

ANNEXES

To the Devfinance quarterly Review

July - September 2001

Publications

➤ Roscas in Japan (1 mail)

From: Dale W. Adams [mailto:dwadams@burgoyne.com]
Sent: Donnerstag, 20. September 2001 19:45
Subject: Roscas in Japan

The following article provides interesting insights on the evolution of roscas—read microfinance—in Japan:

Robert Dekle and Koichi Hamada, "On the Development of Rotating Credit Associations in Japan," <<Economic Development and Cultural Change>> Vol. 49, No. 1, October 2000, pp. 77-90.

Traditionally, roscas in Japan have been called mujin-ko or tanomoshi-ko. Authors note that roscas have roots in Buddhist traditions and were present in Japan as early as 1255. The mujin gradually became commercialized in the form of partnerships and joint-stock companies. Later some mujin evolved into small finance companies that provided loans to small- and medium-sized companies. Still later, they evolved into sogo (mutual) banks. More recently, sogo banks have merged and some have become commercial banks. The authors could have mentioned, but didn't, a parallel evolution from roscas to the financial services in farmers associations in Japan, Taiwan, and Korea.

I wonder why we haven't seen a similar evolution in other countries—or have we? -- where roscas have a long history and are popular: China, India, the Philippines, Ethiopia, Egypt, South Africa, Mexico, and Guatemala, for example? What is noteworthy about this evolution is that it involved financial infrastructure that did both lending and deposit taking. This contrasts with the evolution of the microdebt industry. Would the current make-up of the microdebt industry have been more similar to the mujin in Japan if there had been a more robust tradition of roscas in Bangladesh where the Grameen Bank sprouted and if there had been no donors around who were eager to fund indebted programs for the poor? Continuing the conjecture, would the microdebt industry look different now if Rutherford—who has a feel for traditional forms of lending and saving—instead of Yunus, had started the Grameen Bank?

Unfortunately, the authors don't enlighten readers about the current status of the less commercial tanomoshis in Japan. Tanomoshis are popular among expatriate Japanese living in low-income countries and roscas are all over the place in Taiwan and South Korea. If I interviewed employees of the Central Bank of Japan would I find them putting a substantial part of their savings each month in a rosca? Does anyone know if roscas are still popular among the masses in Japan?

As an aside, I'm puzzled why the authors titled their article "rotating credit associations." In the doing they miss the dominant motive for participating in these self-help financial groups: savings/deposits. Guess I shouldn't complain too much since our CREDIT union friends make the same grammatical error. (I hope this crack doesn't prod Dave Richardson out of his comfort zone).jane.

➤ New book by Margarite Robinson (1 mail)

From: Dale W. Adams [mailto:dwadams@burgoyne.com]
Sent: Dienstag, 4. September 2001 23:26
Subject: Robinson's new book

A recent trip to Central America passed more pleasantly than usual while I read the following book:

Marguerite Robinson <<The Microfinance Revolution: Sustainable Finance for The Poor>> Washington, D.C.: The World Bank, 2001. US\$35 at email address = books@worldbank.org.

This is volume one of three that Dr. Robinson is preparing for World Bank publication. The second volume focuses on the Indonesian experience with microfinance and should be out late this year.

I especially liked three aspects of this tome: It makes a strong case for emphasizing deposit mobilization in microfinance efforts; it does a thorough job of covering recent literature on this topic; and the discussion is enriched with anthropological perspectives that remind us that microfinance clients are complex people.

Proponent of the new paradigm of development finance will warm to Robinson's treatment of interest rate policies, deposit mobilization, stress on sustainability, emphasis on quality of services, and the profitability of providing microfinance—if done correctly. At the same time, supporters of the old paradigm of development finance will find comfort in Robinson's criticism of informal finance and her fascination with information asymmetries, two arguments traditionally used to flog targeted indebtedness efforts.

In some respects Robinson's book is a state-of-the-arguments in microfinance, in other respects it is a truncated historical review of the industry. As do most other recent authors on microfinance, Robinson begins her historical review essentially with Grameen Bank. Those with memories long enough to remember the use of small loans to foment crop production by colonial powers as early as the 1600s, the formation and spread of credit unions in the 1850s, the development of farmers associations in Japan and its colonies in the late 1800s, deposit mobilization efforts among poor people by the Bank of America and the *Caisses Agricola* during the early 1900s, the Farmers Home Administration's indebtedness programs during the 1930s, and the large number of small farmer credit programs around the world after World War II might argue microfinance predated the early 1970s. Perhaps what Robinson is reporting on is more of an evolution than a revolution.

At least in Latin America, credit unions still provide a much larger volume of microfinancial services to many more clients than does the much more highly publicized and subsidized microdebt industry. My guess is that the informal and humble self-help financial groups (*roscas* and *ascras*) around the world, likewise, have far more participants than the microdebt industry has clients. Neither of these types of microfinance received much attention in Dr. Robinson's book.

Perhaps it is unfair to suggest that Robinson might have added another section to her book, one that outlined the conditions that allowed the emergence of the microdebt industry; after all her book already runs to more than 350 pages. That section might have outlined the factors that caused most small farmer credit programs and many credit unions to crash and burn during the 1960s and 1970s: inflation, central planning, directed credit, interest rate subsidies, moribund economies, inept managers of financial institutions, and loads of external funding for on-lending. Clearly, much less inflation, changes to market economies, liberalized interest rates, more vigorous economies, and far fewer external funds for on-lending have provided a much less toxic environment for the microdebt industry. This in turn has attracted more capable managers of financial institutions who now view themselves as running a business, rather than operating a subsidy-dispensing charity.

In the next volume I hope Dr. Robinson will tell us how the Indonesians were able to so quickly abandon the old paradigm and adopt most aspects of the new one in units/BRI. Why were they able to reform successfully the activities of a traditional agricultural bank when most other countries have failed in these efforts? How come they were able to mount a highly successful nationwide deposit mobilization effort while most other countries have been inert in this respect? How did units/BRI keep the government and donors from dumping more funds into the system after it began to perform well? Does the large amount of deposits in the units/BRI make it immune to political intrusions?

I enjoyed reading volume 1 and look forward to chewing on volumes 2 and 3.....jane.

Subjects of interest

➤ Poor savers' risk (6 mails)

From: Rosenberg@worldbank.org]
Sent: Fr 29.06.2001 00:16
Subject: Important study on poor savers' risks

from Rich Rosenberg (CGAP)

Having recently read "The Relative Risks to the Savings of Poor People," by Graham Wright and Leonard Mutesasira (MicroSave-Africa), I'm prompted to recommend it as one of the most incisive microfinance field studies I've read in quite a while.

Graham has long argued that an unsupervised MFI may often be less risky for a poor saver than any of the other realistic savings alternatives she has—including in some cases regulated institutions. Thus, he cautions overzealous regulators to think twice before they prohibit deposit-taking by certain entities—e.g., small community-based organizations—because they are not "safe enough." The research reported in this paper seems to provide strong empirical confirmation of his argument.

The study of over 700 poor savers from different regions of Uganda asked three simple questions:

1. What formal, semi-formal and informal savings systems/services do they use (if any)?
2. How much money have they saved in various systems in the past year?
3. How much money have they lost within the one-year period in the various systems?

The research found that surprisingly (or should I say "astonishingly"?) high percentages of savers in all types of institution lost some of their savings in the past year.

Informal sector (at home, in-kind, saving club, ROSCA,...) losses in one year were 22% of total saved, affecting 99% of the savers!

Semi-formal sector (MFI, SACCO,...) losses were 9% of total saved, affecting 26% of the savers. Most of the losses in MFIs came from clients' forced savings being used to balance out non-payment by another group member.

Even in the regulated formal sector (banks, pension funds,...), losses were 3.5% of total saved, affecting 15% of the savers.

Those with no option but to save in the informal sector are almost bound to lose some money, probably more than one fifth of what they save there. How much sense does it make to deny these savers semi-formal services in the name of "depositor protection," especially for clients and areas that are unlikely to have access to formal sector savings services any time soon?

The authors acknowledge some problems with their data, and some nasty-minded person might wonder whether Mr. Wright's strong views in this area had any influence on the research design. But the results are so striking that I wouldn't lose much sleep over this kind of issue. After all, if the study overestimated by 100% the proportion of clients losing money each year in informal savings mechanisms, so that the actual incidence was 50% instead of 99%, would the policy conclusions be any different?

This study is a must-read for anyone thinking about the design of regulatory regimes for microfinance.

PS Talking to microentrepreneurs in Thailand last year, I found a universal perception that ROSCAs were highly risky. The fact that people continue to use the mechanism despite their awareness of its risk testifies to how valuable they find the service. Would we be "protecting" these people if we managed to stamp out all those unsafe ROSCAs?

From: Graham A. N. Wright [Graham@microsave-africa.com]
Sent: Fr 29.06.2001 08:41
Subject RE: Important study on poor savers' risks

Dear Rich,

Thanks very much for this comment -very kind.

I sincerely hope that there was no bias in the research design (which incidentally involved a sample size of 1500 and was implemented by an international commercial market research company). My "strong views" are largely driven by the (perhaps mistaken) view that (until a year or so ago) I was a lone voice in a wilderness of supporters of central bank supervision without reference to the realities of poor people ... or indeed the capacity/interest of central banks to supervise. When "safeguarding the deposits of the poor", it is essential to think in terms of the relative risk rather than absolute risk facing them as they seek to save.

Incidentally for those interested the paper "The Relative Risks to Poor People's Savings" may be downloaded from the new MicroSave-Africa website: www.MicroSave-Africa.com

Best regards

Graham

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From: FSALTD@cs.com
Sent: Di 03.07.2001 19:57
Subject RE: Important study on poor savers' risks

Having recently reviewed a number of village banks in South West Uganda, I am inclined to disagree with the strong conclusions drawn by Rosenberg from the MicroSave study. I am finding repeatedly that bookkeeping, liquidity management, and loan tracking in these institutions - presently managing in excess of \$ 500,000 of poor people's savings - is alarmingly faulty and inaccurate. Governance, especially in terms of rotation of office holders, control of insider dealings and loan recovery is very weak. They usually do not have a system of knowing their own loan repayment arrears rates and often it is new savings that are financing a very weak and dangerous loan portfolio. The village banks are no longer supervised as the UNDP/PSDP project has come to a close since April 2001. If nothing is done for these village banks to improve their loan portfolio and financial management and audit, I suspect the loss rate of savings among poor rural people in Uganda could rise dramatically and this could substantially weaken Microsave's conclusions.

