
Thinking Micro

Poverty Alleviation through Microfinance, Social Capital and Gender Equality in Bangladesh

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1. Introduction

OBJECTIVES OF THIS PAPER

This paper aims to understand poverty from the framework of development economics, using Bangladesh as a focal case study. We will do this by answering the following questions:

1. What economic and social factors contribute to inequality and poverty in Bangladesh?
2. What specific issues did microcredit address in Bangladesh that the formal financial system did not?
3. What lessons can be drawn from the experience of microfinance as a tool for alleviating poverty?

WHY BANGLADESH?

Despite seemingly insurmountable odds, social movements in Bangladesh used microfinance and social capital to alleviate poverty and promote more equality. While the formal financial system failed to help the poor in Bangladesh, a people-owned corporation called Grameen Bank provided microfinancing to cash-strapped people, empowered them to run their own businesses and make ends meet for the family. Muhammad Yunus, the founder of Grameen Bank, received a Nobel Peace Prize in 2006 to recognize his pioneering effort to use micro-credit for social transformation.

Bangladesh presents an interesting case study to understand the economic and non-economic factors that affect poverty.

CONCEPTUAL FRAMEWORK

In traditional economics, poverty may be viewed from the perspective that people lack capital or lack access to markets that endow capital (eg, loans and entrepreneurial markets). Ray proposed an economic model that explains the poverty trap as a function of imperfect capital markets. Taking into account factors like the availability of collateral, the threat of punishment upon default (a measure of credit risk), the prevailing wages, business startup costs and interest rates, Ray's model demonstrates why formal financial institutions perpetually deny credit to the needy. Essentially, Ray explains the trap this way: if the risk of lending to a per-

son is too high, banks will try to compensate for the risk by imposing stricter lending prerequisites, including increasing the required collateral to secure a loan. In effect, you will only be lent money if you have enough money, in the first place.

Ray's model also explains how this exclusive system in turn suppresses critical economic activity (eg, micro-entrepreneurial activity as an alternative to paid labor) that could invigorate a rural community's stagnant economy. "A missing or imperfect credit market for the poor is a fundamental characteristic of unequal societies." (Ray 226-237) From Ray's perspective microfinance helped turn a fraction of poor Bangladeshi into entrepreneurs. Grameen's efforts therefore created a Pareto improvement, where the condition of some people improved without harming those of others (234).

Sachs pointed to the lack of access to capital as the main reason behind poor people falling in the poverty trap. "When [people] are utterly destitute... they need their entire income, or more, to survive.... They are too poor to save for the future and thereby accumulate the capital per person that could pull them out of their current misery." (Sachs 56-57)

Recent thinking in development economics, however, adds a personal and social dimension to poverty. For example, Todaro says that we need to go beyond traditional economics and view the issue from the interplay of economic and non-economic factors (Todaro 13). He cites Nobel laureate Amartya Sen's concept that the real issue in economic growth is not simply to increase income, but to endow people with the ability to function without hindrances. "What matters is not the things a person has... but what a person *is*, or can be, and does or *can do*." (Todaro 16).

According to Sen, these "functionings" range from very basic needs "such as being adequately nourished and being free from avoidable disease, to very complex activities or personal states, such as being able to take part in the life of the community and having self-respect." (Sen 75) Poverty, in Sen's view, is an encumbrance to a person's ability (or freedom) to attain self-actualization. Moreover according to Sen, poverty is related to two other equally important factors: social capital and equality within a family (reflecting gender issues).

The idea that social capital is a crucial factor that could be used for economic development was popularized by Robert Putnam. For Putnam, social capital includes things like trust, norms and relationships. Rankin summarizes Putnam's theory thus: "... [T]he potential of social capital theory lies in its recognition of social networks and associational life as *resources* for fueling development from the bottom up." Rankin further stated that microfinance effectively used social capital as a substitute for the lack of capital among the poor (Rankin 2, 12).

