The availability and access to finance can be a crucial influence on the economic entitlements that economic agents are practically able to secure. This applies all the way from large enterprises…to tiny establishments that are run on micro credit. – Amartya Sen, *Development as Freedom*, 1999.[1]

BRAC, ASA, Grameen—they're all the same. You just have to pay. They *make* you pay. Sometimes they keep us sitting there all day. It makes my husband furious. That's why he's told me to leave. Everybody knows. Even if you have a dead body in the house that week you still have to pay. – Sakhina,, northern Bangladesh, 2004[2]

Juloo, "rope" to a Mandinko, means several things at once. It can refer to a small-scale trader, or to credit or debt. Every Mandinko knows the meanings are related. Traders are also lenders, and their loans, while sometimes useful like a rope ladder, also tie down a farmer like a rope around the neck. When rural people in The Gambia speak of *juloo*, in any of these uses, they consciously or unconsciously connote slavery. The Mandinko and other peoples of this small and impoverished West African river nation, an ancient trade route winding thinly through southern Senegal, have had occasion in history to learn quite a bit about ropes and involuntary servitude, and about debt. The linked images and overtones are not empty of emotion. – Parker Shipton, "How Gambians Save," 1990.[3]

Chapter 7. Development as Freedom

The microfinance movement turned some old ideas about credit on their heads. If you look in ancient texts of religion and philosophy for references to lending, most of what you will find is stern, especially on charging interest.[4] In the Quran (2:275–80), it is written: "O believers, fear God, and give up the interest that remains outstanding if you are believers. If you do not do so, then be sure of being at war with God and His messenger. But, if you repent, you can have your principal."[5] The ancient proscriptions appear to embody the view that lending money at interest to the poor in duress is the opposite of charity: exploiting their poverty to drive them further into it. Debts are bonds.

Yet today lending to the poor is suffused with hope: hope for the possibilities and freedom of capital. It is called not microdebt but microcredit because "credit," descended from the Latin for "heart," connotes faith. Clearly the economic transformations of the last centuries have disposed us more than the ancients to perceive the possibilities in loans. In Biblical times, economic life changed with imperceptible slowness. The sum of the economic game was close to

[1] Sen (2001), 39.
[2] Rutherford (2006), 17.
[3] Shipton (1990), 1.
[4] Visser and McIntosh (1998).
[5] [http://en.wikipedia.org/wiki/Riba, viewed June 23, 2009]

zero: one family gained land if another lost it. Yet now even the poorest people have witnessed radical innovation within their lifetimes. Motorcycles, mobile phones, high-yield rice and wheat are all far more commonplace in developing countries than they once were. Half the world's people live in cities, whose air, goes the Medieval German saying, makes men free. Rich and poor alike can imagine the transformative possibilities in a loan more than they once could.

Yet the previous chapter concluded that we lack much statistical proof that microcredit lives up to the hopes placed upon it for systematically lessening poverty. (If anything, the evidence favors the overshadowed sister of credit, savings.) That conclusion is one of ignorance: microfinance may well reduce poverty on average, but most studies have not been rigorous enough to prove it.

The absence of clear statistical link from microfinance to poverty forces us think more precisely about how delivering financial services to the poor can contribute to development. Indeed, it forces us to think more precisely about what development is. We must use sensible theories to extrapolate from the limited evidence to the ultimate outcomes we seek. For example, this chapter turns to a theory associated with the Nobel-winning economist and philosopher Amartya Sen, who asserted that the essence of development is *increasing freedom*. Sen defines freedom more than libertarians do, not only as freedom from interference in one's affairs, but as greater agency in one's life, greater control over one's circumstances. For Sen, democracy, education, income, and health are all aspects of freedom. And since they reinforce each other—higher income allows greater investment in education, and vice versa—any given kind of freedom is at once an end in itself and a means to other freedoms.[6] If we can conclude that microfinance expands the freedom of the poor then by Sen's definition microfinance *causes*

[6] Sen (2001).

development. Even when such happy outcomes fall short of immediate improvements in bottom-line measures of poverty such as household spending, Sen's contention that freedom begets freedom offers hope that they do so eventually. The woman who gains more say in financial decisions, for instance, may use that power to put her daughter in school. A generation later, the daughter may earn more and have fewer children. It is hard for researchers to trace these subtle and slow chains of effect. Where the evidence stops, we must rely on credible theories such as Sen's to extrapolate. This perspective helped me resolve the paradox I confronted in Cairo. Even though I had reason to doubt that tiny loans would lift the women I met out of poverty, I could see that they were grasping, or at least reaching for, an increment of control over their lot. Sen's philosophy made sense of the object of their striving, labeling it a kind of "development."

Still, to understand the impacts of microfinance as best we can, we should use the perspective not merely to valorize, but to critique. In particular, viewing development as virtuous cycle of expanding freedoms generates concrete questions about microfinance. To what extent does microfinance give people more control over their lives? Do savings accounts buffer families against income fluctuations? Does lending to a woman give her more say in family financial decisions, or help her pay doctor's bills so her husband returns to work? Or, contrarily, how often does microfinance—microcredit in particular—*reduce* freedom, by binding poor borrowers in the ways the ancients abhorred? Should we worry that microcredit interest rates often exceed 40 percent per year? Are borrowing groups not fonts of empowering solidarity so much as of coercion? Virtuous cycles, after all, can be reversed. The woman who pays a debt by selling her paddy land or even the servitude of her pre-teen son may slip into a downward spiral.

This chapter picks through this tricky terrain.

There is a certain peculiarity about this inquiry, since at one level the outcome is not in

doubt. As I wrote in chapter 2, because the poverty in a poor country is characterized by incomes that are not just low but unstable, poor people need and use financial services at least as much as rich people. Loans and savings accounts give them ways to put aside wealth when they have extra, and summon resources when they are short. The norm appears to be that poor people weave together imperfect portfolios out of low-quality savings, credit, and insurance services, as they strive to keep food on the table and children in school. Microfinance promises poor people more leverage over the uncertainties of their lives. As Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven write in *Portfolios of the Poor*,

> …money management is, for the poor, a fundamental and well-understood part of everyday life. It is a key factor in determining the level of success that poor households enjoy in improving their own lives. Managing money well is not necessarily more important than being healthy or well educated or wealthy, but it is often fundamental to achieving those broader aims.[7]

It is therefore in the *essence* of financial services to give people more agency in their lives. If development is freedom, than financial services inherently deliver development. Full stop. Sen's philosophy suggests that the increase in financial freedom will broaden the ambit of other freedoms over time, if so slowly that it is hard for researchers to trace the effects. Girls who attend schools more regularly, thanks to their parents' improved financial management, may defer marriage some years, have fewer children, and obtain more-skilled, better-paying work. Moreover, the popularized microfinance story, about microenterprise as a ladder out of poverty, holds true for some clients. As reported in the last chapter, the randomized trial in Hyderabad found that microcredit led to the birth of new micro-businesses and increased profits at old ones. Although total income did not rise on average after 15–18 months, these effect on microenterprise hints that credit gave some people more agency.[8] Helen Todd, introduced in chapter 6, documented how women she came to know used credit to lease or buy land, which

[7] Collins *et al*. (2009), 3.
[8] Banerjee *et al.* (2009).

gave them a firmer purchase on the means of agricultural production, thus made them more secure, more able to take risks and invest in new businesses and their children's education.[9]

So why doesn't the book stop here? Because financial services can also destroy freedom. Savings accounts, for example, might seem benign, even ideal, as vehicles for delivering financial self-determination to the poor. But plenty of banks have collapsed in heaps of fraud or bad lending, vaporizing savings. (The same has happened with insurance schemes.) That is why prospective clients and regulators distrust the start-up non-profit that would take savings. And that in turn is one major reason that the microfinance movement has historically emphasized lending (see chapter 5). But with credit comes debt—a bond, a rope.

