

Chapter 2. How the Other Half Finances

If I had my way I would write the word “Insure” over the door of every cottage, and upon the blotting-book of every public man, because I am convinced that by sacrifices which are inconceivably small, which are all within the power of the very poorest man in regular work, families can be secured against catastrophes which otherwise would smash them up for ever. — Winston Churchill, 1909¹

Invented as a way to record speech, the written word became the medium of contracts, government, religion, and science. A handy tool turned into a force for revolution in all spheres of human experience. Similarly, if money originated as a portable store of value, its full import took millennia to unfurl and today touches the lives of nearly everyone on the planet. Money’s function in society has much to do with *financial services*, which are ways of helping people and businesses manage cash flow, assets, and risk. For individuals, the ability to borrow, save, insure, and transact adds possibilities to life: a couple buys a home with only 10 percent down; an immigrant sends earnings to family in the old country. For economies, financial services are the pipes and junctions of an essential infrastructure.

Not surprisingly, people who have less money have less access to money-related services; and countries with less wealth have weaker financial infrastructure. Microfinance promises to reduce this global financial inequity. Because there are many kinds of financial service and people use them in diverse ways, there are many conceptual stories about how microfinance can help poor people and poor economies. The story that dominates the public imagination in rich countries revolves around *credit* and *entrepreneurship*. Perhaps you remember when you first learned about microcredit. Did it surprise you that one could help poor people by putting them in debt? The root of that surprise is the microfinance movement’s propagation of a hopeful storyline of self-reliance. No longer are the poor so trapped by financial circumstance that credit will only stave off hunger for a few weeks, then leave a residue of hopeless debt. Instead, the poor are masters of their own fate, who lack only for credit to empower them. “I believe that all human beings are potential entrepreneurs,” Grameen Bank founder Muhammad Yunus

¹ Churchill (2007 [1909]), 146–47.

has written. “Some of us get the opportunity to express this talent, but many of us never get the chance because we were made to imagine that an entrepreneur is someone enormously gifted and different from ourselves.”²

Yunus’s idealistic statement no doubt contains truth, but it stretches the truth too. Other stories can be told of how the poor might use financial services. A family might use a savings account to prepare for a wedding, take out insurance to dampen the financial shock of a father’s death, or borrow to buy antibiotics for a seriously ill daughter. Microfinance is animated by a belief that the poor are no less creative or ambitious for being poor. To live up to that spirit of respect, attempts to approach the question of how poor people use financial services with a minimum of preconceptions. It turns out that the poor people in general, like everyone else, want financial services for many purposes in addition to starting a business. Precisely because they live close to the edge materially, they, more than the rich, need ways to manage life’s great risks. And while the better-off can usually find services tailored to specific needs, from life insurance to retirement accounts, the poor must choose from fewer options, often coarsely matched to the need at hand—for example, borrowing to pay the midwife.

All that said, a broad understanding of how financial services support economic development leads to an important reminder. In the long run, the most important link from financial services to poverty reduction may be indirect, via formal businesses that use finance to create jobs.

How the rich use financial services

The global rich—by whom I mean all those who live materially comfortable and secure lives—have access to a spectacular variety of financial services: checking and savings accounts, home mortgages, car loans, credit cards, mutual funds, insurance for half a dozen kinds of risk, and more. Just as it is hard for a New Yorker who samples a new restaurant every week to comprehend the lives of Guatemalan

² Yunus (2004), 207.

highlanders subsisting on tortillas, it is difficult for those of us who enjoy such a wealth of financial services to empathize with a woman for whom savings means hiding money under the mattress in the hope that her husband will not find it, and borrowing means going to a moneylender who charge as much per month as credit card companies charge per year.

Despite the gulf in experience, a rich person can gain insight into the poor's use of financial services by contemplating her own. Try this exercise. List all the financial services you have used. For each, determine what the service helps you do. Transact? Invest? Spend money you have not earned yet? Then confront this question: if you had to give up all these services but one, which would you keep? Here is my list, which is fairly representative for middle-class American families:

Table 1. Author's financial service inventory

Service	Purpose
Savings account	Prepare for emergencies such as job loss
Checking account	Transact over long distances or in large amounts without cash
Wire transfer	Send and receive money internationally (rare)
PayPal account	Send money to friends; buy things online
Credit cards	Transact without cash; buy things I want before I have the money
Home mortgage	Live in a home I own before I can pay for it
Home equity line of credit	Ditto; and cheap (collateralized) credit to renovate house
Car loan	Get a new car before I can fully pay for it
Student loan	Invest in my own skills, for higher pay after graduation
Retirement savings	Prepare to support myself when I no longer work
College savings	Prepare to invest in children's education
Homeowner's insurance	Protect family against financial catastrophe in event of serious harm to house
Automobile insurance	Protect family against financial catastrophe in event of serious harm to car, or liability for accident
Umbrella liability insurance	Protect family from liability suits in general
Health insurance	Protect family against financial catastrophe in event of serious health problems; assure access to care
Disability insurance	Protect family against financial catastrophe if I am unable to work
Life insurance	Protect family against financial catastrophe if I die

If you show your list to a microfinance client (assuming it resembles mine), the luxury within it will become apparent—in the breadth of the services, in the college educations foreseen and the home

with a six-figure replacement value. But if you articulate the needs that underlie your use of these services, you two might understand each other well. In scanning the list, I discern four major reasons I use of financial services, all universal.