Social capital in turn, is related to human capital. Economic growth is not just powered by finances, but through the knowledge and skills of the citizens that work within its social system. If a society is short on human capital, then it will be severely limited in its potential for growth. Grameen encountered this as it set up its banking system. Most of its members were illiterate and did not have basic numeracy skills to manage personal finances. Grameen had to put members through training programs to improve its human capital.

Because it looks at poverty from the personal and familial level, the social capital concept may be seen as a “micro approach” to development. The value of social capital is what economics-focused institutions like the World Bank and ADB continued to miss by focusing too much on the “macro” or top to bottom approach to development. Today, even the World Bank and ADB support the strengthening of social capital. We shall see why adding social capital into the picture works as a more effective framework for poverty alleviation than many of the macro or “trickle-down” programs and policies tried by governments and multilateral development banks (MDBs) in the past.

2. Poverty in Bangladesh

INDICATORS

Development institutions rank Bangladesh among the poorest of the poor nations. The Asian Development Bank (ADB) says it has “the world’s third largest population of poor people.” (ADB NPRS-PRF) ADB’s Asian poverty line of \$1.35 per day [in Consumption purchasing power parity (PPP) terms], places more than half of the population (58.2 %) below the poverty line, with about 86.3% of these in rural areas (ADB Key Indicators 33, 35).

With a population of about 154 million in 2008, this means around 75 million Bangladeshi people are living under subhuman conditions. According to the UNDP Human Development Report, Bangladesh ranks 93rd out of 108 developing countries in the Human Poverty Index, placing the country alongside Zimbabwe, Cote de Ivoire, Gambia and Timor-Leste. It is 140th out of 177 countries in the over-all Human Development Index, which is at the lowest of the HDI scale.

INEQUALITY AND OBSTACLES TO GROWTH

Poverty in Bangladesh can be traced to various facets of inequality. The poor are excluded from participating in economic activity because they lack the requirements to do so. They do not have land nor capital. They lack access to ways for gaining capital, either through labor, running a business, and earning interest from savings or other investment opportunities. A further inequality at play in Bangladesh is the unequal status of women. Unequal treatment of women accounts for the shortage of human capital (ie, skilled labor, well-educated citizens) in Bangladesh, particularly among rural areas.

Land distribution and rural development

The major factors hindering growth in Bangladesh may be attributed to political and cultural hurdles that perpetuate inequality. Land is inequitably distributed. About 91% of agricultural land is under share tenancy (Todaro 441). Rural areas, where poverty incidence is highest, are underdeveloped (ADB Key Indicators 35). When there are no harvests, people have very little alternatives to earn. Since Bangladesh is in the typhoon belt, its agricultural farms have been frequently devastated by typhoons and floods, leading to food shortages. The burden to feed the family often falls on the shoulders of the housewives.

Access to credit

In 1997, Fugelsang and Chandler, writing for the UN Food and Agricultural Organization, remarked that “[t]he poorest have no land... [and] no access to credit or only to credit which is highly exploitative. They are underpaid for their work and this cycle of degradation is compounded by the inadequacy of food intake which depletes their only remaining resource, their labour.” This is discussed in more detail, later (under “Failure of Traditional Institutions”).

Gender equality

One critical social factor that contributes to poverty in rural areas are cultural practices that lead to unequal treatment of women in households. For example, upon marriage, a woman’s family must pay dowry amounting to about 200 times the average daily wage. The average daily wage is only 100 taka (\$1.45) while the dowry is a minimum of about 20,000 taka (\$290) (University of Bath, 2008).

The system of *purdah*, which forbids married women to have contact or communicate with males outside their families, has been a dominant force in limiting the rights of women in Bangladesh (Amin 213-233). Yunus also pointed to *purdah* as a major obstacle when they were setting up Grameen Bank, since male bank staff could not talk directly to the women members at first.

Women in Bangladesh are critical to economic activity but, due to inequality, their contribution is often ignored. Bangladeshi culture (like most cultures in Asia), delegate to housewives the responsibility of feeding the family, sending them to school and, in times of emergencies, sourcing capital to make ends meet. Many similar projects focusing on women have turned up positive results: children were better fed, were sent to schools, and small home improvements occurred (ADB Evaluation Study 15).

