

Microcredit: Friend or foe?

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Microcredit has now become a dominant policy apparatus since the worldwide success of Grameen Bank and other Micro Finance Institutions (MFIs) aiming to alleviate poverty in poor countries. The microcredit movement has been regarded as one of most effective innovations in financial intermediation aiming to reduce the costs and risks of lending to poor households in the last century. Over time some eye-catching facts have been evolved. A World Bank estimate shows that there are now over 7000 microfinance institutions, serving some 16 million poor people in developing countries. The Microcredit Summit estimates that US\$21.6 billion is needed to provide microfinance to 100 million of the world's poorest families. Finally, the world's seven richest men could wipe out global poverty; their combined wealth is more than enough to provide the basic needs of the poorest quarter of the world's people. Since the final provision, although welcoming but not feasible, the existence of microcredit has gained popularity among the destitutes and to policymakers as an alternative source of rural credit.

This overwhelming success of microcredit, however, has not been celebrated by all groups of people. Critics of microcredit, both from the Left and from the Right, have provided a multiplicity reasons in assessing the role of microcredit in alleviating poverty. The Right, composed of donor agencies, governments of poor countries, and the MFIs itself; viewed microcredit as an efficient way to mobilize poor by providing access to cheap loan.

While the Left, primarily the social scientists including economists, has questioned how effective these MFIs has been in reaching the most vulnerable, the poorest of the poor. This note will substantiate the idea of the latter and review a recent work in microcredit financing.

A recent study by Sajeda Amin, Ashok Rai, and Giorgio Topa titled "Does microcredit reach the poor and vulnerable? Evidence from northern Bangladesh" recently published in the Journal of Development Economics, where the authors reach to the overall conclusion that while microcredit has been successful at reaching the poor, it has been less successful at reaching the vulnerable. Where a household is defined as poor if it has low consumption levels, and vulnerable if it is unable to meet consumption in the face of personal income fluctuations.

The study uses consumption and income data for 229 households from two villages of Rajshahi in northwest Bangladesh for 12 months in 1991-92 to identify households that are poor and vulnerable when microcredit was scarcely present in these villages.

The authors then checked how many of these households have joined a microcredit program in 1995 by which time microcredit programs had firmly established themselves.

By 1995, one third of the sampled households had joined a microcredit program. The following results have come out of the study.

First, households that joined a microcredit program by 1995 were poorer in 1991-92. Second and most important findings of all, approximately 75% of the households who had joined a microcredit program were below the poverty line than households that did not join any microcredit program. Furthermore, the proportion of the microcredit members below the poverty line is even higher than the village and the national average of poverty line. In other words, the probability that a microcredit member is below the poverty line is substantially higher than that of a randomly picked household from the villages!

Finally, a 24% decrease in average monthly consumption increases the probability of joining a microcredit program by about 7%. Interestingly, poor households that do join a microcredit program tend to have better access to insurance or other forms of rural credit. In contrast, the study finds no evidence that microcredit reaches the households that are most need of assistance, the vulnerable poor.

The vulnerable poor are mostly excluded from the microcredit program or they choose not to join. Overall, microcredit program fails to reach to the vulnerable poor who need it most even though it has some success with the poor.

Poverty alleviation is an ancient quest and the fight to conquer it will continue. When the so called panaceas, foreign aid or controlling population growth, that have failed to change the fate of the poor, people of all groups embraced microcredit as a compelling anti-poverty strategy. And why not? With a loan of Tk. 5000 only, a poor can start a small business, repay the loan in a year, while still owning the productive assets. Over time, one can earn enough to escape from poverty. Can there be any simple rule to fight the poverty? Perhaps not. Twenty five years since the inception of MFIs, people have started questioning the effectiveness of this movement. Does microcredit really help the vulnerable? Has the number

By nature, MFIs are non-profit organizations. A normative question thus arises: will the vulnerable poor continued to be deprived of microcredit? It could be that, vulnerable households have relatively higher default risk rate than poor households. But this apprehension by itself is enough to defy the goal of microcredit.

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