Although user-owned microfinance could be very effective under a variety of socio-economic circumstances, experience has shown that strong external supervision (as in the FSA system in Uganda) is a necessary ingredient for success. In some exceptional cases, lack of supervision has been substituted by strong internal leadership and management but this is a rare event and cannot become a basis for replication. Without an enabling and supporting supervisory system (absent in the majority of user owned microfinance institutions), these systems could be very risky (both absolutely and relatively) in the long run.

The village banks system in Uganda is presently fulfilling a gap in providing a limited but important rural financial intermediation system especially in providing a financial savings and a loans facility. But this apparent success can collapse if the shareholders knew and understood the implications of the present loan portfolio in many of these entities

involving a very high arrears rates. Some loans which were to be repaid over a 3 to 6 months period are almost 2 years old. There is no mechanism to verify and report the "intrinsic value" of these MFIs. The same applies to many other community owned microfinance institutions that are just "self-regulated".

Graham's point is that central banks are incompetent to supervise these entities and formal regulation is often wrong and inappropriate. Agreed. But this does not mean that user-owned microfinance can succeed just on a self-regulated basis because of lower "relative risks" or that we should sit back comfortably and say that they will "self-regulate".

After three years of intensive dealing with user-owned microfinance in East Africa, my own earlier optimism on this point has largely dissipated. I now believe that unregulated community based microfinance organisations "are not safe enough" and disciplined, regular, and specialised external regulation and supervision is a precondition for long term sustainability of such institutions. Peer pressure for loan repayment is not a reliable mechanism for building up an institution. Peer pressure and proximity appear to also work in the opposite direction by increasing the MFI's tolerance for defaulters.

Supervision is required not only on financial matters but also on governance issues. Governance issues arise especially when the number of members grow large and a few powerful and power-hungry influential individuals manipulate the board and the shareholders for personal benefits. The members/shareholders by themselves may not be able to resolve governance issues and an external hand to enforce the rules may be required.

Ahmad Jazayeri
FSA International

From: Dale W. Adams [dwadams@burgoyne.com] Sent: Mi 04.07.2001 22:13 Subject: Study of poor savers' risks
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I appreciated Rich mentioning the Ugandan study and also appreciate the good folks who are digging into savings issues in east Africa.

Nonetheless, I'm uneasy about drawing generalizations from Ugandan research. Civil war, inept leaders, and AIDS/HIV make it a special case. I haven't been there for a few years, so my impressions may be dated. On the several occasions when I was there, however, I stumbled across few roscas—didn't make sense to start a rosca when half of the members might die from AIDS. Lots of people were contributing to ascras, however, mostly to help bury dead colleagues, friends, neighbors, and relatives. The postal savings system was moribund, many of the credit unions had evaporated, the banking system was in flux, and the Central Bank lacked information to publish an audited annual report. Rural people couldn't even hold their savings in livestock because of widespread theft. The Ugandans and their institutions were beaten up, to say the least.

While doing research on informal forms of saving in several other countries I've often heard tales about someone defaulting on their rosca obligations or absconding with group funds. When you run these tales to ground, however, you often find they comprise only a tiny, although long remembered, part of the overall rosca experience. Incorrectly escalating a few horror stories into gross generalization is a common practice when talking about informal finance. It is also easy to confuse the failure to meet one rosca obligations with a group decision to convert the obligation into a grant because of a member's misfortune.

I'd be highly surprised if a random sample of roscas around the world showed an average default rate of as high as 5 percent; in the majority of the cases it would be close to zero. These organizations are completely voluntary and people won't participate if most members renege on their obligations to the group. Besides, there is a natural selection process in these groups that quickly eliminates bad apples, or systematically places them at the end of the rotation.

Although I don't believe informal savers are nearly as badly treated as the Ugandan study suggests, I won't argue that informal saving is ideal; it is clearly a second-best alternative given all of the other rotten options provided to people of modest means. Informal savings lacks the divisibility and liquidity most savers desire. Only secure, semi-formal and formal forms of finance can supply these important features. Unfortunately, the credit-need creed has resulted in deformed financial systems in many countries that deny people of modest means access to attractive deposit services. Savers are further whacked by taxes, substantial transaction costs, interest rate controls, and inflation when they place savings in the formal financial system.

Possibly Mike Gudger was correct; politicians and we developers may be incapable of designing safe and fair deposit facilities on a sustained basis for people of modest means. Or, perhaps it is a question of incentives. Politicians "buy

votes" with credit programs and developers can capture substantial rents by peddling more debt to poor folks. Hard to exploit these types of opportunities on the deposit/savings side of the financial market.....jane.

From: Graham A. N. Wright [Graham@microsave-africa.com]
Sent: Do 05.07.2001 08:25
Subject Important study on poor savers' risks

Apologies, the Relative Risk paper is under the "Study Programme" page under "Synthesis Papers":

<http://www.microsave-africa.com/documents/MicroSave-Africa%20Studies/Syn>

thesis%20Papers/The%20Relative%20Risks%20to%20the%20Savings%20of%20Poor%20People.doc I should also take this opportunity to respond to Dale and Ahmad.

Dale's romantic attachment to RoSCAs and ASCAs (accompanied by Bach fugue music) is understandable - I too was deeply in love with the simplicity and elegance of RoSCAs. But it was the repeated and constant comments about the loss of savings within these informal sector systems throughout MicroSave-Africa's qualitative work (conducted in all the three main countries of East Africa, not just in Uganda) that prompted the programme to hire Research International to conduct a quantitative survey. The results of the qualitative work will be published in due course. Since this work, as we have delivered the "Market Research for MicroFinance" course to practitioners from all over the world, we have heard anecdotal stories of the same problem. MicroSave-Africa is currently running studies to examine the financial landscape of Zimbabwe, Zambia and eastern South Africa ... time will tell if the problems with the informal sector arise in these studies.

I agree entirely with Ahmad's concern that community-based organisations left hanging out to dry (as seems to have been the case with the UNDP/PSDP Village Banks system) represent a significant risk to poor people's savings ... It is for this reason that it is essential that we look for systems beyond the Central Banks (which have neither the competence, time nor interest to supervise rural community-based organisations) to allow members of these institutions to assess the risk to their savings. It is for this reason that the paper concludes with a suggestion for a tiered approach starting with basic "declarations of risk", training, required reporting and audit by certified auditors for very small user owned and managed MFIs and finishing with central bank supervision for "gold standard MFIs" that mobilise deposits on a large scale. At no stage does the paper suggest, "that user-owned microfinance can succeed just on a self-regulated basis because of lower "relative risks"[a logical non-sequitur Ahmad!!] or that we should sit back comfortably and say that they will "self-regulate". " The paper DOES say that poor people need to be allowed to make their own choices on where to save on the basis of as much quality information as we can find systems to generate - so that the savers can assess the relative risk to their savings.

Best regards
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From: J. Roth [jr243@cam.ac.uk]
Sent: Do 05.07.2001 09:18
Subject Study of poor savers' risks

I agree and disagree with Dale:

With respect to stealing ROSCA funds, people rarely run away with ROSCA funds for a number of reasons:

- 1) Self selection of members
- 2) The members are typically drawn from within the “community” and severe social sanctions would apply to deviants.
- 3) Perhaps the most important reason is that ROSCAs and ASCRAs are usually short-lived affairs. They typically have a termination point “after x number of rounds” in the case of ROSCAs or “at some point in the near future e.g. Christmas” in the case of ASCRAs. While they are able to generate “usefully large sums of money” to borrow a phrase from Stuart Rutherford, the amount is very rarely large enough to be worth a member stealing. Because the ROSCAs are located in communities and because social sanctions are so severe, the thief would generally have to leave the community. The transactions costs of moving are more often than not greater than the value of the funds. I disagree with Dale where he writes “Politicians “buy votes” with credit programs and developers can capture substantial rents by peddling more debt to poor folks. Hard to exploit these types of opportunities on the deposit/savings side of the financial market” There is an unjustified ontological assumption of malfeasance in this assertion.

➤ **Flexibility vs. discipline (8 mails)**

From: Imran Matin [comimatin@hotmail.com]
Sent: So 12.08.2001 19:33
Subject flexibility vs discipline

i have been struggling in my mind with a question which i wanted to share. it is argued that the poorer you are more the need for flexibility. however, one can argue that the poorer you are, more the pressures working against long term planning. long term planning can lead to certain choices that are more likely to yield better poverty reducing outcomes. can flexibility generate such long term planning? or do we need externally imposed disciplining devices? clearly we need both, but for a given amount of resources, which strategy generates better outcome as far as poverty reduction is concerned? the pendulum now has swung on the side of flexibility but does certain forms of poverty create environments in which such flexibility may be counter productive? addressing this question has fundamental implications for the way we think about microfinance. any work on this or insights based on experiences?

Imran Matin, Ph.D.
 Senior Research Fellow
 Research and Evaluation Division (RED)
 BRAC, Bangladesh.

From: Craig Churchill [churchill@ilo.org]
Sent: Di 14.08.2001 09:26
Subject flexibility vs discipline

Hi Imran

I have been thinking about this same thing lately. There is a disconnect between the irregular cashflows of low-income people and the strict repayment discipline of microfinance institutions, and the problem becomes greater the deeper the MFI tries to reach (it also becomes a problem with larger loan sizes or shorter terms—the real issue is the ratio between the installment size and net income).

I think flexibility is essential for MFIs that are trying to reach poorer segments of the market. Repayment holidays built into the loan term are a good example, where 20 repayments are expected in a 24 week period, for example, and customers can choose which ones they want to skip (although perhaps not during the first month). This type of arrangement puts less stress on the group to help out during a lean repayment period, and less stress on the household to come up with a double repayment next time.

But to balance your concern about too much flexibility, you can also have discipline incentives, so that those who repay in 20 weeks can apply for a subsequent loan right away, perhaps with a slightly higher loan size cap than those clients who take advantage of the repayment holidays (thus telling the lender that their cashflow may not accommodate a much bigger loan).

Cheers,

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From: OKula@acdivoca.org
Sent: Di 14.08.2001 16:29
Subject flexibility vs discipline

Imran's question was on my mind yesterday when I was reading a CGAP ProPoor innovation award for a flexible loan product in which there is no loan term, just due dates on which the borrower must pay the accumulated interest.