FAILURE OF TRADITIONAL INSTITUTIONS

Traditional development philosophy takes a macroscopic view of growth. Governments and MDBs focus on “top-down” change. That is, they encourage governments to invest on infrastructure, let big businesses grow and sooner or later, these efforts will translate to jobs and demand for supplies that can come from the rural areas.

But this has come at the expense of ignoring more pressing issues resulting from poverty. Sachs takes the IMF to task for insisting on its disastrous recipe for structural adjustment while ignoring poverty traps and factors that contribute or worsen the condition: disease,

gender inequality, etc (Sachs 78-79). In Bangladesh, the government spent 30% to 50% of its development budget on poverty reduction, with lackluster results (Islam 44).

Access to the Financial Market

For a better understanding of the problem of access to financial markets, we take a micro approach on the household finances of the poor. Like many of us, the poor need to tap into cash to give them startup capital, or for use during emergencies or paying for the children's school fees, etc. (Vonderlack and Schreiner)

However, they are barred from borrowing money from the formal system due to several obstacles, some of them trivial to us. Aside from possession of the required collateral, borrowers must also be able to read and write to fill out forms. Saving and withdrawing money in a bank require the same degree of literacy and even numeracy, skills that the Bangladeshi poor rarely possess (Yunus 52-53).

For a long time, the main facility behind rural development was for governments and MDBs to inject capital into rural banks, hoping that this would trickle-down to the rural poor who are often engaged in agricultural activities. But macro-thinking prevented the institutions to see what was happening in reality. The rural banks themselves were and still are trapped in a financial system that excludes participation of the poor. To the formal banking system, lending to the poor is a high-risk activity. The poor do not have collateral and the loan amounts are too small for the banks to earn profit.

Because of lack of access to credit, the villagers borrow instead from the only people willing to take the risk -- the *paikar* or middlemen and the *mahajons* (moneylenders), who often charge usurious rates and create a poverty trap of its own. In his book, *Banker to the Poor*, Yunus recounts the *dadan* system, "in which traders advance loans against standing crops for purchase of the crops at predetermined prices that are below the market rate." Yunus also describes how these trader-lenders charged from 10% per week to 10% per day. (Yunus 47-49)

Starting a Business

To illustrate the failure of formal institutions to provide entrepreneurial opportunities for the poor, we can look at the cost and effort needed to register a business in Bangladesh. The World Bank table, below, shows the cost of business startup procedures in Bangladesh, in terms of percent of gross national income (GNI) per capita, and the time required to set it up. Figures for other countries have been included for comparison.

Although the cost of the startup procedure in Bangladesh has fallen from 63.9% to 46.2% of GNI per capita, this amount (more than \$200) is still very prohibitive for the poor. Compare this with the values for Philippines, Singapore and Australia.

In addition, the time required to startup a business in Bangladesh is also a major obstacle for the poor. To register a business in rural areas, it would be necessary to make trips to government offices, usually located in urban centers. The poor do not have the leisure of time and money to make repeated trips.

Cost of Startup Procedure

Country	Cost of Startup Procedure (percent of GNI per capita)		Time Required to Startup Business (days)	
	2003	2007	2003	2007
Bangladesh	63.9	46.2	50	74
Philippines	24.5	32.6	60	52
Singapore	1	0.8	8	5
Australia	2	0.8	2	2

Source: *Doing Business Online (World Bank 2008)*

In 1976 at the earliest stages of Grameen, the situation was worst. Yunus recounts the story of a mother of three who tried to make ends meet by making bamboo stools. The woman did not have money to buy the bamboo raw material. So she borrowed money from the *paikar*, on condition that her finished goods must be sold back to the trader at a profit of only 50 poysa (or 22 US cents at that time). This tied up the woman to a spiral of endless labor without earning enough profit to get out of her poverty trap (Yunus 47).

This is the situation that Grameen Bank and microfinance changed. In the next section, we discuss the impact of microfinance on poverty in Bangladesh, paying attention to social factors and inequality.

