out of poverty.

An impact study of Center for Agriculture and Rural Development (CARD), Philippines also reconfirms that the problem of poverty can be successfully addressed with micro-finance. According to an estimate 75% of the poor households served by CARD have already crossed the poverty line.

Estimates are also available for many other partners. To mention a few, Lift Above Poverty (LAPO), Nigeria reported that 60% of the poor households served by it have already crossed the poverty line. The percentage of poor households crossing the poverty line is also 60% as reported by Mitra Karya East Java (MKEJ) which is providing financial services to the poorest households in East Java, Indonesia.

Given the above findings and the experiences of Grameen Trust worldwide, it can be concluded that the role of micro-credit as a tool for poverty reduction is now widely established and recognised. How far its power can be successfully utilised to build a poverty free world will depend on measures that can be taken to create an enabling environment to increase its outreach. The more outreach and the more credit for the poor will mean more reduction in poverty -not only of the economic, but also the other kinds.

### **Conclusion :**

Poverty reduction is undoubtedly a doable proposition. It can be significantly and rapidly reduced with Grameen type micro-credit programs provided:

- required funds are available to the nascent micro-credit industry at reasonable costs,
- a professionally, competent and motivated staff is engaged in performing the operational tasks,
- the communication or knowledge gap between donors and practitioners is minimised.
- the gap between words and deeds, assurances and actions, is narrowed down and

an enabling environment is created by removing the obstacles that stand in the way of growth of micro-credit industry.