First is the need to transact. The credit cards and checking account, among others, help me move sums too large to be safe in my wallet, and send sums large and small over long distances. My paycheck goes into the checking account automatically; the mortgage payment comes out. A swipe of a card pays for gas at the pump.

The second purpose I discern is investment: setting aside today in order to have more tomorrow. I borrowed to help pay my college tuition, and invest in a fund to do the same for my sons'. Notably, like most people in rich countries, I have not used financial services to invest in my own business, for I have none. I prefer the stability of a job.

Many people would list a home mortgage under "investment" too. But this misses the full significance of homeownership. In fact, on general principles, and as nose-diving real estate prices have made clear, a mortgage-financed home is a terrible investment. Personal finance gurus teach the virtues of diversification. Buying a home puts a lot of eggs in one basket. When the local economy nosedives, a breadwinner can lose a job and fall behind on the mortgage just as the home dwindles in value. Using credit to buy the home—investing with *leverage*—hugely multiplies the risk because a lot of the eggs are the bank's and the homeowner has to replace them if they are crushed.

I bought my house for a reason that has little to do with investment as that word is usually meant, and which brings us to the third purpose of personal financial services. Owning a home, a car, a bicycle, or a cow helps a family in many ways. With ownership comes security. Someone who holds title to her home need not worry about being forced out by a landlord who does view the building as an investment. And secure people think long-term: a farmer is more apt to take care of land he owns than land he leas-

es. Home ownership also strengthens communities by increasing the interdependence of neighbors. A more long-term, collective view encourages people to work together on local institutions such as schools. In addition, as Peruvian economist Hernando de Soto has famously argued, title to a major asset can also serve as collateral for credit.³ I once borrowed against my house to fix the roof and might do the same to help put my sons through college.

I was struck to discover that most of the 17 services on my list are there because they serve for a fourth purpose: assuring my family's ability to obtain constant necessities such as food and clothing, a pursuit economists call "consumption smoothing." The savings account is a safety net if I lose my job. Saving for retirement maintains my ability to buy what I need after I stop working. Credit cards and the home loans let me make major purchases without curtailing spending on everything else. The insurance policies take the financial bite out of life's traumas.⁴ Indeed, if I had to live with just one financial service, I would beg for two and choose life and health insurance, since they protect my family from bankruptcy in the face of life's greatest tragedies.

We can learn a few more lessons from this exercise. First, *risk* is intimately intertwined with money. Insurance policies embrace risk head-on. But they are not unique in involving it, for whenever one party to an agreement to provide financial services commits to delivering money under certain circumstances at some future date, there is risk. Perhaps a borrower will not repay, or a bank holding deposits will go under. Related to this, and second, many financial services *bind* even as they *serve*. The mortgage and other loans force me to set aside enough money each month to make the payments rather than spending it all on more frivolous things. The retirement accounts add inertia to my financial regime since my employer automatically makes the contributions out of my paychecks. This double-edged nature, of credit especially, is the germ of the ancient debates over what constitutes just lending.

³ de Soto (2000).

⁴ Perhaps I should also have listed the government insurance programs my employer pays into on my behalf, to aid me when I retire, or before then if I lose my job.

Second, what financial services you can use depends on who you are. If I were a poor American, my financial service inventory would look different. I might not have the sort of steady job that includes health insurance and would make me an attractive risk to lenders. I might have trouble maintaining in a minimum balance in a checking or savings accounts, or otherwise banking on a scale that would make me profitable for a bank. So the “concierge services” of government-subsidized retirement and college savings accounts (so-named by the Commission on Thrift, a coalition of U.S. non-profits) would probably disappear from my list.⁵ So might all the insurance, and even the checking account. In their place might appear check cashers and payday lenders extending credit at rates equivalent to over 100 percent per annum. My mortgage, if any, might have started with a teaser rate, only to be jacked up after a year or so. Just as there are more cures for male impotence than malaria, financial services available to the rich outshine those within reach of the poor—in quality, diversity, and cost.

Also worth noting: my wife’s inventory is nearly identical to mine. In many countries law and culture stop women from engaging fully in finance and commerce outside the home.