This product is fairly common in many parts of Asia, At ACDI/VOCA we have institutional partners that have the same product for micro-and SME clients. It is extremely flexible. It is cheap to administer and manage. In the context of Imran's question---it worries me.

Loans with no term are more flexible than a line of credit. In effect the innovative MFI product is a micro-annuity. This is a great product for an institution trying to capitalize. My concern is that that the borrower may end up servicing her/his debt long after the principal has been spent. In Indonesia, these annuity loans made during the economic crisis, are still on the books of a number of MFIs, many of them are still being serviced, most of them have long since supplied the borrower with funds needed to invest in a mix of productive enterprise and household needs. I am not convinced that flexibility is better here.

I continue to be struck when visiting ultra MFIs, small self managed groups that operate as modified tontines or ROSCAs. When members set their own rules, the rules and penalties tend to be more rigid, more strict and the interest often higher than more formal MFIs e.g. MMD in Niger with 70,000 members, ROSCAs in Ghana, and savings associations in Togo. In my limited experience, given a choice, the extremely poor tend to chose discipline.

Great question Imran.

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From: Asif Dowla [audowla@osprey.smcm.edu]
Sent: Di 14.08.2001 17:19
Subject flexibility vs discipline

Imran wrote

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i have been struggling in my mind with a question which i wanted to share. it is argued that the poorer you are more the need for flexibility. however, one can argue that the poorer you are, more the pressures working against long term planning. long term planning can lead to certain choices that are more likely to yield better poverty reducing outcomes. can flexibility generate such long term planning? or do we need externally imposed disciplining devices? clearly we need both, but for a given amount of resources, which strategy generates better

outcome as far as poverty reduction is concerned? the pendulum now has swung on the side of flexibility but does certain forms of poverty create environments in which such flexibility may be counter productive? addressing this question has fundamental implications for the way we think about microfinance. any work on this or insights based on experiences? >>>

For experiences I would like to cite your joint work with Graham and Christen on ASA. You guys found that ASA would have collected more savings at a lower cost had it stick to compulsory savings instead of flexible savings!!!

BRAC's income generation for vulnerable group development (igvgd) program that you mentioned earlier has a compulsory savings component attached to it.

I look at my pay stub—the government does not trust me to save enough for my retirement so much so that it takes a big chunk of my salary to stash away for my eventual retirement. I am forced to save for my retirement!

There is, however, a fundamental difference between the poor and me. The government does not trust me because of lack of self-control on my part—in the language of behavioral economics “hyperbolic discounting”. The poor don't have the luxury of self control—the paramount need of survival force them to use up any surplus they may have right away. The social obligation is another factor for the rapid dissipation of surplus. Platteau's new book succinctly shows how traditional sharing norms can act as an obstacle to economic growth in tribal societies. So, flexibility may not be the panacea as it made out to be. Some degree of compulsion/discipline may be necessary.

Regards.

From: [pcraviolatti@yahoo.com] Sent: Di 14.08.2001 20:12 Subject: flexibility vs discipline
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Imran,

Just few thoughts.

1. Consumption economics can tell you a bit more about 'long term planning', we should look at the time preference of the poor and at their opportunity costs (the latter would be in the production economics domain). Interesting also to read from Rutherford latest book about The Poor and their Money. If you collect their saving daily they would save Tk.1 per day, if you collect their saving monthly they would save Tk.1 per month...this tell you a bit more about the poor's time preference!
2. You assumed long term planning lead to better poverty reducing outcomes. I am not sure about your reference point: are you talking about the individual's (the saver and/or loanee) long term planning? or long term planning of the lending agency? Are you not assume standard quality of planning?
3. Why flexibility VS discipline? If you consider this from the point of view of the loanee/saver you would see that, more flexible repayment schedules provided by the MFI, need more disciplined loanees, thus more flexibility requires more discipline.

Warm regards,
Paolo Craviolatti recently at BRAC, 16th floor [one above Imran! :-)]

From: Sotomayor, Narda [NSotomayor@sbs.gob.pe] Sent: Di 14.08.2001 20:52 Subject: flexibility vs discipline
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I have also wonder about these apparently conflicting concepts, but maybe in a different context. I did some field work for my dissertation with the objective of getting some insights about financial arrangements between crop traders and small agricultural producers in a Coastal Valley of Peru. Traders facilitate working capital to producers under the condition that producers will sell all their harvest to (through) them. I interviewed both traders (lenders) and producers (borrowers) and found that the parties have apparently found an “equilibrium” between flexibility and discipline. Farmers know that if they unwillingly (due to bad weather, pests, etc) fail to pay the loan, traders will understand, and postpone the loan repayment to the next agricultural season. However, if a trader knows the harvest was good but the producer sold it to someone else, the actions taken to impose discipline can be harsh. The right combination of flexibility and

discipline is key to develop a long-term relationship. However, and trying to answer your question, can flexibility be some times counter productive?. I think it can if the parties do not perceive the possibility of a long-term horizon. My survey results showed that very old traders were more likely to be cheated by producers than the others.

I think there are some lessons we can obtain from informal arrangements for microfinance.

Best regards, Narda Sotomayor.

Narda L. Sotomayor Valenzuela

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From: Robert Hickson [Robert@afcap.or.ke]
Sent: Mo 20.08.2001 11:20
Subject flexibility vs discipline

Hi Imran,

I think your questions are very valid and I don't pretend to know the answer. However, my gut feeling is that very poor people actually already have strict self-discipline and are forced to be so by virtue of their acute state of vulnerability. They simply can't risk loosing any of the meagre resources (eg. microfinance services) upon which their survival depends. As we get into the upper poor and lower rich bracket this survival pressure becomes less substantial, and tools that provide external discipline become a more necessary mechanism to prevent diversion of income towards less important needs.

It would make an extremely interesting piece of market research to study the responses of lower poor households to flexible and inflexible microfinance systems and the pattern of arrears in either system.

1. Do very poor households fall more easily into arrears with flexible systems?
2. On the other hand, are these systems able to attract more of these poorer households because their flexibility is less daunting?
3. Are they able retain more of these households BECAUSE although they might fall into arrears they are able to recover WITHOUT BEING EXPELLED from the programme?

Regards,
Robert

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From: Miller, Calvin [miller@care.org]
Sent: Mi 22.08.2001 14:56
Subject flexibility vs discipline

Greetings,

A number of years ago in Bolivia I set up a system with a credit union to offer flexible lines of credit to microvendors. It was an alternative to fixed weekly repayments. Basically for clients who had been responsible with past loans (which were most of course), they had the option of taking a 6-month line of credit up to \$300 (and \$500 on subsequent lines of credit). The client could withdraw or repay as needed within that line as needed as long as they paid it down to zero

within the period. This allowed them to be able to take advantage for payment of bulk shipments (such as vegetables), make loan repayments as they sold them, and then withdraw funds again for the next shipment. It has been quite popular even though it is with a relatively small institution. A debit-type card would have been nicer, but its costs could not be justified for an organization of 2500 members.

In rural finance, I have used lines of credit for agricultural inputs with various organizations for many years. Since insects and fungus can attack very quickly and destroy a crop, the most feasible way has been in essence pre-approved lines of credit such that the client could draw down (usually with loans in kind) according to the need, if and when they needed it. Interest was charged on the actual outstanding balance. Abuse or misuse was not common. The alternative of having clients buy such things as insecticides and store them in their house for when the insects or fungus may attack has serious health and environment risks and financial inefficiencies for the clients. Clients, especially the poor, tend to be very responsible—for one thing, they can't afford not to.

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➤ [Wider impacts of micro finance \(2 mails\)](#)

<p>From: Claudio Gonzalez-Vega [gonzalez.4@osu.edu] Sent: So 23.09.2001 19:39 Subject: Wider impacts of microfinance: general considerations</p>

Spurred by diverse motivations, donors, policymakers, practitioners, academics, and others have attempted to learn something about the “impact” of microfinance. This is an entirely legitimate question. If so, then why is there so much debate about this topic?

Correctly understood, the ongoing debate about “impact studies” is mostly about how best to learn about impact (that is, which ones are the most appropriate methods in the search for answers to this question) and about how much to spend in this effort (cost-benefit considerations).

In turn, the methodological discussion mostly reflects, on the one hand, the complexity and difficulty of undertaking any in-depth analysis of impact and, on the other, valid concerns about inferences frequently derived from “studies” where the methods used would not allow the derivation of such conclusions. These issues cannot be resolved here.

Imran Matin's recent message about “wider impacts” of microfinance is a clear illustration, however, of the extent of the difficulties involved. Indeed, most “impact studies” have attempted to evaluate consequences at the level of specific households, businesses, and organizations; they have ignored consequences for the economic environment where these individual units operate.

In the jargon of economists, these impact studies have been, at best, partial analyses, which have ignored any general-equilibrium consequences of microfinance. This is a serious shortcoming, particularly in countries, such as Bolivia and Bangladesh, where there is much breadth of outreach of microfinance.

The ignored general-equilibrium impacts of microfinance include consequences on local labor supplies, wages, and employment, not at the individual firm-household level, but in the market where the clients operate. General-equilibrium impacts also include consequences on product prices, on competition and other dimensions of market structure, on productivity, profit margins and the like. Many other consequences beyond the household-firm of the clients can be identified.

Current “impact studies” do not recognize these effects and, thereby, offer incomplete and, at times, misleading perspectives on the impact of microfinance. A given study may very well show increases in sales and employment for the clients of a microfinance program, at the same time that it ignores declines in sales and employment, in the businesses of the competitors of these clients, induced by the non-uniform access to financial services. The net impact may still be positive, but impact studies have so far ignored these other effects.

In sum, the impact of microfinance matters. However, the measurement and interpretation of this impact is not a trivial exercise. Current partial analyses may not always provide an adequate perspective on the consequences of microfinance; a general-equilibrium approach may be needed to evaluate its aggregate impact.

Claudio Gonzalez-Vega

From: Elizabeth Dunn [dunne@missouri.edu] Sent: Mi 26.09.2001 20:15 Subject: Wider impacts of microfinance: general considerations

The recent postings on the "wider impacts of microfinance" raise important concerns. I agree with Claudio: our understanding and measurement of the impacts of microfinance will remain incomplete until we analyze the impacts that occur outside of households, enterprises, and organizations. I see at least two areas of challenge.

