From Microcredit to Livelihood Finance

It cannot be said that microcredit can by itself promote economic growth. In reality, microcredit is barely adequate even as an instrument for poverty alleviation, leave alone economic growth. To serve the purpose of economic growth, we need a new paradigm of livelihood finance with much larger levels of resource allocation, both from public resources as well as from the capital markets.

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The origin of microcredit can be traced to the 1976 when Mohammed Yunus set up the Grameen Bank experiment on the outskirts of the Chittagong University campus, as an experiment. Yunus is recognised as the father of microcredit, just as M S Swaminathan is considered the father of the Indian green revolution. Both interventions have made a huge difference to the lives of millions of people, particularly the rural poor. Since the microcredit revolution came a whole decade or two after the green revolution, it was more sensitive to issues of poverty and gender inequality and thus had in its design a focus on the poor, if not the poorest, and specifically on women. By targeting the landless, microcredit also ensured that the poor could make a livelihood from activities other than agriculture.

This year, 2005, is the UN Year of Microcredit. The fact that microcredit has been elevated to such an exalted status that the UN declares a year around it, is quite amazing, particularly to those who have worked in this field for over 20 years. The trend began with the microcredit summit in Washington, DC, in February 1997. The summit was organised to "launch a global movement to reach 100 million of the world's poorest families, especially the women of those families, with credit for self-employment and other financial and business services, by the year 2005".

1997 microcredit summit: The presence of many luminaries at the 1997 summit was an indication of the support garnered by microcredit. For example, from the speech of Hillary Clinton, it was obvious that she was sincerely involved in the field and had visited many microcredit institutions in developing countries. However, for many of the others, it was a case of jumping on the bandwagon, and few raised any issues about the limitations of microcredit. After attending the summit, I had written a critical article titled 'Is Microcredit *the* Answer to Poverty Eradication?' My answer was a qualified no.

Since then, microcredit has become a global fad, to the point where all kinds of claims are being made in its name, as if it is the latest magic potion to resolve the problems of poverty in the world. In response, a range of others, from the *Wall Street Journal* to academic researchers like Jonathan Morduch have taken it upon themselves to question these claims and show that the impact of microcredit on the target households is exaggerated.

The question is – does microcredit promote economic growth? Let us explore the connection between microcredit and economic growth. I do this from the point of view of someone who has given 20 years of his life, to this work. But before coming to microcredit and economic growth, it is pertinent to recall what I considered in 1997 as the limitations of microcredit even as a strategy for poverty eradication.

Limitations of Microcredit: Five Fatal Assumptions

(1) *Assumption that credit is the main financial service needed by the poor.* Actually it is not. The poor need and want to save much more than they want to borrow. They also want to cover themselves against risks through insurance. However, the field in general does not adequately emphasise other financial services, such as savings and insurance. Savings are particularly important, as these act as self-insurance in case of smaller contingencies; meet sudden demands of cash such as due to illness in the family; act as margin money or "equity" for borrowing; and finally, to some extent act as a collateral for repayment of loans, where savings are deposited with lenders. The experience of SEWA Bank in India, for example, shows that women value a safe place to keep their savings as an important service.

Insurance is another important financial service for the poor, given their vulnerability to livelihood risks. Here one is not talking so much of life insurance, but of crop insurance and insurance for income earning assets such as livestock and irrigation pumpsets. For certain occupational groups such as sea-going fishermen and miners, life insurance is important. Money transfers are an increasingly important service, as a large proportion of poor households have one or more members of the family migrating for part of the year or several years at a time, in search of work. Thus to focus on microcredit alone and leave out micro-savings, micro-insurance and money transfers is myopic.

(2) *Assumption that credit can automatically translate into successful micro-enterprises:* This is the familiar debate of "minimalist credit" strategies versus the "integrated" approach to micro-enterprise promotion. Others, (such as Mahajan and Dichter, *Small Enterprise Development,* Vol 1, No 1) argue that there is no one correct approach and that the strategy for micro-enterprise promotion should be contingent on the requirements of the situation, based on a systematic analysis.