Perhaps the most important lesson is about how financial services, like roads and piped water, undergird the comfortable life. Their intangibility belies their importance. Their chief direct benefit lies in making people more secure by helping them manage and maintain consumption, most crucially during catastrophes. In the vocabulary of Amartya Sen, financial services give people more agency, more control over their lives. However, as Sen emphasizes, freedom begets freedom: those who already have more agency, thanks to being rich or male, say, are able to afford and free to buy more and better services.⁶ People who bring fewer advantages to the financial service marketplace leave with fewer.

⁵ Commission on Thrift (2008).

⁶ Sen (1999).

The financial challenges of the poor

I inventoried my financial services to show how vital such services are for families wanting to raise their standard of living and protect what they have. The rich hold no monopoly on these priorities. Poor people also need to transact, invest, build assets, and smooth consumption. But the literary critic Molly Colum was wrong when she told Ernest Hemingway in a New York restaurant that “the only difference between the rich and other people is that the rich have more money.”⁷ Poor people are not just rich people without money. The financial circumstances of poor and rich differ qualitatively as well as quantitatively. Here I briefly point out at similarities, then explore the important differences.

One service millions of poor people use more than the rich is international wire transfer. When a graduate student named Sanae Ito lived during 1995–96 in a village in southern Bangladesh served by the Grameen Bank, she discovered that the surest way to get out of poverty in the village was to get out of the village—more precisely, to send a son or husband to the capital Dhaka, where he would work as a day laborer, or even get a job, and send home money.⁸ Today, Bangladeshi villages are exporting workers even farther afield, thanks to religious affinity with the Middle East. Bangladeshi men working on Kuwaiti construction sites (among others) are sending flows of money homeward so ample as to measurably raise Bangladesh’s economic growth rate.⁹ Thus the global financial system is hugely valuable for linking dispersed families—if they can hook into it. BRAC Bank, a spin-off from the giant Bangladeshi non-profit from which it gets its name, gives its low-income clients just that access through an arrangement with Western Union. (See Figure 1.)

⁷ Berg (1978), 305. This quote is the source of the apocryphal but more familiar exchange between Hemingway and F. Scott Fitzgerald: Fitzgerald observes, “The rich are different from us.” Hemingway replies, “Yes, they have more money.”

⁸ Ito (1999).

⁹ [cite—ask Ceren]

Figure 1. Poster for wire transfer service through BRAC Bank and Western Union, Bangladesh



(Photo by author)

The poor, like the rich, also benefit from owning assets such as their own homes. A “natural experiment” in Argentina vividly demonstrates. In 1984, the Buenos Aires government moved to give 1,800 squatter families title to land on the outskirts of the city that they had occupied for three years. Eight of the 13 legal owners of the land accepted the city’s buyout, while the rest fought the expropria-

tion in twenty-year court proceedings. Thus some squatters were lucked out in quickly gaining title while others did not.¹⁰ The *Wall Street Journal* sketched the consequences:

Mercedes Almada and Valentín Orellana both live in San Francisco Solano, a barrio settled by squatters almost 25 years ago on the fringes of the Argentine capital. They established households on identically sized lots and worked similar blue-collar jobs for comparable wages—she in sewing, he in a factory. They endured the same hardships, including an effort by Argentina's 1980s military government to bulldoze the settlement.

Then, Mrs. Almada gained title while Mr. Orellana did not.

Today, Mrs. Almada lives in a neat colonial-style home with a slab roof supported by pillars as solid as oaks. The six members of the Almada household have rooms of their own. A daughter finished high school and one son finished technical school.

Mr. Orellana's house is made of rough looking cinder blocks and concrete, with thin posts supporting a corrugated zinc roof. It is so cramped that some of the eight family members have to sleep in the dining room and kitchen. None of the children [has] made it past seventh grade.¹¹

The reporter may have chosen extreme examples of a successful title-holder and struggling non-holder.

But statistics back up the vignette. Argentine researchers Sebastian Galiani and Ernesto Schargrodsky confirmed that title-holders indeed have invested more in their homes and in the education of their children.¹²

We could make similar comparisons with respect to the other purposes I identified in inventorying my financial services. The poor, like the rich, want to invest for the future, perhaps in farmland or education. And above all they strive to assure steady access to necessities despite life's vicissitudes. But here the differences between the poor and rich surface to such an extent that it becomes a mistake to view poor people as rich people with less money. The poor are short of money, yes, but also of control over their financial circumstances. Their incomes and spending needs are more variable and unpredictable, their lives more dangerous.

¹⁰ Galiani and Schargrodsky (2005).

¹¹ Moffett (2005).

¹² Galiani and Schargrodsky (2005).