First, there is the challenge of measuring "community"-level impacts. As Imran points out, there are both conceptual and methodological difficulties in analyzing impacts at this level. As an economist, I am intimidated by the fact that many of these are not primarily economic variables. Variables such as freedom of movement, increased levels of group organizing, enforcement of labor and trade laws, and increased voice for women in the community are community-level changes that some organizations (e.g. SEWA in India) are working toward. As far as I know, methods for measuring changes in these social and political variables have not yet been applied within the microfinance industry.

The second challenge is to analyze the general-equilibrium (economic) impacts of microfinance. These include market-level changes in prices and production levels (in goods markets) and on wages and employment (in labor markets). Also, from a financial systems perspective, we should not forget the market-level impacts on interest rates and the volume of financial transactions (in financial markets).

There seems to be an untested assumption that the wider economic impacts will be largely negative due to the "crowding out" effects on enterprises that do not receive credit. In other words, unable to compete with their neighbors who receive microcredit, the non-borrowers are assumed to experience reduced sales and lower levels of employment. This may be, but I am not aware of any empirical evidence to demonstrate this. [Note: I believe there have been one or two cross-sectional studies that looked at the village-wide impacts of having a microcredit program in the village.]

There is also a theoretical basis for arguing that the wider economic impacts of microfinance will be positive. As "multiplier" effects, the clients' increased incomes and their increased levels of employment of non-household members may have positive ripple effects that spread through the local goods and employment markets to provide welfare improvements for non-clients. Again, I am not aware of any empirical evidence in support of this argument, either.

Similarly, wouldn't we expect the development of a sustainable microfinance industry to have positive effects on financial markets as well? What are the welfare implications?

These are important and interesting questions, and I would enjoy hearing what others have to say on these topics.

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ASSESSING THE COMMUNITY ECONOMIC IMPACT OF MICROFINANCE INSTITUTIONS

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ASSESSING THE COMMUNITY ECONOMIC IMPACT OF MICROFINANCE INSTITUTIONS

ABSTRACT

Microfinance institutions (MFIs) ultimately measure their success by the impact they have on their clients, on clients' families, and on the communities in which they live. One potentially important piece to the MFI impact puzzle that has yet to be addressed in the microfinance literature is the so-called community economic impact, defined here as the direct and induced impact of the MFI on local economic activity. Integral to estimating a community economic impact is calculating the relevant regional income multiplier. This article demonstrates how a community economic impact and regional income multiplier might be estimated using the minimum employment requirements approach with the village health bank program of Project Hope in Portoviejo, Ecuador. It is hoped that this article will encourage and help other researchers incorporate community economic impact into future impact assessments of microfinance programs.

Key Words:

Microfinance

Microenterprise

Microcredit

Impact Assessment

Economic Impact

INTRODUCTION

Despite a multitude of studies devoted to the topic, the impact of microfinance programs on the poor in developing countries remains an intensely debated issue. Taken as a whole, the evidence is mixed: some studies find positive impacts, other studies find no or negative impacts, while other studies find positive impacts in some areas and no impact in other areas. (See Sebstad and Chen, 1996 and Chua et al., 2000 for good summaries of existing impact studies.) Nonetheless, the preponderance of evidence suggests the existence of a range of positive impacts, but also that the nature of these impacts and the causal impact chain are highly variable and less straightforward than often portrayed in the promotional brochures of microfinance institutions (MFIs).

Impact can theoretically occur at four levels: the enterprise, the individual, the household, and the community. Impact studies have focused overwhelmingly on the first three of these. Given the nature and mission of most MFIs, this focus is understandable. However, a result of this focus is that other potentially important, community-level impacts are often overlooked. One type of community-level impact yet to be addressed in the microfinance literature is the so-called “community economic impact,” defined here as the direct and induced impact of the MFI on local economic activity. The concept of community economic impact captures the fact that any organization that engages in commercial transactions—for example, that buys supplies, equipment, or inventory from local merchants—or pays salaries to its employees, or makes loans to local residents will have some impact on the local economy. This impact can range from very small to very large, depending on a variety of factors, such as the size of the organization, the amount it and its employees spend in the local economy, the extent and nature of local competition, and the expenditure leakage outside of the local economy. This principle holds true for nonprofit and for-profit organizations alike. The exclusion of community economic impact from impact analyses of microfinance programs is an important gap in the literature, which this paper attempts to fill.

In theory, calculating the community economic impact of a microfinance program is straightforward. All that is needed are the direct expenditures of the MFI, its employees, and loan recipients (using loan proceeds) and an estimate of the relevant regional income multiplier. (The income multiplier measures the increase in spending over and above the original exogenous spending increase.) In practice, regional income multipliers are difficult to estimate. The standard approach to estimating income multipliers requires large amounts of detailed and disaggregated employment and production data. The lack of detailed and disaggregated employment and production data in many developing countries, however, makes standard regional income multipliers in those countries highly impractical.

Fortunately, alternative, indirect methods exist to estimate regional income multipliers that are less data-intensive and relatively easy to calculate. Arguably the best of these methods is the so-called “minimum requirements approach,” which requires only modest amounts of employment data of a type increasingly available in developing countries.

Minimum requirements refer to the level of employment in specific industries that is necessary to maintain the viability of a regional economy. Or alternatively, it is the level of employment in specific industries required for a regional economy to be economically self-sufficient. The minimum requirements approach uses a relatively simple methodology to calculate the minimum employment requirement for a regional economy. The minimum employment requirement then forms the denominator of a simple ratio that yields the regional income multiplier.

We argue that the community economic impact of an MFI is an important piece to the overall impact puzzle and one that should be used, where possible, to arrive at the total impact of microfinance programs. Consequently, our purpose in this article is to demonstrate how a community economic impact and regional income multiplier might be estimated for an MFI using the village health bank program of Project Hope in Portoviejo, Ecuador as an example.

In line with this purpose, the rest of the article proceeds as follows: the second section presents the background for our study, including the relevant literature, and a description of the MFI to be studied; the third section describes the components of community economic impact, while the fourth section describes our methodology and our findings; finally, the last section offers some concluding remarks.

BACKGROUND

We were unable to find any previous efforts to study the community economic impact of microfinance programs. Instead, our approach in this study is drawn from three sources. First, we draw on the general economic impact literature (see, for example, Baade and Dye, 1988; Fjeldsted, 1990; Hewings and Jensen, 1986; Armstrong and Taylor, 1985; Lichty and Steinnes, 1982). Second, we draw on our previous experience in calculating the community economic impact of rural hospitals in the United States (McDermott et al., 1991) and the relevant supporting literature (see, for example, Doeksen et al., 1990; Christianson and Faulkner, 1981). Third, we draw on the minimum requirements literature (Ullman and Dacey, 1960; Ullman, Dacey, and Brodsky, 1971; Moore, 1975; and Brodsky and Sarfaty, 1977).

Surprisingly the minimum requirements literature is small. An obvious inference from this is that the minimum requirements approach has not achieved widespread acceptance among economists. This is surprising, because in situations in which the minimum requirements approach has been used alongside more complicated and data-intensive approaches, it has yielded comparatively accurate results (Ullman, Dacey, and Brodsky, 1971). It is also surprising given its applicability to economies in which detailed, disaggregated employment and production data are unavailable (which includes much of the developing world). As Brodsky and Sarfaty (1977) and this paper demonstrate, we believe that the minimum requirements approach offers a reasonably accurate, contextually appropriate approach to estimate regional income multipliers.

The MFI examined in our study is the village health bank program of Project Hope in Portoviejo, Ecuador. Project Hope is an international NGO whose mission is to improve the health status of poor people living in developing nations via the provision of health care, health training, health research, and financial services.¹ Its village health bank program integrates health education with financial services at biweekly village bank meetings. The methodology, referred to as *Credit with Education*, is based on the belief that health education and access to financial services exert synergistic effects on each other, such that the integration of the two produces benefits in excess of what would be obtainable if the services were separately.² With a population of approximately 180,000, Portoviejo is the major city in the Manabi region of Ecuador, with a population of 1,031,927.

THE COMMUNITY ECONOMIC IMPACT

Microfinance programs impact the local economy in at least two important ways: directly and through induced effects.

Direct Economic Impact. MFIs directly impact the local economy in three ways: (1) through purchases of goods and services from local merchants by the program itself; (2) through purchases of good and services from local merchants by employees; and (3) through purchases of raw materials, working capital, equipment, or other enterprise or non-enterprise related items from local merchants by loan recipients (see Figure 1).

Insert Figure 1 about here.

Induced Economic Impact. MFIs also have a variety of induced or consumption impacts on local economies. When MFI programs and employees make expenditures and village health bank clients spend their loan proceeds within the local community, this spending sets off a chain of secondary, tertiary, etc., expenditures that filter through the local economy, causing increased overall spending much greater than the initial spending. Such increases are known as income multipliers. Defined technically, the income multiplier is the total change in income earned by all workers in the local economy resulting from an exogenous change in investment, consumption expenditures, government spending, and so forth.³

Income multipliers work in the following way. Person A works for an MFI and spends her wages in the local economy. This creates demand for local goods and services. In doing so, Person A creates employment and income for Person B. Person B next spends her income on goods and services, thus creating additional demand that results in employment and income for person C. Person C in turn spends her income, and so on it goes. The same process ensues when the MFI makes direct expenditures or clients spend loan proceeds within the community. The increase in local expenditures and income, however, is not infinite. A portion of spending at each cycle leaks out through either savings or spending in another community, and the chain of new income and spending eventually dissipates. The speed at which the income and expenditure chain dissipates is primarily a function of how much

leakage occurs at each stage. More leakage results in quicker dissipation and a smaller multiplier, while less leakage results in slower dissipation and a larger multiplier.

Income Multipliers. Where data are sufficient, the standard approach to estimating income multipliers is the input-output approach developed by the Bureau of Economic Analysis of the US Department of Commerce. The input-output approach measures the dollar value of a particular input required from sources within a region to produce \$1 worth of a particular output, for example, the earnings of labor required to produce \$1 worth of a particular manufactured good. Regional input-output models require a rich micro data set and sufficient resources to be successful. Calculation of income multipliers using the input-output approach requires the total output of each producing sector within the regional economy and how it is distributed among the purchasing sectors, or alternatively what the total input of each purchasing sector consists of in terms of the regional producing sector source. Not only is the input-output approach very costly and data-intensive, regional multipliers also do not exist for smaller rural regions outside the United States, and extreme care should be used in using multipliers derived from input-output models for small geographic areas.