Microcredit is a necessary but not a sufficient condition for micro-enterprise promotion. Other inputs are required, such as identification of livelihood opportunities, selection and motivation of the micro-entrepreneurs, business and technical training, establishing of market linkages for inputs and outputs, common infrastructure and some times regulatory approvals. In the absence of these, microcredit by itself, works only for a limited the familiar set of activities – small farming, livestock rearing and petty trading, and even those where market linkages are in place. The microcredit summit declaration did make a token recognition of this assumption when, in a shift from the draft to the final, they added "other financial and business services" to credit.

(3) *Assumption that the poorest all wish to be self-employed and can be helped by microcredit:* Most of the proponents of microcredit as *the* strategy for poverty eradication make the explicit assumption that the poor would all like to be self-employed. It is true that a certain proportion of poor people do like to take up small farming, livestock rearing, processing, manufacturing or trading activities, but usually they do so to supplement their income from wage-employment. A majority of poor people, particularly the poorest (such as landless labourers in India) want steady wage-employment, on- or off-farm.

Moreover, there is serious evidence that like all other "single" interventions, microcredit works less well for the poorer clients. As David Hulme and Paul Mosley have shown in their important work *Finance Against Poverty* (Routledge, London, 1996), the increase in income of microcredit borrowers is directly proportional to their starting level of income – the poorer they were to start with, the less the impact of the loan. One could live with this finding in an imperfect world, but what is really troubling is that a vast majority of those whose starting income was below the poverty line actually ended up with less incremental income after getting a microloan, as compared to a control group which did not get the loan. This should stop recent converts from offering microcredit as the solution for poverty eradication, since it can do more harm than good to the poorest.

(4) *Assumption that those slightly above the poverty line do not need microcredit, and giving it to them amounts to mistargeting:* Though several microcredit programmes, including the Grameen Bank, Bangladesh and its replicators have a vast majority of their clients who are poor, mainly landless women, this is not true of a large number of other microcredit programmes, including India's self-help group (SHG)-bank linkage programme. Most microcredit programmes mainly reach the upper layers among the poor and some, mainly those above the poverty line. Because the microcredit promise was to reach the poor, if not the poorest, this phenomenon is not well regarded.

Yet, access to credit by those who are not among the poorest is not very much better than for the poorest, and what is more, these people generate much needed wage employment opportunities for the poorest. In addition, it enables the microcredit channel to spread its costs over a larger base. To therefore treat any lending to those slightly above the poverty line as mis-targeting is naïve.

(5) *Assumption that microcredit institutions can all become financially self-sustaining:* While one supports the overall move for financial self-sustainability, the assumption that this can be possible for all microcredit institutions, needs to be examined. Even the best cases take too long to get there (e g, Grameen Bank of Bangladesh in its first 20 years) or have got there by shedding their NGO avatar which needed early subsidies (e g, PRODEM before it became Bancosol). India's SHG programme has grown big on the basis of external support to the one-time costs of group formation and ongoing group support costs. With political pressure to lower interest rates on loans to SHGs, even the variable costs are not being met in most places.

Recent studies by CGAP show that only about a 100 of the 10,000 odd microfinance institutions (MFIs) round the world are financially self-sufficient. Thus the dual promise that microcredit is able to serve the very poor, and in a financially sustainable manner, is not borne out in practice. Experience shows that either one of these two mutually contradictory goals can be achieved, but not both together.

Risks of "Microcredit by Itself Is Enough" Strategy

India has witnessed a large growth in microcredit over the last decade. By adopting and building on the work of a few pioneering NGOs like MYRADA, ASSEFA, PRADAN and DHAN, the institution NABARD has helped make the SHG-bank linkage model now perhaps the largest microcredit programme in the world, with an outreach to nearly 24 million poor women, who have cumulatively received loans of over Rs 6,800 crore from banks. This is an achievement that we can all – NGOs, MFIs, NABARD, and the banks – be proud of.

But we should also not forget that the average loan size is around Rs 2,000 which is too little to even alleviate poverty, leave alone lift a family totally out of poverty, or trigger local economic growth. In many of the poorer states, it is still hard for SHGs to even open bank accounts, leave alone get a loan. In other states, where a large number of groups have been financed, there is an attempt by various political parties to interfere with interest rates and other terms on which the groups work, to cultivate this new vote bank. Thus, there is a real risk that in celebrating the SHG-bank linkage microcredit programme, attention is diverted from the larger problem of financial exclusion of the poor and banks are let off the hook from their real job.