Disability and death are more frequent visitors to poor households.¹³ Applying a dollar-a-day poverty line to data from household surveys of households in 13 poor countries, Abhijit Banerjee and Esther Duflo of the Massachusetts Institute of Technology found that 11–46 percent of poor households had someone who had been bedridden or had needed a doctor within the last month, the percentage varying by country.¹⁴ Medicine and doctors are expensive; equally harsh is the loss of income when a breadwinner takes sick. One cause of ill health is the seasonality of farming. “[T]he lean season when food is scarcest,” wrote University of Pennsylvania economist Jere Behrman in a study of children’s health in rural India, “may leave those children who are less well-endowed, . . . especially if they are low-caste females, close to or even below the margin for survival.”¹⁵ And survivors may face permanently diminished prospects. “In Zimbabwe,” according to Harold Alderman and John Hoddinott of the International Food Policy Research Institute, “In Zimbabwe, children exposed to the civil war preceding independence and the droughts that occurred in the early 1980s were more likely to be stunted as pre-schoolers, had reduced stature by late adolescence, and completed less formal schooling.”¹⁶

Perhaps the most important financial distinction between the global poor and the global rich—leaving aside the capitalist superrich—is that by and large the rich have salaries. My steady paycheck rivals all the insurance I buy as a source of financial security. It allows me to think long-term, helping me invest in my children, and makes me more credit-worthy, which helps me borrow to build up assets. Banerjee and Duflo compared people living on more than \$2 a day with those living on less on dozens of indicators of wealth, education, and health.¹⁷ One factor consistently distinguished those a step up on

¹³ On income volatility, see Morduch (1995).

¹⁴ Duflo and Banerjee (2007), 149. The poverty line is \$1 of household spending per member per day, converted to local currency using purchasing power parities.

¹⁵ Behrman (1988), 52.

¹⁶ Alderman and Hoddinott (2007), 2. [change to Oxford economics paper?]

¹⁷ Banerjee and Duflo use purchasing power parities to convert to U.S. dollars.

the income ladder: having a steady job. People with jobs are not only richer. They also have fewer children and invest more in educating the children they do have.¹⁸

The truly poor, meanwhile, survive on variable incomes sources such as farming and street hawking. When I lived in central Ho Chi Minh City in 1998–99, a Vietnamese family had staked a claim on the right to do commerce at the entrance of the alley where we lived. Anh Le could usually be found there, snoozing on his Honda motorcycle while waiting to sell rides for a dollar. Some days were busier than others. When ferrying my wife, he would stop well short of a red light if it kept her in the shade, so as to keep the sun from darkening her skin. Dark skin like his was a sign of the poor laborer exposed to the elements. He said he once lived in the neighborhood, but the victorious Communists have evicted him after the war, sending him to a less-central district. At mid-day, his sister would appear with a small pushcart, from which she sold dishes of sautéed vegetables and meat amply seasoned with monosodium glutamate. Her husband would join Anh Le in the motorcycle taxi business. One day, we were shocked to emerge from the alley and find a new and unfamiliar group of Vietnamese engaged in the same activities. As if in a Twilight Zone episode, Anh Le and his family were gone. Then, a week or so later, the dispossessed repossessed: Anh Le and company came back. We never did extract a full explanation for the turnabout. It appeared to involve rival but informal claims to the concession on that spot, and a bribe to a low-level official. The episode illustrated how a life in poverty can mean a tenuous hold on a variable income.

It also illustrated a response: diversification. By practicing distinct trades, Anh Le and his sister smoothed their income the way a portfolio reduces risk by investing in many securities. A survey of 27 villages in [West Bengal] found that households typically had three workers who among them practiced seven occupations.¹⁹ Banerjee and Duflo found that a fifth of urban households in Peru living on less

¹⁸ Banerjee and Duflo ([forthcoming]).

¹⁹ Ibid., p.152. “Typical” figures are medians.

than \$2 a day per person earn from more than one source, as do a quarter in Mexico, a third in Pakistan, and half in Côte d'Ivoire.²⁰ Poor people can diversify across three broad types of work—farming, other self-employment, and day labor—and diversify within these categories. In villages of the extremely poor Udaipur district in the Indian state of Rajasthan, almost everyone owns and farms some land, but 74 percent of those living on less than a dollar a day earn most of that dollar in day labor—working for others without the security of long-term employment.²¹ Self-employment, what is also called entrepreneurship, is common too, found among a quarter percent of similarly poor and rural households in Guatemala and a third in Indonesia and Pakistan.²² Banerjee and Duflo explain the attraction of working for oneself:

If you have few skills and little capital, and especially if you are a woman, being an entrepreneur is often easier than finding an employer with a job to offer. You buy some fruits and vegetables or some plastic toys at the wholesalers and start selling them on the street; you make some extra *dosa* [rice and bean pancake] mix and sell the *dosas* in front of your house; you collect cow dung and dry it to sell it as a fuel; you attend to one cow and collect the milk. These types of activities are exactly those in which the poor are involved.²³