The dual aspect of credit—a thing which at once frees and binds—is what complicates the question of how microfinance affects agency, and is this chapter's subject. Accepting the common sense that credit on interest is not inherently damaging—religious edicts to the contrary—the chapter looks at factors that might tip the judgment in any particular case about how much borrowing is too much. These include the interest rate, how clearly it is disclosed to borrowers, how flexible and reliable the financial service is, and whether the social experience of group credit gives women new confidence and voice in family and community affairs. The chapter then reviews the research, most of it qualitative, and concludes tentatively that the most famous form of microfinance may do the least for development as freedom.

On usury

We start by investigating the ancient charge against moneylenders: usury. Hindu and Buddhist traditions both contain condemnations of lending at interest, while the sacred texts of Judaism,

[9] Todd (1996), [xx].

Christianity, and Islam prohibit it.[10] "When your brother-Israelite is reduced to poverty and cannot support himself in the community," God instructed through Moses with lawyerly thoroughness, "you shall not charge him interest on a loan, either by deducting it in advance from the capital sum, or by adding it on repayment."[11] In the 1200's, the Scholastic theologian Thomas Aquinas argued that charging interest is unjust because it constitutes a charge for time, which no person can rightly own or sell.

Yet the ethics of lending are not so clear-cut. Through most of human history, mmoneylending was widely resented in part because it was widespread. Credit met needs so great and opportunities so profitable that lending for a fee could never be stamped out. The *Oxford Classical Dictionary* records that the formal repayment amounts on Athenian *eranos* loans sometimes exceed the principal and were "used by Hellenistic Jews to evade the biblical prohibition of interest."[12] Centuries later, European Jews lent with interest to Christians, whom they conveniently viewed as other than "brother-Israelites," thus exempt from God's prohibition on interest.[13] Muslims have developed banking methods that charge interest in effect if not in name. "When the law prohibits interest altogether," Adam Smith observed, "it does not prevent it."[14]

Lending money is like any other business in involving costs and risks. Unless those are covered in the price of credit, lenders cannot be relied on to lend. And for the lenders most excoriated for high prices, the costs can be surprisingly high. Consider the moneylenders of Chambar, a market town in Pakistan on the Indus River, whom World Bank economist Ifran Aleem studied in the 1980s. Before extending credit to a new client, a moneylender would

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[10] Visser and McIntosh (1998).
[11] [Leviticus 25:35–36, New English Bible]
[12] Cary et al. (1950), 336. *Eranos* loans are described in chapter 3.
[13] Steinwand (2001), 48.
[14] [Wealth of Nations, 11th ed., book I, chapter IX.]

typically check the person's business references in the market, visit his village to check more references, and stop by the farm to see whether claimed herds and crops existed. The moneylender would then typically reject half of applicants, doubling screening costs per *accepted* client. And costs continued after the loan was extended. A small percentage of loans, typically less than 5 percent, were never paid back in full. Of those that were, a typical 10–20 percent were repaid half a year late—often with no extra interest and only after the lender spent several days searching for the debtor. After putting a reasonable value on the lenders' time and money, Aleem calculated that their costs averaged 79 percent of the capital lent. That was exactly the average interest rate charged. High as their rates were, the lenders thus did not appear to be engaging in gross profiteering.[15] These numbers lend credibility to the words of a woman Sanae Ito met in Bangladesh, who quit moneylending as unprofitable:

> When I [Ito] discussed moneylending with her, she grumbled about the difficulty of turning down persistent requests for loans because everyone in the village knew she was earning cash income every month: "You wouldn't know how difficult it is to ask these people to pay back loans. Oh, it's such a trouble. You have to go to them over and over again. Sometimes you almost have to beg. Even then, it's not always possible to get them to repay. I've finally decided never to lend to these people, no matter how hard they might try."[16]

And as we saw in chapter 5, various factors and risks drive up the cost of microcredit too, such as the size of the loan (smaller loans for poorer people cost more per loan), population density (more time spent travelling between hamlets spreads each loan officer's salary over fewer loans), and economic inequality (which makes educated workers expensive relative to the loan sizes the poor can afford).

In weighing the historical antipathy toward lenders, it is also worth recognizing how tempting they are to scapegoat. If a woman in a rich country loses her job, her family may hit the

[15] Aleem (1990), 334–37, 345. Total cost figure is average cost for lenders when viewed as pursuing lending as their primary activity.
[16] Ito (1999), 123.

financial breaking point when the mortgage comes due. That makes even a responsible lender an easy target for anger. Divisions along lines of class, caste, or religion can turn frustration into hatred. Henry Wolff's 1890s description of how moneylenders were viewed in Germany reads chillingly in post-Holocaust retrospect:

> In [the United Kingdom] we have no idea of the pest of remorseless usury which has fastened like a vampire upon the rural population of those parts….The poor peasantry have long lain helpless in their grasp, suffering in mute despair the process of gradual exinanition. My inquiries into the system of small holdings in those regions have brought me into personal contact with many of the most representative inhabitants…and from one and all—here, there, and everywhere—have I heard the self-same, ever-repeated bitter complaint, that the villages are being sucked dry by the "Jews." Usury laws, police regulations, warnings, and monitions have all been tried as remedies, and tried in vain. There are not a few Christians, by the way, among those "Jews," though originally the evil was no doubt specifically Hebraic—not altogether owing to a predilection of those who made a practice of it. They were practically driven into it. Germans do pretty well even now in the way of anti-Semitism. But that is nothing to the outlawry everywhere practised against the obnoxious race before 1848, when in scarcely any town were they allowed even to trade, except by sheltering themselves behind some friendly Christian, who could be brought to lend them the use of his name.[17]

But while it is tempting to dismiss the old interest bans as hypocrisy and racism, or as ignorant of business imperatives as commanding farmers to give away their wheat and corn, the bans embody a timeless concern, which is that credit can make the rich richer and poor poorer. When you have nothing to eat, you may be willing to pay a lot for loan: yes, the interest will cost you tomorrow, but if you do not eat, there will be no tomorrow. In economic parlance, the poor discount the future more than the rich, so that credit markets tend to concentrate wealth. In ancient societies, most wealth was in livestock and land. People who defaulted on their loans lost their stock and became alienated from their land, having to rent it back from their former creditors. To reverse such creeping inequality, the Hebraic God decreed periodic years of jubilee, in which all land titles were to be restored to their original holders.[18]

The collision between the Christian ban on interest and the irrepressibility of credit must