A second risk that the poor may suffer as a result of an overemphasis on a microcredit strategy, is the reduction in government budgetary allocations for other efforts at poverty alleviation, such as the well-tried but less dramatic strategies of investment in human capital such as through primary health and primary education programmes. While there is no denying that such social sector programmes can be run more cost-efficiently and that they can be better targeted at the poor, the replacement of such programmes with microcredit programmes will be a double disaster for the poor. If the implicit subsidies to microcredit institutions are made explicit, then subsidising microcredit programmes versus subsidising social sector programmes can become an informed policy choice, rather than be carried out under the mistaken notion that the former will require only temporary and diminishing subsidies. But the implicit subsidies to microcredit, legitimate as they may be, are not being described or analysed.

Thus, there is the risk of reducing the overall resource allocation for poverty alleviation and social sector programmes. We need to recognise that by pointing to numbers like the Rs 6,800 crore of bank credit to SHGs, politicians and the government can take attention off the fact that not enough resources are being put on more pressing needs such as nutrition, primary health and primary education. We have to thank the Eleventh Finance Commission for recognising this and making additional allocations to the poorer states for precisely these things. But, as the mid-term review of the Tenth Five-Year Plan shows, the progress on most of the Millennium Development Goals (MDGs) is tardy and no amount of microcredit is going to make up for that.

Microcredit and Economic Growth

What should then be done to make microcredit become a true instrument of poverty alleviation, and even further, for economic growth?

In an impact assessment study carried out at Basix (an NGO involved in microcredits) six years after inception, we found that only 52 per cent of our three-year plus microcredit customers reported an increase in income, 23 per cent reported no change while another 25 per cent actually reported a decline. What was the reason for this? Our analysis showed that the reasons were (i) un-managed risk, (ii) low productivity in crop cultivation and livestock rearing, and (iii) inability to get good prices from the input and output markets.

Based on this study, Basix revised its strategy and now offers microcredit along with a whole suite of insurance products covering life, health, crop and livestock. For enhancing productivity, a whole range of agricultural and business development services are being offered to borrowers. For ensuring better prices, alternate market linkages are being facilitated both on the input and output side. Producers are encouraged to form groups and cooperatives, which are then given institutional development services to become more effective.

Since microcredit is able to address the livelihood problem only peripherally, we need to broaden the paradigm from microcredit to "Livelihood Finance". Let me explain the term first. Livelihood finance is a comprehensive approach to promoting sustainable livelihoods for the poor, which includes:

Financial services: (i) Savings; (ii) credit both short- and long-term, for investment in natural resources: land, water, trees, livestock, energy; (iii) insurance for the lives and livelihoods of the poor, covering health, crops and livestock; (iv) Infrastructure finance: roads, power, marketplaces, telecom, as needed; and (v) investment in human development including in nutrition, health, education, vocational training.

Agricultural and business development services: (i) Productivity enhancement; (ii) risk mitigation, other than insurance (such as vaccination of livestock); (iii) local value addition; and (iv) alternate market linkages.

Institutional development services: (i) Forming and strengthening of various producer organisations such as self-help groups, water users' associations, forest protection committees, credit and commodity cooperatives, panchayats and (ii) Establishing systems for accounting, performance measurement, incentives, MIS, etc.

Seen in the above context, microcredit pales into insignificance as a "solution" for poverty alleviation and promotion of livelihoods. Microcredit by definition, is a single intervention: small loans, given for short durations, with repayments beginning as quickly and as frequently as possible. Moreover, whether given through self-help groups, Grameen Bank-style groups, joint liability groups or directly to individuals, most microcredit eventually is loans to individuals, not to any collectives.

In contrast, livelihood finance will require large amounts; it may need more than just loans (it may need equity or risk funds and indeed some public subsidies); it will invariably be for long durations, at least five and maybe 20 years, and its use will almost always be for collective purposes. Thus microcredit and livelihood finance are fundamentally different.

To explain the difference let me take you to a village called Rozkund in the Bijadandi block of the Mandla district of Madhya Pradesh, truly the heartland of India, known for the Kanha Tiger Reserve. The village is 16 kms from a tarred road. The district was densely forested, though now the forest cover is denuded near inhabited areas. The rainfall is plentiful, between 1,200 and 1,400 mm pa. The soil cover is still good. The inhabitants are mainly tribals – the gonds, who till a generation ago lived off the forests and patches of valley land, irrigated by rivulets.