Because of the intensive data and methodological requirements of the input-output approach, economists have turned, when possible, to simpler, indirect methods to estimate regional income multipliers. To understand how these approaches work requires an understanding of the concepts "nonbasic employment" and "basic employment." Nonbasic employment is defined as employment that creates goods and services for consumption within the community. Any employment level above this amount is considered excess or basic employment. Basic employment is defined as employment that creates goods and services for consumption (or for export) outside of the region. Nonbasic employment plus basic employment equals total employment. Both indirect approaches described here use the ratio of total to basic employment to estimate the regional income multiplier.

Perhaps the most common indirect approach is the so-called "location quotient," which uses national averages as a standard of comparison with cities or regions. The location quotient compares employment in specific regional industries to the national average. For those industries with employment proportionately greater than the national average, that portion below the national average is considered nonbasic employment, and that portion above the national average is considered basic employment. Those industries with employment proportionately lower than the national average are assumed to have no basic component in that industry.

Estimates of location quotients using a fairly low-level of industrial aggregation have produced reasonably comparable income multipliers compared to those using more sophisticated approaches (Isserman, 1977). Nonetheless, the approach suffers from three distinct weaknesses that limit its application to developing world contexts (Brodsky and Sarfaty, 1977). First, at high levels of industrial aggregation, it produces grossly exaggerated income multipliers. Second, estimates of the basic component of each industry using this method are subject to an unknown and probably systematic error of underestimation. Third, while in the United States national employment in each industrial category is approximately equal to national consumption in each case (given its relatively low dependence on international trade), this is not the case in developing countries (given their relatively higher dependence on international trade), and particularly in small developing countries such as Ecuador. A location quotient would have to be adjusted to take this factor into account, but in the process of making the adjustment, a relatively simple approach is transformed into a highly complicated and unwieldy one.

The minimum requirements approach is another indirect method for estimating regional income multipliers. It yields a quantitative estimate that closely approximates the minimum percentage of a labor force required in various industrial sectors to maintain the economic viability of a region, which is equal to the nonbasic component of those industrial sectors. Employment in those sectors that is greater than this minimum is considered excess or basic employment. The method to calculate the minimum employment requirement (and thus basic and nonbasic employment) is described at length in the following section.

Like the location quotient, the minimum requirements method is not without defects. Perhaps the most serious defect is that all regions within a given population range are assumed to have the same level of nonbasic employment. As Tiebout (1962) has shown, variations in local consumption, income, and distance from economic centers will affect nonbasic activity. Nonetheless, minimum requirement figures unadjusted for these variations have produced results comparable to those of more sophisticated approaches (Ullman, Dacey, and Brodsky, 1971, pp. 34-56), including minimum requirement figures derived in a developing country context (Brodsky and Sarfaty, 1977).

Once the minimum employment requirement is estimated, the regional income multiplier can be calculated using the following equation derived by Tiebout (1962):

(1) $M = 1 / 1 - E$, where M is the income multiplier and E is the minimum employment requirement, or nonbasic employment, in percent. Of course, $1 - E$ is also equal to the basic level of employment.

The reader will note that a higher level of nonbasic employment (lower level of basic employment) in equation 1 means a lower denominator and thus a higher income multiplier. This relationship is easily understood once we consider that the more economically self-sufficient an economy, the higher will be its component of nonbasic employment. (Researchers have found a consistently positive relationship between region or community size and the percentage of nonbasic employment.) A higher level of economic self-sufficiency in turn implies less expenditure leakage and thus a higher income multiplier.

Parameters of Study. Having established what impacts our approach will measure in this study, it is important to state at the outset what impacts our study will not measure. We do not attempt here a full-scale impact assessment of Project Hope's village health bank program. We measure only short-term, point-in-time direct and induced economic impacts. We take no account of any long-term economic or short-term indirect economic benefits that may result from Project Hope's operations. Examples of these types of factors might include (1) the number of suppliers or service providers drawn to the community (Armstrong and Taylor, 1985), (2) the number of other MFIs drawn to the community, or (3) the economic effects of any resulting improvements in the health status of program beneficiaries over time. Nor do we consider any direct or indirect improvements in health outcomes, such as improvements in the health status of program participants and their families, or the creation of horizontal and vertical networks to promote health care education and improved health care outcomes.⁴

Finally, we do not consider program costs, be they negative program impacts or the accounting or economic (opportunity) costs of program funding, even though we assume such costs exist. One theoretic cost of microfinance programs is that they introduce economic distortions into the marketplace, which in turn lead to an inefficient reallocation of economic resources within the local economy. For example, microlending programs may lead to an artificial increase in the production and supply of certain petty trade goods, diverting resources from more productive purposes, artificially suppressing prices for those petty trade goods, and thereby hurting existing producers and traders. A full-scale impact assessment would need to take into account these program costs.

The point is that while community economic impact and multiplier analysis are appropriate tools to assess the direct and induced economic benefits of microfinance programs, they are not appropriate tools to assess other direct, indirect, or induced benefits or costs. What is required in the latter case is a full impact assessment, which goes far beyond the scope of this study. We leave it to other researchers to incorporate community economic impact and multiplier analysis into future impact assessments of microfinance programs. Our intent here is to show them how they might do this.

RESEARCH METHODOLOGY AND FINDINGS

To calculate the direct and induced economic impact of Project Hope in Portoviejo, we obtained data from Project Hope accounting records, employee expenditure surveys, client loan use surveys, and population and employment data from the 1998 Ecuador national census.

Direct Economic Impact

To calculate the direct economic impact of Project Hope on the local economy, we considered three factors. First, we totaled local purchases of goods and services made by Project Hope, information readily available from administrative sources. Second, following a common methodology (Lichty and Steinnes, 1982), we developed estimates of local expenditures for goods and services made by all twenty-two Project Hope employees in Portoviejo through a survey questionnaire. (Employees included administrative staff, secretarial support, financial personnel, health/loan promoters, vehicle drivers, and other auxiliary support personnel.) All Project Hope staff lived in the economic area served by Portoviejo. Data collected from the questionnaire included monthly expenditures by category and by geographic location (whether inside or outside of Portoviejo). Separating total expenditures by geographic location allowed us to measure the expenditure leakage outside the Portoviejo economy. From these data, we calculated total employee disposable income and the percentage of disposable income spent within the Portoviejo economy.

Third, we visited each of the twenty village health banks in Portoviejo and administered a short survey questionnaire asking clients where they spent their loan proceeds and what they purchased. Overall, we surveyed 445 clients. To simplify the data collection and analysis process, we assumed that clients spent their entire loan amount.⁵ After collecting individual-level expenditure data, we next aggregated the data for analytical purposes.

Table 1 presents the total direct community economic impact of Project Hope, broken down by expenditure categories and geographic regions, and Table 2 breaks down client loan expenditures further by enterprise type and geographical area. Over the twelve-month period of April 1, 1998 through March 31, 1999, Project Hope directly contributed \$215,640 to the Portoviejo economy, for an average of \$17,970 per month. Of this amount, \$62,640 (29 percent) came from program expenditures, \$43,000 (20 percent) from employee expenditures, and \$110,000 (51 percent) from client expenditures. The remaining expenditures went to other towns in the Manabi region, to Guayaquil or Quito, or to other locations.⁶ As can be seen, the leakage in the first round of direct expenditures was low; fully 74 percent of direct program, employee, and client expenditures were made within the Portoviejo economy.

Insert Tables 1 and 2 about here.

Induced Economic Impact

To estimate the induced economic impact of Project Hope, we performed eight steps. First, we assembled employment data for each of nine economic sectors across the twenty regions of Ecuador. Employment data from the 1998 national census were provided by the Instituto Nacional de Estadística y Censos (INEC) in Ecuador.⁷ The nine economic sectors are (1) mining; (2) manufacturing; (3) commerce, (4) hotels and restaurants; (5) financial intermediation; (6) real estate, (7) healthcare and other social services; (8) other community activities; and (9) manufacturing support services. Three of the regions had insufficient data, so we eliminated them from the analysis, leaving us with seventeen regions for analysis. The seventeen regions, along with population, are shown in Table 3.

Insert Table 3 about here.

Second, we ranked the regions into a population size array. From this array we placed the regions into population groups. Our cutoff for grouping was 100,000 inhabitants, which gave us the nine population groups shown in Table 3. We based our group selection on our assessment of where significant differences in regional characteristics might be found.

Third, we converted employment numbers by industry and region into percentages of total regional employment, so as to standardize the employment data. Fourth, we selected the minimum percentage employed in each economic sector and assigned this value to all regions within the population group. This represented the minimum employment requirement (or nonbasic employment) for that sector and in that population group. We repeated this process for each of the industrial sectors and population groups.

Fifth, with the data set so constructed, we estimated the minimum employment coefficients for each industrial sector using the following regression model derived by Ullman and Dacey (1960):

$$(2) E_s = a + b \log X,$$

where E_s is the minimum employment requirement in percent for each of the various economic sectors, X is the \log_{10} of the population of the relevant community, and a and b are the relevant parameters.

Ullman and Dacey derived this equation by discovering that plotting the minimum employment requirement across industry sector and metropolitan area population on a \log_{10} scale closely fit a straight line. Equation 2 calculates the slope of this line, thereby enabling the appropriate minimum employment requirement to be calculated for a city or region of any size. We regressed equation 2 across the population groups for each of the nine industrial sectors separately. This yielded the minimum employment coefficients for each of the nine industrial sectors.

Sixth, and again following the methodology established by Ullman and Dacey, we summed the minimum employment coefficients from the nine sectors so as to create a single set of minimum employment coefficients for all nine industrial sectors combined. (The individual sector and summed minimum employment coefficients are shown in Table 4.) Seventh, we calculated the minimum employment requirement for Portoviejo by plugging the summed coefficients and Portoviejo's population in equation 2. The calculation was as follows: $E_s = a + b \log X$; $E_s = -2.440 + 0.569 \log_{10} (180,000)$; $E_s = 0.554$.

Finally, we plugged the minimum employment requirement for Portoviejo into Tiebout's income multiplier formula found in equation 1 to calculate the relevant income multiplier for Portoviejo. The calculation was as follows: $M = 1 / (1 - 0.554)$; $M = 1 / 0.446$; $M = 2.24$.