3. Microfinance, Social Capital and Equality

GRAMEEN BANK

There are several microfinance institutions in Bangladesh, but Grameen Bank is now famous around the world, especially after its founder, Muhammad Yunus received the Nobel in 2006. By briefly examining how Grameen has evolved, we will also understand the relationship between economics, social capital and equality, and the role micro thinking played in effecting change.

The Beginning of Grameen Bank

Yunus started Grameen Bank in 1976 when he discovered that forty-two poor people in a nearby rural village needed only 856 taka (about \$27 at that time) to allow them to buy their own raw materials for their microbusinesses. Yunus and his assistant were surprised to find such a small amount was all that was needed to help the villagers out of usurious loans. Yunus eventually took the money out of his own pockets and lent it to the villagers.

Yunus knew he could use his status to secure a loan for more people in the same plight, but when he went to the local bank, the bank refused to loan him the money, for reasons stated in the previous section. In the end, Yunus persuaded the bank to grant the loan by making himself the guarantor. These events led to the establishment of Grameen Bank which is now famous worldwide for its pioneering success.

What Grameen Did Differently

Grameen effected a paradigm shift that flipped the iniquitous and exclusive formal financial system upside down. The result was to provide financial services previously denied the poor.

The table below summarizes some of the innovations Grameen introduced to solve issues that formal banks were unable to address. (In a way, it may be said that Grameen used the techniques of usurers to outdo them. For instance, the door-to-door collection system used by Grameen is the same method used by the moneylenders.)

Note that in maintaining its practices, the formal banking system also inevitably socially excluded the poor from ever tapping into this financial activity. Ironically, the poor needed only very small amounts, compared to what banks were used to transact. These small amounts could have helped the Bangladeshi poor to get out of the poverty trap, but the system itself prevented this otherwise trivial step.

All these resulted to the perpetuation of the inequality.

Formal Banking System	Grameen's Micro Approach
The poor have no capital for collateral.	Use social capital to guarantee the loan. Grameen requires members to form associations (or solidarity groups) of at least five members who then become the guarantors for each other. The associations are given the freedom to decide who gets loans and in what amounts. They are also used as a form of social (peer) pressure group to enforce loan payments. To improve on human capital, members are trained on basic skills like keeping track of money and leadership skills.
Banks are owned and controlled by a few stakeholders -- those who hold the capital.	Grameen is owned by the members, the basis of social capital.
Collecting payments from the poor will be inefficient. They live in rural areas and travel will be costly for them. In fact, the cost of travel will sometimes equal the small loan amounts.	Send Grameen staff to the villages and collect from door to door. Use the regular membership meetings as venues for payment.
The priority is profit. Lend only big amounts (relative to microcredit amounts) in order to maximize profits.	The priority is to extend cash to the needy who have no access to capital. Lending these small amounts will help the poor get out of the poverty trap.
Document transactions carefully through the use of forms and contracts.	Take into account the illiteracy of members and let the staff assist do the documenting. Here, trust (social capital) again comes into play.
Men usually have work and earn higher wages. Prefer to lend to men than women.	Lend to women. Giving capital to women has the additional effect of improving households in terms of nutrition, health and education.

Evolution and Growth

By 2007, Grameen had 7.41 million members, an increase of 137% from 2003. It has disbursed a total of Tk 356,798 million (around \$5.17 million in 2009 rates), an increase of 86.38% from 2003. Ninety-seven percent of its members are women and repayment rate is 97-98% -- something even formal banking institutions cannot attain (Grameen website). One

source states that Grameen has helped 48% of its members to cross the poverty line (Matthews 183-185).

It has entered into diverse products and investments, including housing loans, emergency lending (aimed at helping victims of calamities and disasters), a mobile phone network serving the poor and even plans to provide internet service. Grameen has transitioned from a one-product microcredit institution into a microfinance institution (MFI). It now allows members to deposit and withdraw money.