It is worth pondering how we label people who work for themselves as a matter of survival. In the 18th and 19th centuries in the British Isles, they were “industrious tradesmen.”²⁴ Many observers on the Continent in the 19th century some saw them through the lens of the capital-labor division—as laborers who could become small capitalists.²⁵ A popular term today is “microentrepreneur.” The word is apt in important respects, for these people risk their own capital, work for themselves, and reap the profits and loss of their operations. But unlike the ideal entrepreneur, few poor “microentrepreneurs” draw in new investors, innovate, expand, or create jobs. They do not launch themselves into bold ventures in the hope of a pay-off much greater than they could get from a job. Rather, they are quite conservative in investing in themselves. Evidently, living on the edge curtails one’s appetite for risk. Experiments in Mex-

²⁰ Idem (2007), 152.

²¹ Ibid., 151.

²² Ibid., 152.

²³ Ibid., 162.

²⁴ E.g., Piesse (1841), 9.

²⁵ E.g., Wolff (1996), 2, 10, 16, 19.

ico and Sri Lanka suggest that injecting modest additional capital into these informal businesses can earn average returns exceeding [5% per month], far higher than conventional first-world investments.²⁶ Yet poor entrepreneurs rarely do so. They are not the agents of creative destruction whom economist Joseph Schumpeter saw as the heroes of economic development. They *undertake*—to revert to the root meaning of “entrepreneur”—because they must. To this extent, labeling them “microentrepreneurs” romanticizes their plight and implies too much hope for their escape. A somewhat older and now less fashionable view of poor entrepreneurs, historically associated with the United Nations’s International Labor Organization, is as victims of economic systems that fail to provide enough jobs. To put this more constructively, since the Industrial Revolution, explosive job creation has powered all national economic development successes. Comprehensive economic development is hard to imagine without jobs. In this view, the people of whom we speak are “people without jobs” or “self-employed” or “own-account workers” who heroically, but tenuously, survive their circumstances.²⁷

We do not need to choose between seeing the poor as victims or masters of their own fates, for there is truth in both views, and both have implications for what the poor need from financial services. If the financial services I prize most are those that guarantee my access to the necessities of life, come what may, poor people feel that need more intensely. For the poor, what economists clinically call consumption smoothing is a matter of how often children go to bed hungry, even of life and death. At baseline, many barely consume what is necessary to live. Small loans or savings account can help poor people spend less than they earn in good times, so that they can spend more than they earn in hard times. Thus a tragic irony in the availability of financial services: those who have them least need them most.

But casting poor people as entrepreneurs of necessity helps us appreciate why they, more than the global rich, use financial services for investing in their own businesses. *Documenting* that they do is

²⁶ [de Mel, MacKenzie, and Woodruff papers]. Other studies have found similar conservatism among poor farmers in deciding, for example, whether to apply commercial fertilizer. See Morduch (1995), 105.

²⁷ ILO (1993), §§7, 10.3.

surprisingly difficult, for two reasons. First, when asked how they use a service, microfinance clients often give the answer they believe—correctly as often as not—the questioner wants to hear. Some microcredit lenders, for example, valorize investment over other uses. Second, what a person thinks she is using a loan or savings drawdown for often differs what it enables her to do. Beatrice, the female half of an entrepreneurial couple in Zambia’s Copperbelt, explained to British researcher James Copestake that, in Copestake’s words, “the main difference the loans had made over the last year was in freeing their own capital for construction of their house.” Microcredit loans formally went into the business, but only by supplanting the couple’s own capital into personal uses.²⁸ In Bangladesh, a borrower’s husband told anthropologist Lamia Karim with a smile that “We took a cow loan. Fifty percent will be spent to pay off old debts, and another fifty percent will be invested in moneylending. If the manager comes to see our cow, we can easily borrow one from the neighbors.”²⁹ The fungibility of money means that we can never be sure how the borrower would have channeled her money without the loan.

The Malaysian journalist Helen Todd has made one of the best attempts to deal with the first problem at least, giving us a rare statistical view of how the poor use financial services. Throughout 1992, she and her husband David Gibbons, who was also studying microfinance, lived amid two villages in the Tangail district of Bangladesh, one of the first regions in which the Grameen credit program operated on a large scale. With funding from the Grameen Bank and a research team including several Bangladeshis, they tracked the financial and personal lives of 62 women, 40 of whom borrowed from Grameen, recording every loan payment, every sale of rice paddy, every lease of land. The depth and detail of their perception into how particular women use microcredit has rarely been equaled. Table 2 shows their tabulation of how the 40 borrowers said they would use the credit, in order to obtain loan approval,

²⁸ Copestake (2002), 746.