[17] Wolff (1896), 116–17.
[18] [Leviticus 25:8–11?, New English Bible]

have become increasingly intense as city states on the Italian peninsula became hubs of trade and banking in Medieval Europe. It seems to have led to a search for compromise. Within Christianity, "usury" shifted from referring to all interest to only that above some just price. In 1515, a papal council illustrated the newer conception in adjudicating the controversy that had erupted over whether the *monte di pieta*—the charitable pawn shops originating in Perugia—were usurious.[19] "[W]e declare and define…that the above-mentioned credit organizations…do not introduce any kind of evil or provide any incentive to sin if they receive, in addition to the capital, a moderate sum for their expenses and by way of compensation, provided it is intended exclusively to defray the expenses."[20]

The papal judgment has a remarkably modern resonance: most observers today acknowledge the legitimacy of interest even as they feel twinges at the idea of charging the poor rates higher than those the rich ordinarily pay. Surely it is not always bad to charge the poor interest, whom we saw in chapter 2 can make good use of loans. The more the activity is criminalized, the more it will discourage what can be an invaluable service. Muhammad Yunus bristled when I once suggested that Grameen Bank's finances contain an element of subsidy. He wrote a book about self-financing businesses like his can fight poverty.[21] Clearly, he believes that creditors should charge enough to cover costs, as Grameen largely does.[22] The sad history of heavily subsidized credit—in which the rich and connected capture cheap loans meant for the poor—backs him up (see chapter 4).

But is the papal compromise over the meaning of usury, which engenders a search for the Golden Mean between no interest and extreme interest rates, more practical than interest bans?

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[19] See chapter 3.
[20] ["Session Ten: On the reform of credit organisations (Montes pietatis)," Fifth Lateran Council, Rome: Catholic Church, 1515, translated in Tanner (1990).
[21] Yunus (2007).
[22] On subsidies to Grameen, see Morduch (1999).

How do you determine when a rate is just? Yunus attacked the Mexican microfinance bank Compartamos when it made millions for its founders by cashing in on profit statements fattened by an average interest rate of 85 percent a year (plus a 15 percent tax): "Microcredit was created to fight the money lender, not to become the money lender."[23] One can see how Yunus would be confident that the line to draw lies somewhere between Grameen's sub-20 percent and Compartamos's 100 percent in 2007.[24] The middle ground is murkier: is it moral to, say, lend through Kiva to another Mexican MFI, Fundación Realidad, which charges 59 percent on average.[25]

One point of triangulation as we navigate this moral terrain is the distinction between earned and unearned income, as we saw in the papal decision. It seems fair that the Chambar moneylenders charged enough to cover their expenses as well as the value of their time and capital (which we can think of as the income forgone by not putting that time and capital into another activity). But if the moneylenders exploited a superior negotiating position to set prices even higher, that would begin to feel wrong to the modern sensibility steeped in the ideals of market-based competition. In the most hateful caricature, the moneylender is a monopolist.

In fact, Aleem found evidence of subtle *oligopoly*, in which lenders restrained themselves in competing with each other on price. Repeat customers, who were cheaper to serve because they had already been screened and had demonstrated their trustworthiness through repayment, did not pay lower rates. Whether or not by design, the moneylenders appeared to take advantage of the way that up-front screening locked in creditor-client relationships. Switching lenders

[23] 100 percent from Rosenberg (2007); quote from Epstein and Smith (2007).

[24] "Sub-20 percent" from [http://www.mixmarket.org/en/demand/demand.show.profile.asp?token=&ett=1658, viewed June 29, 2009].

[25] Rosenberg, Gonzalez, and Narain (2009); kiva.org/about/aboutPartner?id=130, viewed July 8, 2009.

entailed hassle and risk for all involved.[26] (Similar dynamics seem to explain why credit card interest rates and profits remain high in the United States despite competition.[27])

Yet by producing evidence of unearned profits, Aleem showed just impractical it can be to use the concept to pass moral judgment on rates. To reach his conclusions, he had to perform months of field work, then make arguable assumptions about such things as the value of moneylenders' time. Analyzing the finances of microfinance institutions might seem easier, since MFIs are formal organizations with payrolls and bookkeepers. But in general drawing the line between earned and unearned profits remains problematic. The riskier a venture, the higher must be the prospective profits to draw investors. And a start-up company in an immature and potentially controversial industry in a developing country looks pretty risky to most investors. Moreover, even small layers of fat in operations can rival profits as a cause of higher costs and interest rates at MFIs. Many are small and inefficient, some because they receive grants and feel minimal pressure to operate in a businesslike way. How sharp is the moral line between an efficient MFI that earns high profits on 50 percent interest and an inefficient one that charges the same rate and breaks even after covering a bloated payroll? In one case, affluent investors skim the cream. In the other, salaried and relatively educated MFI employees do, however unwittingly. Among financially self-sufficient MFIs in 2006, eliminating profits (both "earned" and "unearned," however defined) and passing the savings on to customers would have cut interest charges by just a sixth.[28]

Carlos Danel, one of the Compartamos co-founders whom Yunus likened to a moneylender, pointed out another challenge to distinguishing good profits from bad. He told me

[26] Aleem (1990), [xx].
[27] Ausubel (1991); Calem and Mester (1995).
[28] Rosenberg, Gonzalez, and Narain (2009). Their sample consists of 175 MFIs that were self-sufficient in 2003 and 2006.

that Compartamos, which was born out of a non-profit group with a social mission, sought abnormally high earnings in order to prove that microcredit is serious business and draw in competition from mainstream banks, among others.[29] Though self-serving, the argument was serious. Patents grant monopoly profits to innovators precisely in order to midwife new industries. Apple's path-breaking iPod and iPhone raked in billions—and stirred imitation and competition that gave consumers new choices.

Ironically, while Danel's defense of monopoly profits further complicates our search for a practical definition of fair interest rates, it also points a way out of the impasse by introducing the element of *time*. If the increasing competition in Mexico drives rates down—as it seems to have done in Bolivia and Uganda (see chapter 5)—that will partly vindicate Danel. Indeed, Mexican microcredit competition indeed appears to have intensified since Compartamos went public, though whether that has reduced rates is less clear.[30] More generally, one of the best practical ways to judge whether the microcredit is serving the customer is to look at trends. If rates are falling, especially relative to benchmarks such as government bond interest rates, that is an encouraging sign that MFIs are becoming more efficient and passing savings on to borrowers in order to compete or serve their social mission.

So far in attempting to answer the question of what constitutes usury, we have collected half-answers: the impracticality of zero interest, the attractive if impractical distinction between earned and unearned profits, and the importance of trends. What happens when these ideas are brought to the available data on microcredit? The best analysis to date comes from Richard Rosenberg, Adrian Gonzalez, and Sushma Narain at CGAP, the autonomous microfinance research unit of the World Bank. Their conclusions are reassuring. Figure 1 is inspired by one

[29] Interview with author, June 24, 2008.
[30] Kneiding and Rosenberg (2008), 3.

piece of their analysis. For each region of the developing world, it shows the spread of 2007 interest rates among MFIs reporting to the MIX Market data warehouse. In Latin America and the Caribbean, for example, the median (50th percentile) MFI reported an average interest rate of 26 percent per year. But 5 percent of these 259 Latin MFIs, including Compartamos, charged more than 69 percent. Sub-Saharan Africa is also home to a notable number of expensive creditors. Rates are consistently low in South Asia.