Anokhe Lal Gond, a resident of this village has 3 acres of cultivable land and a separate patch of 2 acres on the hill slope. He has about 20 livestock, including a scrub buffalo, two cows, a pair of bullock and a dozen goats. He is married and has three children, and his old mother lives with him as his father is no more and his brothers have separated. Anokhe is unable to make a living from his land and goes to Jabalpur, about 100 kms away for about six months every year. His wife joins him for part of the time, but comes back after every two weeks to look after the children and the cattle. With all this, we estimate Anokhe Lal's annual income to be Rs 15,000, putting him squarely below the poverty line.

On first sight, Anokhe Lal looks like a potential candidate for microcredit. But I maintain that microcredit will not benefit him much, if at all. Let us take the typical microcredit loan, through the SHG route which his wife could get by being a member of an SHG. For this, she will have to join an SHG, which someone, perhaps an NGO or a government agency would have to form. No such agency is in sight. But even if an SHG were formed, and then its members met and saved regularly, it would take a bank at least 18 to 24 months before the SHG would qualify for a loan. By that time Anokhe's wife would have saved say, Rs 20 per month, or Rs 360 in 18 months, to eventually get an SHG loan of perhaps Rs 1,000 or 1,500. What would Anokhe and his wife do with this loan?

– They cannot level or bund their 3 acres of farm land, to conserve soil cover and rainfall, since it requires at least Rs 3,000 per acre or Rs 9,000.

– They cannot dig a well, which they need, since that requires Rs 20,000 and which, if it has not to dry up requires treatment of the watershed.

– They cannot buy a diesel pumpset and pipeline to raise water from a nearby stream, since that needs another Rs 15,000. The stream also requires watershed treatment if it has not to dry up.

– They cannot buy a buffalo, for that needs Rs 9,000 even for a graded Murrah, and even if they do, without insurance, it can be a major risk. Once bought, it needs fodder, feed, veterinary care and the milk will have to be sold outside the village.

– They cannot plant trees on their two acres of sloping land, since that needs Rs 5,000 and the trees need protection from grazing for the first three years.

– They cannot get a road to their village or an electric line to their field, since the proportionate cost of each of these is Rs 15,000, or Rs 30,000 for both a road and and a power line.

– They cannot educate their elder daughter beyond the local school as it will need Rs 12,000 for her to pass a teacher's training course.

Yet, each of the above "investment" opportunities has positive rate of return, shown by numerous World Bank and NABARD studies to be in the range of 25-30 per cent and more. But all of them require larger, longer-term loans, with long moratoriums and no possibility of repayment for a number of years. Repayment is not only after a long-term but it is also rife with all kinds of uncertainties, since there are a number of externalities in the projects. This is the kind of situation which makes financial institutions shy away.

Even if we found a financial institution to give a loan for any or all of the above investment opportunities to Anokhe Lal, he alone cannot make much use of it, because almost all of these require collective action. Even digging a well in his own land, which looks like a simple, private thing to do, is no good, since unless the ridges and slopes overlooking the valley where his land are treated, the chances are that the water table will go down in a few years and his well will dry up.

Even if Anokhe gets water in his well, for him to make a return on investment on his well and pump, he will have to at least partially grow cash crops such as vegetables and there is no way he can sell those, being 16 kms away from a tarred road. In any case, drawing water from a well using a diesel engine is expensive, so unless he can get electricity, there is no point having a pump. Thus, if the productive base of the village has to go up, it cannot be just for Anokhe Lal alone, but for a much larger number of farmers, if not all of them. This necessarily means they have to be brought together in various groups – self-help groups for savings and credit, watershed groups for land and water conservation, forest protection committees for regenerating the degraded patches.

Thus, in one shot of reality, we find that a Rs 1,500 microcredit loan is at worst an apology for no access to formal credit, and at best a palliative to be used to smoothen consumption in those months when Anokhe and his wife cannot even migrate to Jabalpur.

What Anokhe needs is not microcredit but livelihood finance. In that paradigm, the Livelihood Finance Institution or LFI would begin with forming self-help groups, not for disbursing credit but for encouraging savings and building a sense of solidarity. Other institutions – the farmers' club, watershed committee, forest protection committee, dairy cooperative – in the village would also be formed or strengthened. Over a period of a few years, investment would be made on all the above projects, adding up to Rs 1,00,000 just for Anokhe Lal's household.