²⁹ Karim (2008), 16.

and how the women actually used it. All the stated purposes were investments. “According to the [Grameen] Bank records,” Todd writes,

35 of our 40 member sample took loans in 1991/92 for either “[rice] paddy husking” alone or “paddy husking/cow fattening.” As far as we could tell, only four women did any paddy husking for sale during the year and that only for limited periods. Two young women who lived in the same *bari* [or homestead lot] had taken their last few loans for “cow fattening.” Although I was in and out of their *bari* for seven months of the year, I never saw hide nor hair of any cows.³⁰

Todd’s data in Table 2 do not debunk the image of poor women using financial services to invest in small-scale economic activities, but they do paint a picture richer than that the standard microcredit stereotype. Some women used the loans to pay dowry, breaking a vow they took as Grameen members.³¹ Others bought rice. Some improved the roof or walls of their small homes. The majority *did* use the credit for enterprise, but not in ways envisioned by the Bank: lending to others and leasing paddy land. Bank policy proscribed land leasing in particular, viewing the rents as usury extracted by landlords, a perspective which reflects the long and bitter history of the intertwining of moneylending and land monopoly in South Asia. But for many families, leasing land was a step up in security and freedom: instead of working someone else’s land for an unpredictable day wage, the husband could plant and manage the family’s “own” field. Once during the research project, Muhammad Yunus visited Todd and Gibbons, who briefed him on their findings. They urged him to allow land leasing:

Dr Yunus listened but did not commit himself.

“Let’s go to the village,” he said.

...

Professor Yunus questioned Kia [a borrower] about [a new] loan. “Do you want one?”

“Yes, sir!”

“What will you use it for?”

I saw Kia hesitate for a moment. Then she looked the Managing Director in the eye.

“I won’t lie to you,” she said. “I am going to lease in some land.”³²

³⁰ Todd (1996), 25.

³¹ The custom of paying dowry makes girls economically burdensome and boys lucrative, reinforcing discrimination against girls within families.

³² *Ibid.*, 16–17.

We see here some basic differences and similarities between rich and poor in how they manage money. As for the differences, the poor more than the rich pursue strategies that incrementally diversify and improve their control over their sources of income. As for the similarities, the poor, like the rich, juggle several fairly universal priorities such as consumption smoothing and investment. And they do so with resourcefulness and diversity that sometimes elude even the managers of microfinance organizations.

Table 2. Approved and actual use of Grameen Bank loans to 40 women, 1992

	Number of loans		Amount of loans (<i>taka</i>) ²	
	Approved	Actual ¹	Approved	Actual
Rice paddy husking	20		73,500	
Rice husking/cow	8		46,000	
Cow	7	4	42,500	19,300
Mustard oil grinding	4	2	23,000	5,760
Grocery trade	1		5,000	
Mustard oil/sweets	1		5,500	
Land transactions		20		70,320
Loan repayment		16		24,720
Stocking rice		12		27,134
Lending		7		6,849
Rickshaw		3		6,137
Dowry/wedding		2		5,075
Housing materials		1		4,680
Other/unknown				25,025

¹Loans put to more than one use listed more than once. ²\$1 = 40 *taka*.

Source: Todd (1996), 24.

How the poor use financial services

Introduced as a small window onto the financial goals and strategies of the poor, Todd's data also raise the question of how poor people incorporate *financial services* into their survival strategies. Perhaps no one is a better interpreter of how poor people use financial services than Stuart Rutherford. Trained as an architect, he became interested in how the poor manage their finances after investigating the effects of the earthquake in Managua just before Christmas in 1972; many slum dwellers lost their homes, but rebuilt quite rapidly. A trim man with thin-rimmed glasses and a dusting of white hair, he loves almost nothing more than interviewing people about they handle their finances. In his book, *The Poor and Their Money*, Rutherford focuses less than we have on the *purposes* for which the poor use financial services,

and more on the *transactions* involved. At base, he argues, most poor people need financial services in order to turn small, regular savings into “usefully large sums” that can go toward most of the purposes I discovered in my inventory: investment, gaining ownership of assets, and managing consumption.³³ The last purpose is especially important because of the mismatch between volatile incomes and constant spending needs for food and shelter. The last purpose is especially important because of the mismatch between volatile incomes and constant spending needs for food and shelter. As one poor Bangladeshi told Rutherford, “I don’t really like having to deal with other people over money, but if you’re poor, there’s no alternative. We have to do it to survive.”³⁴ Rutherford emphasizes how credit, savings, and insurance are all as tools for accumulating usefully large sums. Providers of any of these services can take small, regular payments from the client—loan payments, savings deposits, or insurance premiums—and occasionally make large pay-outs. As a matter of money flow, the services differ only in when the large sums are paid out.