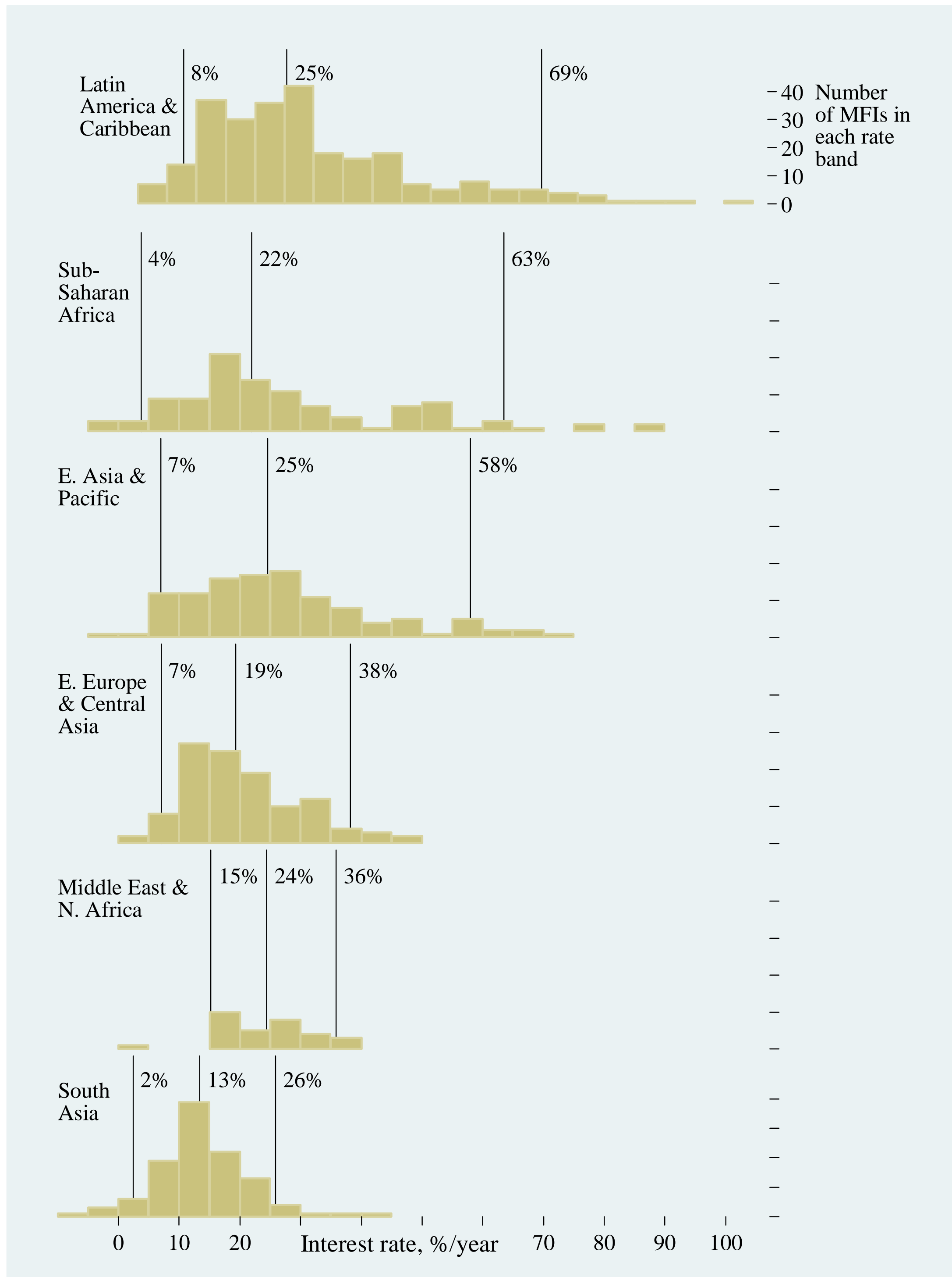
The CGAP researchers made other encouraging comparisons. In most countries with data, microcredit appeared cheaper on average than credit card and consumer loans. Looking along the time dimension, they found that among financially self-sufficient MFIs, rates fell an average of 2.3 percentage points per year between 2003 and 2006. Both profits and operating expenses fell. "Mission drift"—shifting to larger, more economical loans for richer people—could not explain the efficiency gains because costs fell per loan, not just per dollar lent.[31] Thus, most poor clients are paying less for microcredit each year.

In sum, although microcredit interest rates are generally steep by rich-world standards, once the higher cost of lending to the poor, the value of covering those costs in order to grow, and immaturity of the industry are taken into account, rates high enough to be called usurious appear to be the exception. A combination of social mission and competitive pressures generally keep rates in check. Still, there are exceptions. Rosenberg, Gonzalez, and Narain conclude that "a few MFIs have charged their borrowers interest rates that may be considerably higher than what would make sense [for financial self-sufficiency]. Indeed, it would be astonishing if this were not the case, given the diversity of the industry and the scarcity of competitive markets."[32] And the exceptions, including Compartamos, need watching: will they persist, or be eroded by

[31] Rosenberg, Gonzalez, and Narain (2009); rates unadjusted for inflation.
[32] Ibid., 21.

the competition they attract?

Figure 1. Counts of MFIs by region and average interest rate, 2007, with 5th, 50th, and 95th percentiles vertically marked



Note: Rates are gross portfolio yields, adjusted for consumer price inflation. They do not factor in the hidden costs of forced savings and overpriced credit-life insurance. From left to right, vertical lines show

5th, 50th, and 95th percentile interest rates.
Source: Author's calculations, based on [MIX Market] and [World Bank (2008)].

Beyond pricing: Transparency, reliability, flexibility

In addition to the generally reassuring conclusion, the enquiry into usury offers an important lesson: judging whether lending is just and freeing is best done not by looking at a snapshot of the interest rate at one moment, but by understanding the relative power of borrower and lender. An MFI charging 50 percent in a market it monopolizes may arouse more concern than one charging the same rate in a competitive market. But the power dynamics between borrower and lender play out around more than interest rates. Here, we look at three other aspects of lender behavior that also matter for whether credit bestows agency: transparency, reliability, and flexibility.

Transparency

The argument for *transparency*—clear disclosure of the costs and obligations of a credit contract—is much like that for competition (and against monopoly). As we noted, the pope's distinction half a millennium ago between earned and unearned interest meshes with more modern ideas traceable to Adam Smith about how markets ought to work. Though the market ideal should not be taken as gospel (we will discuss the dangers of competition later) it does generate some sensible norms about lender behavior. In ideal markets, for instance, competition allows sellers the minimum profit necessary to persuade her to enter the market in the first place—and no more. Monopoly and oligopoly violate that ideal, appearing coercive in contrast. They generate "unearned" profits. Another assumption embedded in the market ideal is that all buyers know exactly what they are buying and reveal exactly what they are charging.