An income multiplier of 2.24 means that each dollar generated by Project Hope results in \$1.24 in additional income, or induced economic impact. This suggests, therefore, that Project Hope's direct economic impact of \$215,640 generates approximately \$267,394 in additional income as induced economic impact equaling a total of the direct and induced economic impact of \$483,034 per year, or \$40,253 per month. We interpret this estimate to represent a reasonable estimate of the order of magnitude of the community economic impact of Project Hope, and not a precise calculation.⁸

CONCLUSION

We have argued that the community economic impact is a potentially important, although heretofore overlooked, component of the overall impact of microfinance programs. We then demonstrated a methodology for calculating the community economic impact using as an example the Project Hope village health bank program in Portoviejo, Ecuador. Using this methodology, we estimated that Project Hope throws off a positive economic benefit of approximately \$483,034 per year, or \$40,253 per month to the Portoviejo economy.

Relative to industrialized world standards, a yearly economic impact of \$483,034 per year for a community of 180,000 might not appear significant. To assess the significance of this number, perhaps a little perspective is in order. Project Hope has twenty-two employees in its Portoviejo office. Thus the yearly community economic benefit per employee in 1999 was \$21,956. This appears to be a non-trivial amount for a country whose average per capita income in 1999 was only \$1,101 (Embassy of Ecuador, 2000).⁹

The implications of the analysis presented in this study are several. To begin with, the absence of community economic impacts from microfinance impact studies implies that impact studies probably have systematically underestimated actual program impacts. This implies in turn that community economic impact ought to be an integral part of full-scale microfinance impact studies, where the appropriate data exist.

For program planners, our study highlights that the benefits of microfinance programs are economic as well as social; that the economic benefits of microfinance programs extend beyond program beneficiaries into the wider local community; that these economic benefits can be nontrivial by themselves and are quite possibly significant in the aggregate; and that these economic benefits may be estimated in a reasonably simple, straightforward way.

Another implication for program planners is the opportunity to increase overall program impact by forging backward and forward links with economic actors in the local economy. The economic impact of microfinance programs will be increased to the extent, for example, they hire local staff (who are more likely to spend in the local community), purchase goods and services from local merchants, support local microenterprises that tend to purchase working capital and other business assets from local merchants, or facilitate enterprise diversification among clients (so as to avoid possible negative impacts described above). These are but a few of possible strategies. Implied as well, therefore, is that program planners investigate ways to create, strengthen, and extend such linkages.

For policy makers at the local, regional, or national level, an important implication is that promoting investment in and by MFIs makes good policy sense, both from a social and an economic perspective. Governments have long promoted private-sector investment in selected regions or communities or in certain industries so as to create jobs, increase income and living standards, and diversify the economic base. However, in economically disadvantaged communities or among economically disadvantaged groups where significant amounts of private-sector investment are unlikely to materialize, investment in and by MFIs can play an important complementary or substitute role. This study suggests that not only should this role not be overlooked, but that it should be promoted as well.

Taking this idea a bit further, it implies that we reorient how we think about microfinance and microfinance programs. Within donor and practitioner circles, microfinance is typically viewed within the context of a social development paradigm. That is, the *raison d'être* of microfinance, ostensibly at least, is to alleviate poverty. But a more expansive view of microfinance sees it as an emerging global industry within the context of an economic development paradigm as well. The difference is subtle, perhaps, but significant.

Take job creation as an example. An impact assessment guided by a social development paradigm will tend to focus on jobs created for microentrepreneurs and for employees within microenterprises and how they contribute to the narrower objective of poverty alleviation of program participants and their families. An impact assessment guided by an economic development paradigm as well will also focus on jobs created within MFIs themselves and by MFIs within the local, regional, or national economies in which they operate. In other words, jobs created by MFIs directly (program staff) and through income multipliers constitute real and measurable economic benefits of microfinance, as would be jobs created in, for example, banking, retail, or tourism. Moreover, microfinance is a growing industrial sub-sector that provides opportunities for active and widespread participation in legitimate economic activities across a broad spectrum

of the population in developing countries, including, perhaps most importantly, populations heretofore excluded from such opportunities.

It should also be noted that in this study we have focused on a single MFI. It is expected that the community economic impact of Project Hope will be but a fraction of the cumulative economic impact of the multiple MFIs operating in and around Portoviejo. This conclusion would be true as well for large numbers of developing country communities in which multiple MFIs operate. Based on the analysis in this study, it appears reasonable to conclude that the presence of multiple MFIs in local developing country economies could have a significant economic impact on those communities, in many cases possibly reaching well into the millions of dollars.¹⁰

This study also raises several questions for future research. How can microfinance programs be designed to maximize forward and backward economic linkages? How do the local economic impacts and income multipliers of microfinance institutions targeting low-income persons compare to those of traditional financial services institutions (e.g., commercial banks) or MFIs targeting relatively well-off persons. How do the local economic impacts and income multipliers of social enterprises (social and financial bottom line) compare to those of for-profit enterprises? How do the local economic impacts and income multipliers of the microfinance industry compare to those of other industries? Do different types of MFIs (e.g., rural vs. urban, village banking vs. solidarity lending vs. individual lending, donor funded vs. market funded, poverty focused vs. mixed focus, enterprise lending vs. multi-purpose lending, inflexible savings and loan policies vs. flexible savings and loan policies, etc.) produce different types and levels of community economic impacts and income multipliers? Answering such questions will enable program planners and policymakers to understand better how to use microfinance to pursue a variety of economic development objectives.

We end with a couple of cautionary notes. Although this study has focused on the economic benefits of microfinance programs, it must not be forgotten that the primary intended benefits of microfinance programs as often as not are social. Thus while economic benefits are important in their own rights, they are often subordinate to or on par with the MFI's social mission. Even when economic objectives guide microfinance programs, social objectives are often still considered important. The implication is that when assessing the impact of microfinance programs, community economic impact analysis will necessarily be nested within a more general analysis of social benefits and costs.

In addition, while multiplier analysis is a useful tool for estimating induced economic impact, it can be, and often is, misused. For example, two common misuses of multiplier analysis are the application of multipliers to situations in which there is no infusion of exogenous investment or spending or the use of multipliers of apocryphal origins.¹¹ Moreover, within the context of local economic competition, economic impact analysis too often is employed in the service of rent seeking, to demonstrate the "importance" of a certain economic sector by some special interest group, to justify socially questionable activities, or to pursue personal or political ends rather than legitimate social or economic objectives.¹² Finally, there exists a tendency to assume greater precision in estimating income multipliers and economic impact than is generally warranted, given data limitations, measurement error, and methodological weakness. These caveats all suggest that in estimating income multipliers and community economic impact, some degree of humility is advisable.

But the very same problems exist to largely the same degree in measuring the impact of other development programs and the economic impact of for-profit firms or industries, and this has not deterred researchers from moving forward productively in these areas. The existence of a relatively simple and contextually appropriate methodology, the increasing availability of appropriate data, and the potentially significant contribution to our understanding of the overall impact of microfinance argue for a wider application of community economic impact analysis in assessing the impact of microfinance programs.

ENDNOTES

¹Project Hope began as a peacetime hospital ship—the SS Hope—which launched its maiden voyage in 1960 and traveled from country to country rendering health care assistance. Currently, Project Hope provides assistance to twenty-eight countries and has provided medical aid to over seventy countries since its inception.

²See Dunford (2000) for more on the Credit with Education methodology.

³To have an induced economic impact on a community, the increase in initial spending must come from source outside the local economy, which is the case for Project Hope's village health bank program in Portoviejo. If on the other hand, spending is merely diverted from one section within the local economy to another, there will be no multiplier effect.

⁴Project Hope has developed alliances with the National Institute of Cancer, Loor Eye Foundation, and other NGOs that provide housing support for construction cost and AIDS education

⁵Of course, clients may save (not spend) a portion of their loan proceeds. They may also gift, lend, remit, etc. portions of their loans. However, we are not aware of any research indicating that clients do so consistently to any great extent. Thus we believe our simplifying assumption to be generally accurate. Another possibility is that clients do not spend the entire loan amount on their enterprises. This does occur with some frequency. Still, research indicates that clients spend the large majority of their enterprise loans on their enterprises (see, for example, Chua et al., 2000). Regardless, it is irrelevant to the final analysis. For the methodology used in this study, what ultimately matters is *where* the money is spent, not on *what* it is spent.

⁶The breakdown of employee expenditures by category is as follows: food (27.6 percent), housing (5.4 percent), clothing (10.2 percent), health care (8.0 percent), other family members (4.4 percent), church (1.4 percent), savings (3.1 percent), animals (0.4 percent), vehicles (6.0 percent), child care (3.84 percent), personal care (8.1 percent), taxes and bribes (1.6 percent), and other (11.7 percent).

⁷The employment data for Ecuador used here were provided to the authors by INEC staff.

⁸The income multiplier for Project Hope lies within the range of income multipliers for financial institutions in the United States. For example, income multipliers calculated in the financial service sector in the state of Utah by Fjeldsted (1990) yielded multipliers of 1.81 for commercial banks and 3.70 for non-bank credit agencies.

⁹Since we did not calculate other economic benefits or any negative economic impacts of Project Hope's village health bank program, we cannot know what the net community economic impact is. The net impact could have been higher or lower than this amount (and theoretically even negative), depending on the nature and extent of unmeasured negative and positive impacts.

¹⁰This is true, however, only to a point. If the number of microfinance providers grows too large, they will possibly reach the point where they are simply reallocated existing expenditures among themselves and not creating new spending at the margin. Nevertheless, this point still appears distant. Reasonable estimates suggest that overall demand for financial services among the poor in developing countries still far exceeds supply (Consultative Group to Assist the Poorest 1995; Christen, et al., 1995). Moreover, wide variations in target markets, products, pricing, methodologies, etc., among microfinance programs suggest a lack of pure substitutability among competing MFIs. Although in specific communities, demand and supply might be nearing an equilibrium point, this is not true for many communities, Portoviejo among them. In particular, we argue that Credit with Education programs serve a particular market niche that remains unsaturated.

¹¹Commenting on the misuse of multiplier analysis, Fjeldsted (1990) notes that if all claims by special interest groups in the state of Utah regarding income multipliers and economic impact were true, Utah would have a \$300 billion economy in terms of gross state product, rather than the \$30 billion economy it actually has.