Borrowing and saving, in particular, are not nearly so opposite as they appear. Rutherford illustrates the kinship with two examples he and his research partner Sukhwinder Singh Arora found in the slums of Vijayawada, a city in southeastern India. The first example is of savings:

Jyothi is a middle-aged semi-educated woman who makes her living as a peripatetic (wandering) deposit collector. Her clients are slum dwellers, mostly women. Jyothi has, over the years, built a good reputation as a safe pair of hands that can be trusted to take care of the savings of her clients.

This is how she works. She gives each of her clients a simple card, divided into 220 cells....In each cell, clients commit themselves to saving a certain amount in a certain period. For example, one client may agree to save five Indian rupees (Rs 5) [about 10¢] per cell at the rate of one cell a day....Having made this agreement it is now Jyothi’s duty to visit this client each day to collect the five rupees...

When the contract is fulfilled—that is when the client has saved Rs 5, 220 times...the client takes her savings back. However, she does not get it all back, since Jyothi has to be paid for the service she provides. These fees vary, but in Jyothi’s case it is 20 out of the 220 cells—or Rs 100 out of the Rs 1,100 saved by the client in our example.³⁵

³³ Rutherford (2000), 1.

³⁴ Collins et al. (2009), 13.

³⁵ Ibid., 13–14.

Notice that Jyothi does not pay interest on deposits as rich-world savers expect of their banks; she *charges* at a rate that works out to 30 percent a year.³⁶ Rutherford asked Jyothi's clients why they pay so much to save when stashing cash in a box is free:

The first client I talked to...knew she would need about Rs 800 in early July, or miss out on admitting her children to school. Her husband, a day labourer, could not be relied on to come up with so much money at one time, and in any case he felt that looking after the children's education was *her* duty, not his. She knew she would not be able to save so large an amount at home—with so many more immediate demands on the scarce cash. I asked her if she understood that she was paying 30 per cent a year....She said that she did, and still thought it a good bargain....[D]wellers in a neighbouring slum where there is no Jyothi at work actually envied Jyothi's clients.³⁷

Bankers would call Jyothi's service a commitment savings product. By removing a bit of money from the house each day, Jyothi protects her clients from themselves—from temptation to spend everything on the needs of the moment—and from children, husbands, and parents pressing for cash. Jyothi facilitates thrift. Subtly and paradoxically, commitment savings ties the client's hands in a way that strengthens her control over money and her power in the family. Poor people do have other ways to save, such as in jewelry and livestock. But gold rings can be stolen and pigs can die. And such assets are inconvenient: as one Indonesian pointed out, “when you have to pay the school fees, you cannot sell the cow's leg.”³⁸

In India, Rutherford also talked to clients of a moneylender, whose

...working method is simple. He gives loans to poor people without any security (or “collateral”), and then takes back his money in regular instalments over the next few weeks or months. He charges for the service by deducting a percentage (in his case 15 per cent) of the value of the loan at the time of disbursement. One of his clients reported the deal to me as follows.

“I run a very small shop” (it's a small timber box on stilts on the sidewalk inside which he squats and sells a few basic household goods) “and I need the moneylender to help me maintain my stock of goods. I borrow Rs 1,000 from him from which he deducts Rs 150 as interest. He then visits me weekly and I repay the Rs 1,000 over ten weeks....As soon as I have paid him off he normally lets me have another loan.”

This client (Ramalu) showed me the scruffy bit of card that the moneylender had given him and one which his weekly repayments are recorded. It was quite like the cards Jyothi hands out.³⁹

³⁶ As discussed below, steady repayments over the loan period make the *average* balance half the starting balance and approximately double the effective interest rate.

³⁷ *Ibid.*, 15–16.

³⁸ Robinson (2002), 264.

³⁹ Rutherford (2000), 17–18.

The similarities to Jyothi's commitment savings service are striking. The moneylender too uses grids printed on cards to track payments. Both the savings and credit services operate cyclically, producing the same predictable rhythm of frequent, small pay-ins and infrequent, large pay-outs.

Perhaps most importantly, both provide discipline. Again, we see financial services meeting a need that the rich experience, but that the poor generally feel more intensely. Discipline is more difficult where money is tighter and life is less predictable. In the slums of Nairobi, researchers Siwan Anderson and Jean-Marie Baland found that 84 percent of participants in local savings groups known as ROSCAs were women.⁴⁰ And among women, the ones mostly likely to join were neither those earning all the household's income nor none of it, but those in between. Roughly speaking, sole breadwinners did not need the leverage of a commitment savings arrangement; non-breadwinners had no power to leverage; and women needed more leverage than men. In their paper, "Tying Odysseus to the Mast," economists Nava Ashraf, Dean Karlan, and Wesley Yin discovered the same need in the southern Philippine island of Mindanao. Working through a rural bank, they offered a new commitment savings account to a randomly selected group of the bank's customers. Interestingly, the commitment account did not pay a higher interest rate than the bank's ordinary savings account to compensate clients for locking up their money. Yet 28 percent of customers who got the offer took it. After one year, those offered had saved 81 percent more than those not. Women in whom psychological tests revealed a strong tension between how they manage money in the moment and how they wish they could over the long term were more likely to join than other women, and than men in general.⁴¹

⁴⁰ Anderson and Baland (2002). The rotating savings and credit associations (ROSCA) is the most prevalent form of informal financial service. It is described in chapter 3.