Many MFIs violate this ideal by imposing subtle fees that effectively raise interest rates without seeming to. Some charge one-time loan origination fees. Some require borrowers to

deposit a percentage of each loan amount with the MFI in a savings account that pays interest at a rate lower than that on the loan. Some overcharge for credit-life insurance bundled with the loan (see chapter 5). Another oft-criticized practice is to charge interest on the full loan amount even as the outstanding balance declines over the repayment cycle. Such “flat-rate” interest effectively doubles the interest rate: since the average balance on a $100 loan steadily repaid over a year is $50 (again, see chapter 5), $20 of interest may look like 20 percent interest but it is 40 percent of the average balance of $50. Some MFIs quote their rates on a monthly basis, perhaps exploiting borrowers’ ignorance of how a seemingly modest 6 percent per month compounds into 100 percent per year.

Among those steeped in finance, the reflexive response to such fine—or invisible—print is to demand to know the annualized percentage rate (APR), the number that sums all costs and expresses them as an interest rate over a standard time frame. In the first half of the twentieth century, for example, the Russell Sage Foundation became convinced that much of the harm of informal “loan-sharking” lay in its lack of transparency. Clyde Olin Fisher, an economist of the day, studied the Morris Plan practice of deducting a flat 8 percent interest charge up front and calculated that it yielded a 17.3 percent APR (see chapter 3), mainly because of the doubling phenomenon explained above. “No useful purpose,” he wrote in 1929, “is served by confusing the nominal and the real rate of interest paid by the borrower.”[33] The Foundation eventually persuaded two-thirds of U.S. states to pass versions of a Universal Small Loan Law, which offered loan sharks a deal worth pondering today: it exempted them from interest rate caps provided they disclosed their charges simply and transparently.[34] In our era, Chuck Waterfield of

[33] Fisher (1929), 500. The balance on a $100-face-value loan would descend from $92 to $0 over a year, for an average balance of $46, of $8 of interest is about 17.3 percent. A more precise internal-rate-of-return calculation yields slightly more than 18 percent.
[34] Carruthers, Guinnane, and Yoonseok (2007), 3.

Columbia University has proposed a more voluntary initiative. Launched in 2008, MFTransparency signs up MFIs to a code governing how they report their charges. The MFTransparency website puts forward the APR as a universal yardstick with which MFI investors and clients can compare apples to apples.[35]

While any move to make fees transparent is laudable, APRs may not be the best tool. Consider the reply in 1931 to Clyde Fisher by Ralph W. Pitman, a top Morris Plan banking executive:

> If he had stated that our advertising was to the effect that a Morris Plan loan costs 8 per cent interest per annum, then his point would be well taken. If he will inspect the bulk of Morris Plan advertising, however, he will find that this statement is never made and the only reason that we tell the public that a $100 loan costs $8.00 is that this statement is plainer to the average borrower than would the statement be that our charge mathematically figures 17.3 per cent….He will also find that frequently Morris Plan banks publish charts showing the face amount of the loan, the amount deducted, the amount to the borrower and the weekly, semi-monthly or monthly payments. We believe we are safe in asserting in this connection that our advertising does not intend to deceive and that it does not deceive.[36]

In other words, Morris Plan banks made their loans easy to understand: "if you borrow $100 from us, we keep $8 but you pay back $100 in small, even installments over a year." Even if borrowers did not think in APRs, Pitman argued, they understood the deal, and the cause of transparency was served. In fact, even a mathematician needed to pull out a slide rule to compute an APR, which said something about how natural they were to the human mind.

Recent research has vindicated Pitman. University of Chicago economists Marianne Bertrand and Adair Morse arranged for an American pay day lender with operations in many states to experimentally place educational graphics on the cash envelopes clerks pass to patrons under bulletproof glass. Then Betrand and Morse monitored how much and how often people exposed to the images borrowed in the months that followed. One graphic showed that the APR

[35] APR Calculation Tool, mftransparency.org/media/misc/UnderstandingInterestRatesTool_1_04.xls and slideshare.net/mftransparency/why-we-need-transparent-pricing-in-microfinance, both viewed July 7, 2009
[36] Persons *et al.* (1931), 16.

of the loans—which cost $15–17 per $100 for two weeks—worked out to more than 400 percent year. An alternative graphic, placed on envelopes at other of the company's store fronts, instead showed how the $15-per-fortnight in interest adds up for repeat borrowers. And one showed how often people slip into serial borrowing. (See Figure 2.) The APR message had little or no effect rates of borrowing in subsequent pay periods. The third graphic also had minimal impact. But the second one cut the frequency of reborrowing in future pay cycles by roughly a tenth. Evidently, translating the fees into terms that people could relate to easily—highlighting that borrowing $300 for three months costs $270—hit home.[37] And if people saw the message every time they took a two-week loan instead of just the once during the experiment, they might borrow even less. For the typical one-year loans of microcredit, a simple and clear statement of total costs appears to inform borrowers better than an APR.

[37] Bertrand and Morse (2009).

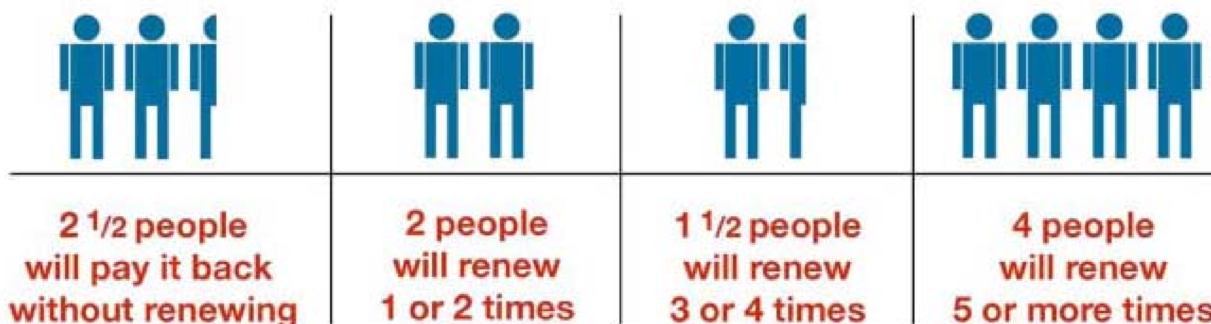
Figure 2. Three experimental messages on cash envelopes for clients of payday lenders

Annual interest rates on different types of loans

	Median Annual Interest % (from government surveys)
Payday Loan	443%
Installment Car Loans	18%
Credit Card	16%
Subprime Mortgages	10%

How much it will cost in fees or interest if you borrow $300

PAYDAY LENDER (assuming fee is $15 per $100 loan) If you repay in:		CREDIT CARD (assuming a 20% APR) If you repay in:	
2 weeks	$45	2 weeks	$2.50
1 month	$90	1 month	$5
2 months	$180	2 months	$10
3 months	$270	3 months	$15



Source: Bertrand and Morse (2009).