¹²That an activity can be demonstrated to produce positive community economic impacts is hardly sufficient justification for it. For example, a brothel may very well produce non-trivial direct and induced community economic benefits, but these must be weighed against its costs, both social and economic, and against society's mores. Thus our argument that community economic impact analysis should be nested within a more general analysis of benefits and costs.

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Figure 1
The Community Economic Impact of Microfinance Institutions

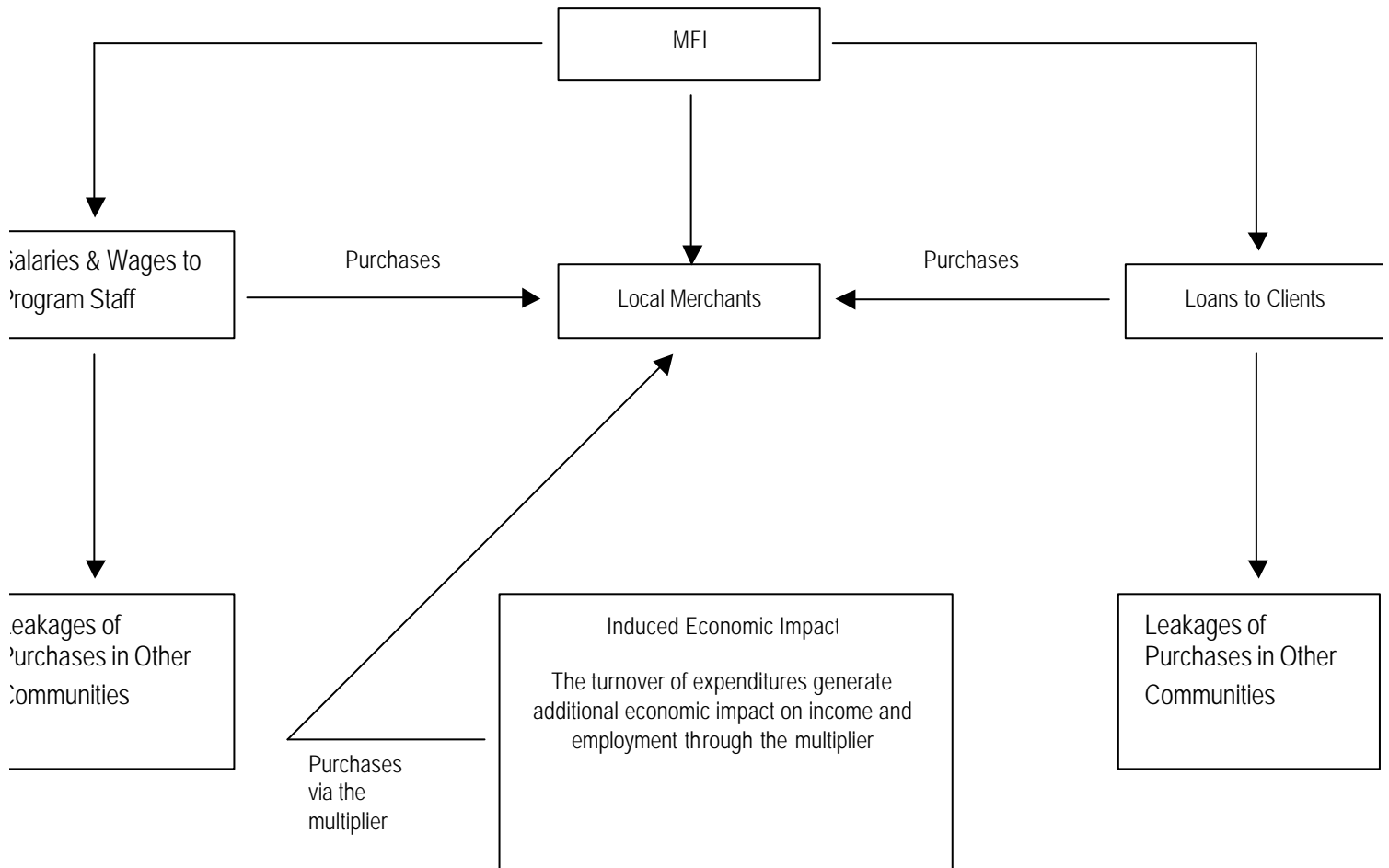


Table 1. Total Direct Economic Impact of Village Health Banks on the Economy of Portoviejo, April 1998-March 1999 (all figures are in constant 1999 U.S. dollars)

Expenditure Category	Portoviejo	Manabi Region	Other	Total
Institutional Expenditures	62,640	8,700	15,660	87,000
Employee Expenditures	43,000	6,070	1,518	50,588
Client Expenditures	110,000	5,854	38,207	154,061
Total Direct Impact	215,640	20,624	55,385	291,649

Source: Project Hope accounting, employee expenditure surveys and client loan use surveys.

Table 2. Average Expenditures by Type of Business and Geographical Area (percentages)

Type of Business	# of Clients (445 total)	Portoviejo	Manabi	Guayaquil	Quito	Outside Ecuador
Beauty products (cosmetic s)	51	30.8	0.6	20.6	28.4	19.6
Beauty services	13	88.5	0.0	3.8	7.7	0.0
Clothing products	117	45.1	8.2	25.7	9.0	12.0
Clothing services (e.g., sewing)	26	85.9	7.6	0.0	0.0	6.4
Entertainment products	4	67.5	0.0	0.0	0.0	32.5
General supplies	25	88.0	0.0	6.0	0.0	6.0
Grocery	99	91.6	6.2	1.0	0.0	1.2
Jewelry	29	52.4	10.3	6.9	13.1	17.3
Construction services	6	50.0	0.0	16.7	0.0	33.3
Medical products	7	71.4	0.0	7.1	21.5	0.0
Prepared food (e.g., bakery)	61	91.6	1.1	6.5	0.0	0.8
Transportation	2	100.0	0.0	0.0	0.0	0.0
Miscellaneous	5	65.0	15.0	0.0	0.0	20.0
Average by Type of Business		71.4	3.8	7.3	6.1	11.5

Source: Client loan use surveys.

Table 3. Regions with Populations Analyzed in Ecuador

Region	Population
Pastaza	41,811
Zamora Chinchipe	66,167
Sucumbios	79,952
Bolivar	155,088
Cañar	189,347
Imbabura	265,499
Cotopaxi	276,328
Esmeraldas	306,628
Tungurahua	361,980
Chimborazo	364,682
Loja	384,698
El Oro	412,572
Azuay	506,090
Los Rios	527,559
Manabi	1,031,927
Pinchincha	1,756,228
Guayas	2,515,146

Table 4. Parameter Values for Minimum Employment Requirement

Economic Sector	a	b
Mining	-0.00125	0.00034
Manufacturing	-1.41400	0.37100
Commerce	-0.41000	0.08009
Hotels and Restaurants	-0.06362	0.01306
Financial Intermediation	-0.06256	0.01190
Real Estate	-0.32000	0.06099
Healthcare and Other Social Services	-0.04620	0.00914
Other Community Activities	-0.07357	0.01401
Manufacturing Support Services	-0.04904	0.00945
Sum	-2.44024	0.56998

From: Richard Meyer [meyer.19@osu.edu]
Sent: Mi 01.08.2001 17:22
Subject Defaults in Bolivia

I just learned that on July 2 a group of Bolivian microcredit clients invaded the Superintendency of Banks, took the staff hostage, strapped dynamite to their own bodies, and demanded that their loans be written off. I don't recall seeing any comment on the dfn. Can anyone provide details? Is this a sign of overlending or the economy going unexpectedly bad with selective impacts on the poor? What MFIs are most affected? Group or individual lenders? Rural or urban? Any evidence that this may be due to borrowers being clients of more than one MFI? Dick Meyer

From: [roquiros@la-academia.or.cr]
Sent: Fr 03.08.2001 18:17
Subject Defaults in Bolivia

Professor Meyer:

I do not have detailed information, but have some facts that am glad to share with you.

The incident was kind of scary, given that almost everyone in the Superintendency was taken hostage, and dynamite necklaces were placed on a couple of secretaries. After 24 hours government officials were substituted for the hostages. Although protests become violent in Bolivia once a year, this one apparently shocked the country.

I was there a couple of months, earlier this year. There was already a small group of protesters requesting first a reschedule of loans, but later demanding a total forgiveness of their operations. I did not feel it was more than that, a small group of protesters. It did not seem as a movement throughout the whole financial system, not even seriously threatening micro finance organizations.

Back then (May), government officials met with them and stated their impediment to intervene in private contracts, and the danger for the system as a whole, of forcing institutions to condone or reschedule operations.

All these happened at a time when other highly influential groups (campesinos and coccaleros) were demanding solutions to their problems and forcing the government to comply with a set of agreements reached last October, in order to avoid road blockades. This led the government merely to "suggest" to the financial institutions to avoid any legal actions against agricultural producers defaulting on their loans.

I do not know how things have evolved after May and am totally unaware of the type of agreement that the Government might have reached with those that took the Superintendency.

I hope someone in Bolivia (USAID or GTZ, perhaps), could provide more information about what else has happened.

Regards, Rodolfo

From: Martina Wiedmaier-Pfister, Rural Finance Project, FONDESIF-GTZ, Bolivia [sfrgtzwp@ceibo.entelnet.bo]
Sent: Sa 03.08.2002 23:02
Subject Defaults in Bolivia

Bolivia: Crisis in the Microfinance Sector

In the following, a brief summary of the recent happenings in the Bolivian MFI sector and my personal assessment of the situation. I have to remark, that it is not quite easy to picture the whole magnitude of the problem and get precise data, yet we are working on it.

Background

- **Since 1999, Bolivia is hit by an economic crisis due to the problems in neighboring countries, continuous natural disasters, massive eradication of coca plantations**

leaving the economy with 500 million \$ annually less, restrictive customs procedures impeding smuggle, widespread social uprisings, etc.