⁴¹ The average effect reported here is for those receiving the offer, not those *taking* it. The group receiving the offer is randomly defined, and is the basis for meaningful comparisons. People in the subgroup taking the offer are self-selected and might have saved more anyway. "Tension" refers to the time consistency, or hyperbolic discounting, the researchers found. Asked to choose between hypothetically receiving 200 pesos today or 300 a month later, and then between 200 in 6 months or 300 seven months from now, those women offering conflicting answers—200 when the choice was today, 300 when it was deferred—were more likely to join than other women, and than men generally.

To the extent that financial services resemble one another, they can substitute for one another. One woman might save to buffer her family against the possibility of a husband taking sick. Another might avail herself of rudimentary health insurance such as that offered by the Grameen Bank. Another might borrow to pay clinic fees when needed. Of course, few poor people are in a position to choose from all these options. In a [200x] survey in the Indian state of Karnataka, 40 percent of households included someone who had suffered an expensive health problem in the last year. 67 percent of these tapped savings to help pay the bills and 44 percent borrowed.⁴²

But financial services are not completely interchangeable. In Karnataka, only 0.3 percent of the households with health troubles drew on health insurance, which is not surprising since almost none could find any to buy. For most, this superior service could not be swapped in to replace savings or credit. By and large, the poor must self-insure. And the intuition that credit and savings are opposite does contain truth. Usually financial service providers are easier to hold to account than their clients, some of whom can disappear overnight. That means that a client must pay more to compensate creditors for trusting her (as she must if she borrows) than she must pay if she is to trust them (as she must if she saves). Returning to Vijayawada, the 15 percent up-front charge that Ramalu pays the moneylender for a 10-week loan is deceptively modest. After subtracting the Rs 150 fee, his initial balance is Rs 850. He starts repaying immediately so that his *average* balance over the 10 weeks is half the Rs 850, or Rs 425, of which the Rs 150 is 35 percent. A rate of 35 percent for 10 weeks compounds to a stunning 382 percent on an annual basis, more than ten times what Jyothi the deposit collector charges.⁴³ Meanwhile, the unpredictability of the borrower's financial trajectory makes taking on debt more risky and stressful.

⁴² Duflo et al. (2008). "Expensive" means costing more than 300 rupees. The average reported cost for such episodes was Rs 1,900, which is more than twice the average per-capita consumption in the sample, Rs 708.

⁴³ Rutherford calculates the rate at 180% because he does not compound.

That various financial services *can* substitute for one another, but at a cost, means that poor people often use financial services in ways that are not ideal. That a loan is taken, for instance, does not mean that a loan is the best option in the ideal.

Conclusion

This chapter's review of the role of financial services in daily life and economic development generates a series of cautions for those who see microfinance—microcredit in particular—as an eliminator of poverty. The poor need financial services for many uses in addition to enterprise. Credit can serve many needs, but savings and insurance serve many needs more effectively when available. Thomas Dichter, a long-time practitioner and evaluator of microfinance, observes that no country that is rich today got that way through tiny loans for tiny enterprises.⁴⁴ Indeed, every comparison between rich and poor countries, as between poor and middle-class people within poor countries, drives us to conclusion that in the broad, economic development is synonymous with *reduction* in microenterprise and growth in employment due largely to the expansion of formal enterprises backed by more conventional finance.

All this suggests that next to the extraordinary poverty-reducing power of the industrial revolution, microfinance is a palliative. Does that mean that the value of microfinance is sometimes exaggerated? Probably. Does it make microfinance wasted charity? Not necessarily. The poor need financial services at least as much as the rich. For people navigating the unpredictable and unforgiving terrain that characterizes the lives of most poor people, any additional room for maneuver, any additional control, can be extremely valuable. As Jonathan Morduch, a New York University economist and thoughtful observer of microfinance, told a writer for the *New Yorker*, “That is a valid critique, to a point. But get real. How long are you willing to wait for the revolution? I can't see any moral foundation for not trying to

⁴⁴ Dichter (2007).

address the current deprivations of the world's poorest billions. If microfinance can help provide options in cost-effective ways, we should celebrate it.”⁴⁵

⁴⁵ Bruck (2006).