APRs arise from a metaphor foreign to many poor people, the rich-world bank account maintained for a year or more while earning interest compounded daily. What matters most for transparency is not that fees be summarized according to a particular convention, but that they be clear and simple. Some poor people regularly borrow for periods as short as a day. But as terms shorten, interest rates climb: it does not cost on lender half as much to lend for half as long. Vegetable sellers in a market in Chennai, India, reportedly borrow from their suppliers at 10 percent per day.[38] On a credit card with that rate, unpaid interest would compound to an incomprehensible 128,330,558,031,335,170 percent per year. Are the lenders remiss in not disclosing this? The actual interest cost, probably measured in pennies, may be a reasonable price to pay for the liquidity on days the vendors need it. The timeframe mismatch brings to mind a Steven Wright joke: "One time, the police stopped me for speeding, and they said, 'Don't you know the speed limit is 55 miles an hour?' I said, 'Yeah, I know, but I wasn't gonna be out that long.'"[39]

The larger point is that transparency is in the eye of the beholder. Disclosure only succeeds if people understand the message. To work, disclosure must be designed to overcome the foibles of human cognition, which the ascendant field of behavioral economics has increasingly helped us understand. Most people tend to overestimate their own luck and skill—to believe, for example, that they will live longer than most people. On average, people think they are above average. Optimistic, we rationalize when we yield to temptation and take on debts we cannot handle.[40] "For the past few million years it has been much more important to think fast than it has been to think accurately," writes Mike Dixon of the Institute for Public Policy

[38] Ananth, Karlan, and Mullainathan (2007).
[39] pastemagazine.com/blogs/lists/2009/05/steven-wright-has-a-pony-the-king-of-deadpans-10-b.html, viewed July 7, 2009.
[40] Slovic (1987).

Research in London. But "the short cut can sometimes lead to the wrong place."[41] We are descended from people who did not give up. It would be foolish to try to change human nature, but perhaps less so to leaven it with appropriate explanations about the true costs of credit.

In that light, even if MFTransparency is overemphasizing APRs, it is attacking a real problem. Microcreditors often explain their contracts in ways that are incomplete, confusing, even misleading. In Dhaka in 2007, Rutherford introduced me to a client of his *Safe*Save microfinance project who lived in the slum around the corner from a *Safe*Save branch. He took pride in showing me the rules for the woman's loan and savings accounts: in plain Bengali, on a single sheet of paper folded into her passbook. She could not read it but she and Rutherford took further pride in showing me that her school-age son could. Through its transparency, *Safe*Save implicitly criticized business-as-usual microfinance in Bangladesh.

Reliability

Akin to the notion of transparency is that of reliability: commitments should be not only clear but honored too. Here, microfinance appears to be doing well by the standards of the poor.[42] MFIs operate at the boundary between the formal and informal economies, between the world where institutions are born out of, and do business through, legal documents and the world where businesses are hardly distinct from families and transactions are recorded in people's heads. When MFIs, formal institutions, sell services to people who work primarily in the informal economy, they deliver a more contractual style of doing business than such people may ordinarily experience. In essence, formality abstracts from social context. In the ideal, participants in a formal financial arrangement are legal persons, parties to a contract that

[41] Dixon (2006), 49–50.
[42] One exception appears to be the Ugandan health insurance program documented in McCord, Botero, and McCord (2005). See chapter 4.

precisely stipulates obligations. Whether the persons are rich or poor, giant corporations or tiny families should not matter. Thus, inherently, MFIs are more dependable that than those with whom the poor otherwise do financial business: friends, family, moneylenders, and moneyguards (who hold savings for a fee). If the Grameen Bank says you will be eligible for a new loan if you maintain your payment record for 17 weeks, you can bank on it. The authors of *Portfolios of the Poor* extol microfinance for its rule-bound reliability:

> It represents a huge step in the process of bringing reliability to the financial lives of poor households. For many poor people, having to deal with unreliable financial partners is just part of a general environment of unreliability that they must live with every day. Institutions that they interact with in other aspects of their lives are unreliable as well: the police and the courts, for example, or the health and education services.
> …
> [The Bangladeshi microfinance] loan officers came to the weekly meetings on time, in all kinds of weather; they disbursed loans in the amount they promised at the time they promised and at the price they promised; they didn't demand bribes; they tried hard to keep passbooks accurate and up-to-date; and they showed their clients that they took their transactions seriously.[43]

In the spirit of diversification, argue the authors, poor people welcome this distinctive style of finance into their portfolios, along with informal services.

Informal financial relationships, by contrast, are more embedded in social relationships, which is both a curse and a blessing. The curse is the tincture of precariousness it brings to economic life. Will your brother pay back? Will the "merry-go-round" ROSCA (see chapter 3), in which one person takes the pot each week, keep rotating till your turn comes around? Will the moneyguard abscond?

The blessing of informal finance is flexibility. This brings us to the last aspect of customer service we will touch upon. Classic microcredit disburses once a year, but husbands do not fall sick on such a neat schedule, which is where other, more adaptable forms of finance must fill in. Recall how Ifran Aleem discovered that 10–20 percent of clients of Pakistani

[43] Collins *et al.* (2009), 26–27.

moneylenders repaid late, generally without incurring extra interest. The authors of *Portfolios of the Poor* discovered the same leniency in the “financial diaries” they helped poor people maintain for a year in Bangladesh, India, and South Africa. Late payments, defaults, and wrangled interest forgiveness often dramatically reduced the effective rates paid to moneylenders. In this way, the flexibility of informal finance begat freedom. And in this light, favorably comparing microcredit interest rates to the higher ones of moneylenders, as Kiva does on its website, is misleading. The two credit relationships differ fundamentally.