In 2000, Grameen launched a new program that gave rural Bangladeshi access to a pension savings plan called GPS, or the Grameen Pension Savings. GPS allows the poor to deposit small amounts of money (eg, \$0.75 per month) that can be allocated for a future use. By mid-2006, the total balance on GPS deposits was 10,799 million Taka (or \$158 million) held by 5.65 million accounts (Rutherford 2).

Rutherford, who led an academic team that studied the effects of GPS in depth, noted that people began to see Grameen as a serious competitor to formal banks. GPS was so attractive that Grameen had the problem of deciding whether to allow non-poor citizens to avail GPS. "The GPS has helped transform Grameen's balance sheet and turn it from a microlender to a true intermediary bank." (Rutherford 1)

Conclusion

Many have criticized Grameen Bank from the economic and social standpoint. Some early critics asserted that Grameen's loans were not really going to women's microenterprises but more to the husbands or for the daily consumption of their family. Still other studies have indicated that payment of the loans may in fact have increased violence against women-members (Mallick).

Valid or not, the innovations and impact of microlending on poverty from the perspective of development economics cannot be ignored. We draw the following lessons from poverty, microfinance, social capital and equality.

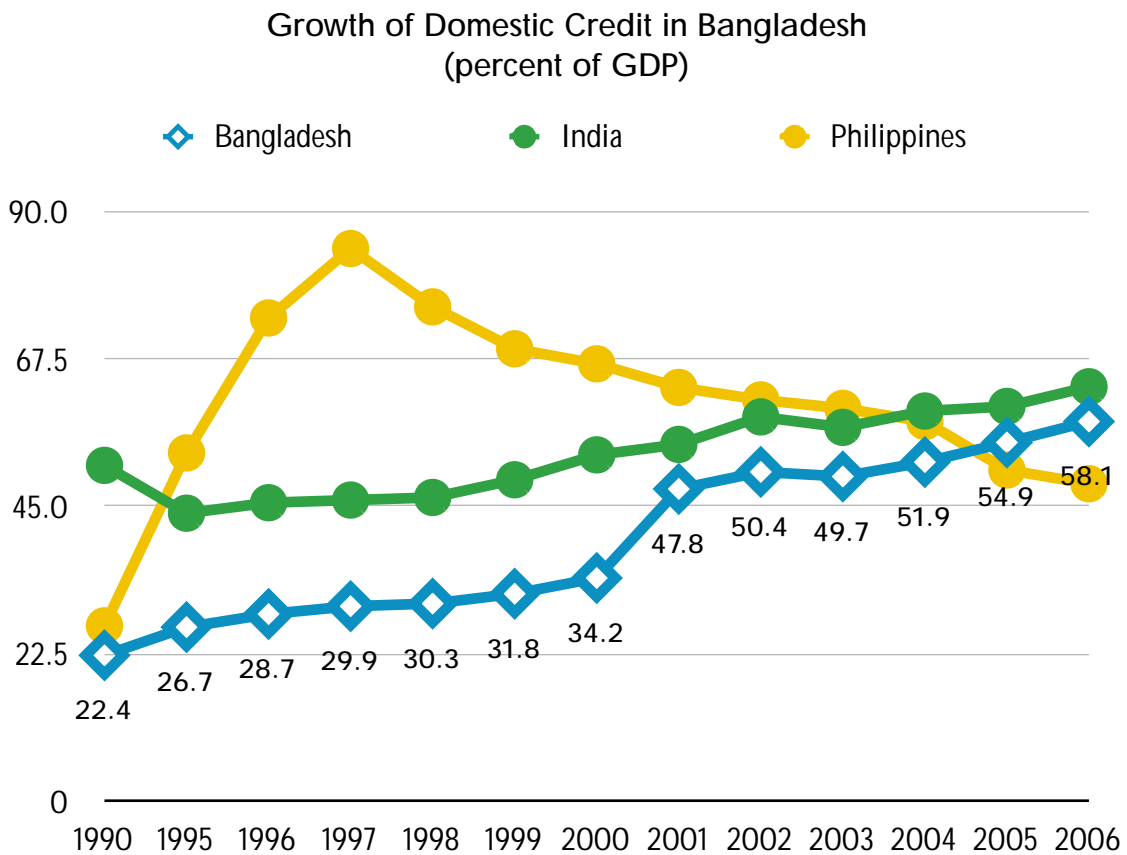
LESSONS

First, by making social capital a substitute for traditional capital as collateral, Grameen gave the poor much-needed access to funds that would have otherwise been denied by formal institutions.