- Over indebtedness of the microfinance sector, mainly due to the aggressive lending of consumer finance companies.
- There exist 4 to 5 associations of small debtors. This movement arose in mid 1999. Claims are the forgiveness of the debts of their members (principal, or only the overdue interest and/or legal costs), in some cases the erasing from the Central Credit Bureau. These associations were politically and financially motivated and abused for other purposes. Members which joined the associations and paid the entrance and in some cases regular fees (8 - 20 \$) believed the promise of the forgiveness of their entire debt and felt represented only in the beginning.
- The phenomenon is present in rural and urban areas, however, there is more pressure in La Paz, where the Government, the Superintendence and the main offices of the MFIs are located.
- Generally, all MFIs and some other FIs are affected: Private Financial Funds (PFFs), Financial NGOs, Cooperatives, Mutuals, Banks. However, the individual involvement of each MFI differ a lot.
- Approximately 60 % of the cases presented in a list to parliament in 1999 refer to amounts beyond 5.000 \$ and loans from consumer lending companies.
- Associations of Banks and MFIs as well as Superintendence have been dealing with the movement since 1999. At that time, the Superintendence meditated the conflict. An agreement on reprogramming was then signed and ended in nothing since the leader of the association was put in jail. He had organized a series of protest marches in the main cities and was blamed to act against the law. However, he reappeared in the recent uprisings.

Recent occurrences

- The movement (pressured especially by one borrowers association led by a lawyer) culminated in the hostage taking in the Superintendence on July 2nd, 2001. Hostages were exchanged on the following day for representatives of human rights organizations, Women Groups and the Church, they were freed later on, promising to mediate in the conflict.
- A settlement was signed on July 4th, 2001 between the three financial associations (ASOBAN/Banks, ASOFIN/PFFs, FINRURAL/NGOs) and representatives of 7 regional borrowers associations and their lawyer, as well as the Superintendent agreeing on:
 - The treatment of loans only up to 5.000 \$ (intents were made to also present larger, mainly consumption loans)
 - Resolving the cases of the reclaiming borrowers in 100 days
 - Superintendence will supervise the treatment of the claims, which will be handled individually by the main offices of the MFIs which involucrate their respective association.
 - Lists of the debtors will be handed on to each MFI within 7 days.
 - The conciliation of debts in special cases (death, debtors of zones of natural disasters etc.) will be handled with priority.
 - Negotiations are only on the individual base, no borrower association can negotiate for their members in bulk (as often promised) , but, each borrower must negotiate with the main MFIs passing through the main office
- Some details on the agreements were wrongly conveyed to the press, again speaking on the waiver of overdue interest which was never agreed. It was only agreed to forgive the legal expenses of the executed cases.
- Human rights organizations, a women´s group and the church are planning to organize a seminar on the problem in the coming weeks. However, the position of these institutions is rather partial to my consideration, for example focusing on the supposedly high interest rate level in the sector which the allegedly “poor people cannot pay”.

Some Facts

- The microfinance sector counts with more than 400.000 borrowers at present. About 200.000 are clients of the regulated MFIs (PFFs, 1 NGO and 1 Coop. Bank), associated in ASOFIN. From those, 46.000 are overdue loans (from 1 day on).
- About 150.000 are clients of financial NGOs, of which only 5 % (7.500) have overdue loans (1 day). According to a representative of FINRURAL, some debtors stopped paying their loans in the expectation of a loan waiver.
- Apparently, there are various lists of debtors circulating in the sector, one presented to parliament in 1999 with supposedly 14.000 borrowers (data is in the process of verifying!), another one just recently to the associations of regulated MFIs (ASOFIN) and a third one to the financial NGOs (1073 cases).
- The individual cases of the two latter lists are being analyzed at present by each of the MFIs, apparently they include a lot of current loans, borrowers with loans that had been written off (who want to get out from the Credit Bureau) and many data inconsistencies.
- Some of the cases presented to ASOFIN are or not even overdue loans. And from the 1003 cases on the list, only 340 refer to the regulated MFIs (PFFs).
- The aggressive lending as well as recovery practice of consumer credit companies since 1998 had negative repercussions on the microfinance market, leading to over indebtedness of some of the traditional clients of MFIs.
- The issue has been politicized ever since by individuals and pressure groups, trying to disgrace the work of 15 years of microfinance in Bolivia, where sustainable MFIs were created which in the course of time reduced their interest rates for small loans from nearly 60 % to sometimes less 30 % today.

Conclusions

- Superintendence, MFIs and their associations stick to a complete negation of a waiver (apart from legal costs) even though a lot of pressure on many levels (parliament, repeated protest marches since 1999, negative press campaign etc.) is executed.
- The present general “satanization” of microcredit in Bolivia, motivated by pressure groups and persons seeking a global waiver of loans, is a serious threat for the whole industry, endangering the future of micro lending not only in Bolivia.
- The involvement of church and human rights organizations added weight to the movement. Their position is clearly in favor of these “poor”, without yet recognizing the opportunistic behavior of many involved association members and leaders, and evaluating the threat for the sustainability of the MFI industry - with all its past and present positive effects for exactly these poor.
- The poor need to be taught more about the real costs of lending, and become “critical clients” who are able to compare the loan offer critically and fully understand the meaning of a (PRIVATE) loan contract. This is also understood by the Superintendence and the MFIs.
- MFIs recognize that more emphasis must be put in informing their customers and establish a positive customers relationship which could impede such phenomenon, as well as to make their credit conditions fully transparent.
- The present crisis in the MFI sector, with high default rates and declining loan portfolios forces MFIs to further improve their institutional policies, especially to diversify their product range which on the long run contributes to their sustainability and improves their customer services.
- The phenomenon is now taken more seriously than before by all actors involved, even though numbers might suggest that only a relatively small number of borrowers are involved and opportunistic behavior appears to be dominating.

Activities to combat the crisis

- **Government, MFIs and their associations, sector institutions and the international cooperation are presently joining hands to overcome the problem with a “emergency plan” still to be developed, including all kinds of activities, like a press campaign, campaigns directed to the borrowers etc..**
- **The facts of and behind the phenomenon are recently analyzed thoroughly to be able to argue in a profound way, to separate problem cases from opportunistic behavior and black sheep, and finally avoid future pressure measures.**
- **Campaigns and events to rescue the image of micro lending and the MFIs have been initiated or are being prepared.**
- **Studies and investigations to detail the cost of lending and provide better arguments on this important detail are implemented.**
- **Measures to improve customer orientation in the MFI industry are being prepared to be implemented on the medium term.**

I'll be waiting for your contributions and try to get back with news and more details!

Best Regards

Martina Wiedmaier-Pfister, Main Advisor of the Rural Financial Systems Project (GTZ-FONDESIF)

August, 3rd, 2001

From: Robin Ratcliffe [rratcliffe@accion.org]

Sent: Sa 04.08.2001 02:51

Subject: Defaults in Bolivia

Dear Colleagues: The problems in Bolivia are multifaceted and to our knowledge all Bolivian microfinance institutions are being affected and are struggling with portfolios at risk of up to 20% which only a few years ago was unheard of in Bolivia. In addition to overindebtedness, which many observers believe was occasioned by the consumer lending institutions that launched lending in Bolivia in the late 1990's—to microentrepreneurs—the situation in Bolivia is, both politically and economically, at its lowest point in the last 15 years (since Bolivia overcame its hyperinflationary period). The president is terminally ill, will probably resign next week, and the current government is not providing clarity of direction. Overall public dissatisfaction is high. Add to this a persistent economic recession for the last three years that is seriously affecting the poor and you have a very bleak picture for the country. Estimates are for negative overall growth this year and for an increasingly shrinking banking sector with lowering quality of assets. While microfinance institutions in general are suffering (some more than others) - they are actually faring well in comparison to banks, mostly, some say, because they provisioned so conservatively.

Jacques Trigo, former Superintendent of Banking in Bolivia and now ACCION Senior Fellow for Policy, was working closely on this issue. As a result of the dramatic events in July, an agreement was signed between the Bolivian Association of Debtors (which is composed of political groups with their own power agendas and which may have discredited itself with this move) and Asofin and Asoban (trade organizations in Bolivia) laying out the terms under which loans will be repaid. The agreement also details certain practices of overcharging and harassments in collecting debts practiced by some microfinance institutions and banks. The agreement also includes an event that will be sponsored by Asofin and Asoban help inform people about the role of credit for the poor.

It is not an easy situation and the very best microfinance institutions are all being affected.

Robin Ratcliffe

Vice President, Communications

ACCION International

From: Miguel de Leon [migs@codewan.com.ph]
Sent: Mo 06.08.2001 13:09
Subject Defaults in Bolivia

This sounds like fight on several fronts:

- 1)collection
- 2)public image
- 3)future growth

On the onset, the amounts past due does not seem to large. At 46,000 past due from a total of 400,000 borrowers (are these loans outstanding?) that would be 12% depending on the loan sizes. In spite of the seemingly small amount, it would not be advisable to "go easy" on those in arrears lest the microfinance industry present itself as lacking in conviction. With regard to the public image, you may want explain the rationale of micro credit and its process. Testimonials from successful borrowers would be good too. I find, however, that dissenting opinions on microfinance stem from deeper ideological bases (socialized credit vs. market-based interest rate can easily turn into a debate on the role of the state vs. the evils of capitalism) so choose your market for the public image campaign.

If the first two issues are addressed well, the future growth of microfinance can be protected. Reforms in both regulation and implementation would be advisable. Personally, I think that government should not engage in microfinance directly. In the Philippine experience, borrowers tend to associate government loans with dole outs and conveniently forget to repay the loans. MFIs should take the time out in explaining the nuts and bolts of the loan to their borrowers and, as you wrote, work on customer relations.

Good luck!

Miguel de Leon

From: Petronella Chigara [vulihre@africaonline.co.zw]
Sent: Di 07.08.2001 09:13
Subject Defaults in Bolivia

I have been following the discussion on the Bolivian market with interest. We are going through one of the worst crises ever in Zimbabwe and are getting concerned about the macroeconomic environment and its impact on the MFI industry.

Just to give you a feel of the issues

Inflation is around 70%

Lending rates have been forced down to 30% in the banking sector - TB rate is about 15%-govt has been setting up policies to manage the rate. The MFIs rate is pegged at 35% which is a real -35%.

The exchange rate is managed - official rate sitting at 55 to the US while the unofficial rate is sitting at 200 to 230 ridiculously parallel!!! The political climate is tense and in relative terms we going through the worst. The first time we are having real opposition after 21 years of one party rule. The violence we are experiencing which when compared to other environs is minimal but by Zim standards is really unprecedented.

Economic decline - negative economic growth about -2,5%

Unemployment rate over 50%, poverty levels about 80% As expected the informal sector is growing.

The formal banking sector is thriving - still able to maintain their margins and maybe making money out of the exchange rate gains.

Should we be panicking? Should MFIs reduce investments into the sector - clients seem to be overborrowing - lots of consumer or microlenders have started operating and are charging huge rates.

Please comment!!!