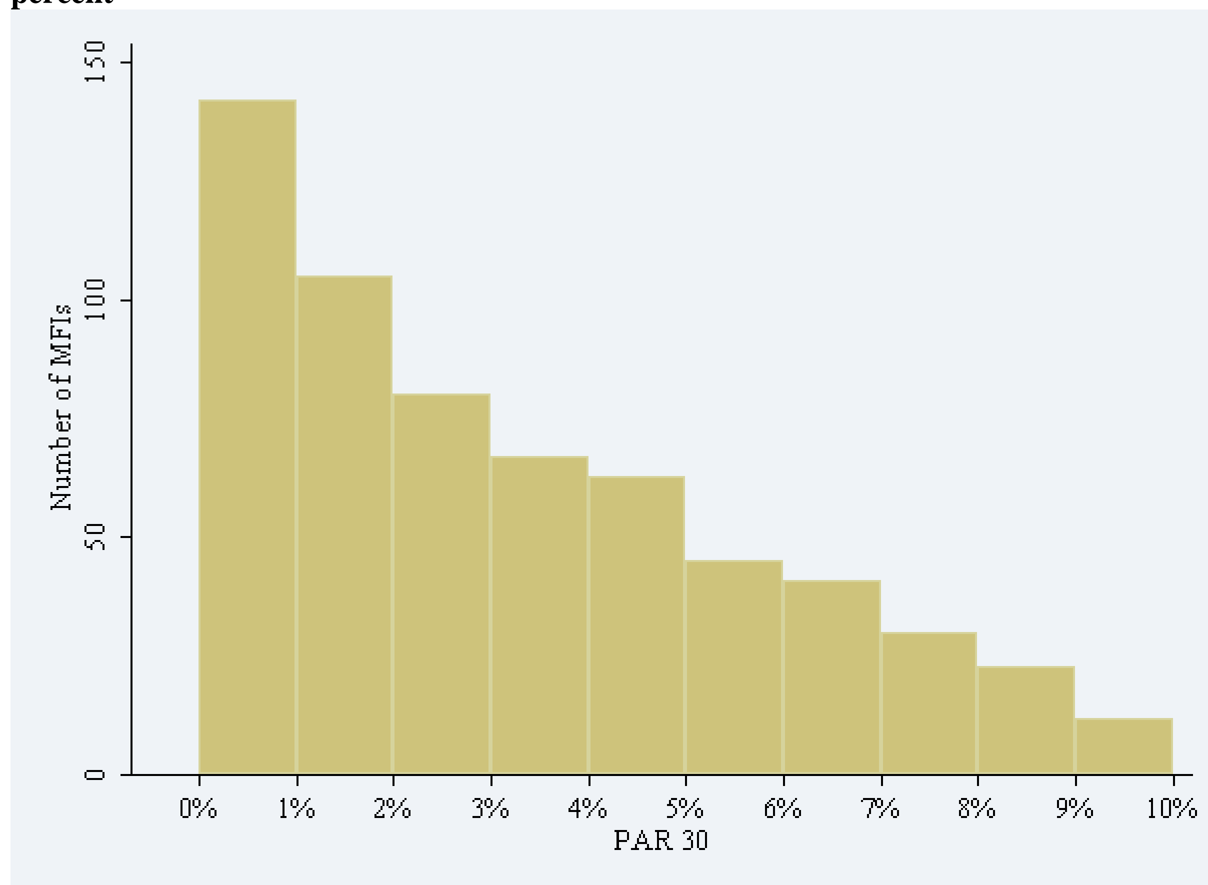
To an extent, flexibility is the flipside of reliability. The social context that lubricates and restrains informal dealings at once complicates them and softens their rough edges. If your sister cannot pay you back because she has just lost her husband, that lessens the harshness of debt for her even as it makes your finances more precarious. By nature, informal finance is unreliable and flexible. Meanwhile, microfinance offers more reliability to clients—and usually demands more of it from them. By nature, it is reliable and inflexible. That inflexibility can give microfinance a sharper edge when it comes to pursuing repayment.

One potential indicator of the inflexibility of microcredit is the high rate of on-time repayment. Like interest rates, on-time repayment rates in microcredit exceed rich-world norms, enough so to startle newcomers to the field. Among 718 microfinance institutions (MFIs) that voluntarily supplied relevant data to the MIX Market for 2007, the median “PAR 30” rate was 3.4 percent. That is: half MFIs reported that total repayments overdue at least 30 days constituted 3.4 percent or less of outstanding loan balances. Eighty-five percent boasted a PAR 30 below 10 percent of outstanding credit, tantamount to a repayment rate of over 90 percent. (See Figure 3, which tabulates MFIs in that 85 percent by their PAR 30 rates.) MFIs are much quicker to showcase repayment rates close to 100 percent than they are to showcase interest rates that high.

Not without reason, they take high repayment as a sign that the poor are reliable, that the poor value microcredit, and that microcredit business models work (as discussed in chapter 5). But can repayment rates, like interest rates, be too high? Does the near-perfection indicate that some MFIs wield a fearsome capacity to extract repayment through peer pressure and offers of bigger loans down the road? In one village Brett Coleman studied in Northeast Thailand (see chapter 6), "approximately 20 of its 30 members regularly borrowed from a moneylender to repay their village bank loans, but the village bank had a 100% repayment rate." He viewed members the rolling over debts in this way as trapped in a "vicious circle."[44] Around the same time, a researcher named Shahin Yaqub theorized that BRAC's microlending was indeed empowering poor Bangladeshis—who then used their power to default more! For Yaqub, perfect repayment was a sign that borrowers lacked power.[45]

[44] Coleman (1999), 108.
[45] Yaqub (1995).

Figure 3. Counts of MFIs by PAR (Portfolio at Risk) 30 rate (principle amounts overdue at least 30 days, as share of all outstanding balances) among those with a rate below 10 percent



Source: Author's calculations, based on [Mix Market].

Near-perfect repayment must in some cases be a sign of how much people value microcredit or even of flexibility, if some MFIs coax high repayment rates from clients by conforming better to their cash flows. But the opposite implication, of dangerous pressure on debtors, seems to hold sometimes too. Sanae Ito heard from some teachers and a carpenter, relatively well-off themselves, who saw things that way:

> [T]hey were of the opinion that [Grameen] Bank members who ran around desperately trying to borrow repayment instalment money from relatives and neighbours before the bank meetings could not possibly be experiencing any reduction in their poverty. When I asked them why they thought that the bank members were still so desperate to take loans despite such difficulties, the assistant head master answered: "It seems to me that they borrow to meet their immediate financial needs, which have no limits of course." Others were less kind, seeing the beautiful brick building of the bank branch as a symbol of exploitation. A carpenter…added: "The Bank can get

away with it only because it is dealing with the illiterate poor. It couldn't have done it with us."[46]

If the Compartamos stock flotation is the touchstone controversy for the debate over whether interest rates are too high, then the microfinance world's previous imbroglio—in Andhra Pradesh, India, in 2006—is the rough counterpart for repayment rates. In both cases, the most thoughtful observers have been unable to dismiss the charge that rates—interest rates in Mexico, repayment rates in India—were too high. What happened in Andhra Pradesh remains murky to this day. In March of that year, authorities in the Krishna District padlocked all the local offices of Spandana and Share Microfin (then India's largest MFIs), jailed loan officers, and announced that clients need not repay their loans. The move was unfair in several respects. The legal justification, that the MFIs were violating usury laws, was dubious. Spandana's and Share's interest rates were low by global standards, in the mid-20s. Biased newspapers cooperated with inflammatory stories about debtors committing suicide. Undoubtedly petty bureaucratic interests were at work too, given the rivalry between the fast-growing MFIs and an equally ambitious self-help group program backed by the government and the World Bank.[47]

Yet the public ire at MFIs seemed genuine. Syed Hashemi, whose studies of microcredit and empowerment appear later in this chapter, visited Andhra Pradesh for a week at the height of the crisis and spoke to all sides. In a public online discussion group, he ruminated:

> I have spoken strongly against the government closure of bank branches….The government however claims that they were merely doing their duty according to the laws of the land. Many women had complained to them about MFIs seizing assets. There were many demonstrations of women against MFIs (which were incidentally touted as examples of women's empowerment). While I realize much of this was orchestrated, most people I talked to vouch for the integrity of the District Collectorate (the person who ordered the closures). Many civil society organizations were against the MFI position.
> …
> The Andhra issue also made me think of our message of zero tolerance to delinquency. Sure I swear by it, but what does it mean in practice? Were the MFI staff right to be coercive in

[46] Ito (1999), 86.
[47] Ghate (2007).