This approach enabled the poor to build their own thriving network of relations that served as the foundation to build village economies. The micro amounts enabled the poor to make ends meet, build their own microbusinesses, fund emergency gaps, send children (especially women) to school and participate in politics. Grameen and microfinance, to use a tired development term, *empowered* the poor to realize their functioning without hindrances. Perhaps aside from all other measures of success, one of the best indicators of the power of social capital is in the high repayment rate of loans at Grameen, compared to the recovery rate of formal banking establishments.

Second, and arguably: Grameen reinvigorated interest and injected innovation into the topic of rural development. Many official rural development projects were plagued with corruption and inefficiency. Grameen's micro bottom-up approach showed that rural development could be done in a better way. Ironically, Grameen's model, which used to be frowned upon by the MDBs, created a template for World Bank and ADB to follow as an alternative to its old rural development paradigm (Rankin 4). The websites of World Bank and ADB now contain documents on microfinance and the value of social capital. These institutions have even sponsored research and conferences on microfinance.

Third, in creating rural financial systems that worked, Grameen also posed competition to the formal banking institutions. But, as network theory explains, this competition created a network effect. Grameen may have directly or indirectly led to rural banks reaching out to more customers. The graph below from ADB shows a steady increase in lending activities of Bangladeshi rural banks from 1990 to 2006. India and the Philippines are included for comparison.



Source: World Development Indicators Online (World Bank 2008)

Fourth, by focusing on women, Grameen created venues and procedures that led oppressed women to realize their own agency and therefore struggle for more equality in the household (and eventually, the community and society). According to Hunt and Kasynathan, microfinance created opportunities for women to be empowered (48).

More surprisingly, Sanyal's study of women involved in microfinance in India found that it was really not the money (or economic power) that was the source of the reversal of inequality, but the association of women in a culture that was repressive towards them. She found that even members who had not borrowed at all became more assertive and more involved in their family affairs and later even in community concerns. Sanyal attributes this to the associative mechanism of microfinance (like Grameen, the Indian MFI required regular meetings and conducted leadership seminars for its members). She linked back the associative effects to Sen's

concept of capabilities. “This social circulation and exposure expands women’s mental capacities and is reflected in their new attitudes and actions.” (Sanyal 9)

In his book, *Banker to the Poor*, Yunus cites several stories on how Grameen broke formal barriers in politics to let in more women in political positions. The table below also shows how Bangladesh has progressively included women in its parliament. For comparison’s sake, note that the Philippines, a country that supposedly espouses gender equality has an equal percentage of women in high political seats compared with Bangladesh. Several decades ago, it would have been difficult to imagine women winning seats in Bangladeshi parliament.

Proportion of Seats Held by Women in Parliament (percent)

	1990	2000	2007
Bangladesh	10.3	9.1	15.1
India	5	9	8.3
Philippines	9.1	12.4	15.3

Source: Asian Development Bank, Key Indicators for Asia and the Pacific, 2008.

The experience of Bangladesh in poverty is a story of inequality leading to social exclusion of the poor. Society and its financial institutions barred access to capital which would have helped the poor get out of the poverty trap. Because of their insistence on traditional economic principles, governments and multilateral development banks hardly had any impact on alleviating poverty.

It took a micro approach and a wider perspective of development economics that embraced social capital to create an alternative financial system that could serve the needs of the poor. In doing so, microfinance was directly approaching the problem of poverty from Amartya Sen’s perspective of providing growth: that it should look beyond simply giving income to the poor, but should look more into removing the obstacles for self-actualization.

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