But we need to remind ourselves that livelihood finance is not only about finance. For the land treatment to work, the trees to grow on the land on the hill slope, and for the road to be built, functioning local institutions such as watershed committees, forest protection committees and panchayats are needed. To sell his vegetables or milk from his buffalo, in Jabalpur or Mandla, Anokhe needs to get together with other farmers, to transport the produce collectively. As we know, this rarely happens on its own. Some outside motivation and initial training is needed, from an NGO or a specialised agency such as an NDDB team forming dairy cooperatives. Once formed, to function effectively, these groups/committees/cooperatives require regular hand-holding and ongoing institutional development. Intangible though that process is, it also requires an investment. Let us say this will need 25 per cent on the Rs 1,00,000 of project investments we mentioned above.

After several more years, as the projects start yielding benefits, Anokhe would get a (back of the envelope) return of Rs 25,000-30,000 per annum and after paying interest and principal instalments, he would be able to increase his net annual income by at least 50-60 per cent. He would also diversify his livelihood portfolio, reduce the risk due to rain failure after the crop is flowering and generate much needed work for his wife and his mother, while staying in their village. The investment would generate wage employment for landless families in the same village for an additional 60-120 person days. It would conserve land, water and increase the tree cover. Anokhe's eldest daughter could study and become a teacher, and the additional income would also enable the two younger children to finish school, and perhaps even pursue higher studies.

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So, to get out of poverty permanently, Anokhe Lal and 40 million households like his, each need Rs 1,00,000 worth of direct investment, and another 25 per cent of that amount as institutional investment to make it work. Multiply and you arrive at a figure of Rs 5,00,000 crore (about $ 120 billion). This sounds like a large figure, almost 25 per cent of India's GDP. But is that too much investment to eradicate poverty, while rebuilding the natural and human resource base of our country?

Even if India were to spare 2.5 per cent of its GDP for livelihood finance on an annual basis, the task could be completed in a decade and we would still be in time for the 2015 deadline of the Millennium Development Goals for halving poverty. In any case, if we take into account that the Golden Quadrilateral and related highway works will cost the nation Rs 1,00,000 crore, and that the proposed river linking system is supposed to cost Rs 5,00,000 crore, livelihood finance is not such an expensive idea.

Thus, it cannot be said that microcredit can by itself promote economic growth. In reality, microcredit is barely adequate even as an instrument for poverty alleviation, leave alone economic growth. To serve the purpose of economic growth, we need a new paradigm of livelihood finance with much larger levels of resource allocation, both from public resources as well from the capital markets.

So, what is needed to adopt livelihood finance as a national strategy?

(i) Step one should be an intellectually rigorous analysis, careful crafting of the concept and then a wide and open debate on the idea of livelihood finance. The existing experience of both government and NGO projects in natural resource and human resource development should be thoroughly examined for lessons.

(ii) Step two should be convincing the capital markets that livelihood finance is a good deal, and that the risk adjusted returns in it are comparable to or better than well accepted investments such as "housing finance", which all banks are chasing with lower and lower spreads.

(iii) Step three would be ushering institutional changes in the way our natural resources are owned and managed. New models will have to be developed which ensure a congruence of interest for the state, the community, and for the investors.

(iv) Step four is ensuring that high quality human resources are made available to work close to the ground in the districts, where all the implementation is done, in places like Bijadandi. Only highly capable and committed human beings working at the grassroot can make livelihood finance benefit people like Anokhe Lal and his family.

To end though M S Swaminathan was one foremost architects of the green revolution when he realised the negative effects of the "high yielding variety, high chemical fertiliser, high pesticide, high irrigation", strategy, both in terms of the environment as well as in terms of enhancing inter-farmer and inter-regional disparities, he changed his prescription in favour of sustainable agriculture, or what he calls the "evergreen revolution". He accepted the flaws in what was a right prescription in different circumstances.

Microcredit and the SHG-bank linkage programme was the right remedy for the ills of a banking system rendered hostile to the poor after the excesses of the IRDP under which they were forced to lend to a government generated list of poor households. It is time the proponents of narrow microcredit and the SHG-bank linkage programme move from this to the more holistic concept of livelihood finance. EPW

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