> recovering loans? How far does one go? Do you seize assets? Do you stand in front of their house and shame them till they pay back? I don't have answers but we need to get a handle on this. There's got to be a balance between sound financial practices and looking after the welfare of clients.[48]

A leading authority on Indian microfinance, Prabhu Ghate, voiced similar thoughts:

> The point at which peer group pressure becomes coercive is an extremely difficult one. However one clear lesson...is that the policy of 100 percent repayment and "zero tolerance" for default carried a very high cost in terms of client dissatisfaction, and provided ample material to be exploited by interested parties. Clearly there is a need for flexibility to accommodate cases of extreme distress in which a borrower is unable to pay because of critical illness, hospitalization, and so on. A second lesson is that there is a great need for action research to provide answers to the question of how flexible MFIs can afford to be, even in cases of lesser distress (such as failure of a business) in rescheduling loans, without affecting repayment discipline generally, and how much operational costs would go up to introduce such flexibility.[49]

The Andhra Pradesh incident raises an important question: must microfinance demand the same mechanical reliability that it supplies? Or can it be both reliable and flexible? Hashemi and Ghate voice hope, and the trade-off is theoretically avoidable. The "cash credit" that originated in Scotland in the 1700s was at once flexible and reliable (see chapter 3). So are lines of credit today. True, the business imperatives of mass-producing small-scale services for the poor do crank up the tension. What BRAC's Imran Matin called the "unzipped state," a viscous spiral into widespread default that occurs when people ask, "Why should I pay back when my neighbors are not?" is especially pernicious for lenders to the poor because it sends costs through the roof (see chapter 5). But there is unquestionably scope for improvement, perhaps especially in South Asia, where population density and relative economic equality combine to make microfinance most economical in general. The best proof of the potential is the package of innovations the Grameen Bank adopted in 2001, "Grameen II." At the time, Yunus characterized classic Grameen microfinance with remarkable frankness:

> The system consisted of a set of well-defined standardised rules. No departure from these rules was allowed. Once a borrower fell off the track, she found it very difficult to move back on, since

[48] microlinks.org/ev.php?ID=13486_201&ID2=do_discussionpost_list, viewed July 18, 2009.
[49] Ghate (2007), [xxx].

> the rules which allowed her to return, were not easy for her to fulfill. More and more borrowers fell off the track. Then there was the multiplier effect. If one borrower stopped payments, it encouraged others to follow.[50]

Grameen II aimed almost entirely at making the Bank more flexible, by making existing services more accommodating and by adding new ones. For example, clients can now open flexible individual savings accounts. And they can "top-up" loans that are at least half paid off—that is, they can borrow back the amounts just paid in (see chapter 5). In work behind *Portfolios of the Poor*, Stuart Rutherford tracked the finances of some households in Bangladesh after the dawn of Grameen II. Ramna's story exemplifies how Grameen II freed clients from the traditional one-year loan cycle:

> Ramna…and her husband were completely landless, sheltering on her brother's land and trying to bring up two school-age sons. The husband had few skills and was in poor health, and though he tried day laboring, working in a tea stall, and fishing for crabs, he was never able to maintain steady income during the three years we knew them.
>
> Ramna had…taken a loan of $83 used to buy food stocks in a lean period. She was repaying weekly from a variety of sources including her husband's income, interest-free loans from family and neighbors, and her own Grameen II personal savings. In April 2003 she "topped up" her Grameen loan and used it to buy grain to keep in reserve for the coming monsoon period….Then in October her father-in-law died and they financed the funeral with another top-up, worth $67. They managed to make repayments during the winter dry season, so that in May 2004, when she was eligible for another top-up, she took it and stored it with a moneyguard, from whom it was later recovered and used to pay down a private loan that had been hanging over them for some time. She topped up with another $75 once more in December, the month of the main rice harvest, and it was spent on stocks of grain and on medical treatment for her husband, with a portion held back to make weekly repayments. They struggled to repay in early 2005 because her own father was ill and they had to find money to pay for his treatment, but in early July she was able to top up again ($65), this time paying school fees as well as restocking with food.[51]

Ramna and her husband fought to keep up with their debts. Indeed one wonders whether the bottom half of her repeatedly topped-up Grameen loan will ever be paid off. Yet it would have been even harder for them to mesh their sporadic income with volatile spending needs without the ability to borrow and save flexibly. If the Grameen Bank had insisted on a strict annual

[50] Yunus (2002).
[51] Collins *et al.* (2009), 163.

schedule, that would have pushed Ramna's family even more toward flexible but *less reliable* informal services—not unlike the Thai village bank members whom Coleman found using moneylenders to stay current on their microloans. Grameen II may well have given Ramna a precious increment of freedom.

Group dynamics

It is often suggested that the groups in group credit directly empower their members. That is, in addition to unlocking access to credit through joint liability, groups are a novel structure through which women can support each other in times of need and collectively agitate for their rights within the community. Solidarity groups imply this idea with their name. Self-help groups (SHGs) do too, once "self-help" is understood to tap into Gandhi's philosophy of collective grassroots action. And village banks, like SHGs, devolve credit and savings administration to members in the name of empowerment.

It's not hard to see how groups could empower women. Most poor societies restrict the women's roles outside the home. Bangladesh again provides the classic example; there, the custom of *purdah* has formally proscribed women from seeing or talking to men outside their extended family.[52] Even when it is not obeyed literally, *purdah* inhibits women from acting in public fora and engaging in commerce. Only men, for example, are supposed to bargain and truck at the markets. Women walking along roads between villages raise eyebrows—or at least used to. Amidst such paternalism, a space for women to convene in a public space, to pass money from hand to hand and discuss business affairs, is inherently radical. And one can imagine how these tight-knit groups, meeting weekly over the years, could become platforms for mutual aid. A story from an authoritative 2006 report on SHGs:

[52] Rahman (1999a), 80.

> Traditionally, married women were never allowed to stay away from home for an entire night and if they even tried doing it they knew they could be beaten up or even thrown out by their husband.…[T]raining programmes for SHG members sometimes involve their stay overnight at another village.
>
> When this happened in Manikhera village (Orissa), soon after the SHGs were formed 6 years ago, one of the SHG members was locked out the house by her husband when she returned from two nights out at a training programme. But, when the other SHG members rallied round, and said they would report the matter to the police, the man gave in and accepted her back. This early success was a source of strength to the group, building their confidence that they could support each other and act together to deal with issues within the family.[53]

On the other hand, as we saw in chapter 5, the *raisons d'être* for groups originally had less to do with empowerment than with discipline and efficiency. Joint liability substituted for collateral as a way to compel borrowers to repay. Group meetings saved microfinance officers time compared to going door to door—but by the same token imposed on borrowers' time. Village banking went further in shifting the management burden onto borrowers. India's SHGs are perhaps exceptional in this regard as the non-governmental organizations (NGOs) that promote them appear to invest great energy in teaching women that such phenomena as dowry and domestic violence are unacceptable and organizing the women to fight for change. Still, the point stands that as a general matter, the peer pressure of joint liability is inherently coercive. Thus, how much various forms of group microfinance directly expand or contract people's freedom is unclear.

The dangers of competition and multiple borrowing

This chapter has been about how various aspects of credit behavior—interest rates, transparency, rigidity, flexibility, group structures—affect borrowers. But it is hard on a lender too if all its borrowers sink too deep into debt. The popular forms of microcredit have thrived precisely because they imposed restraint on both lenders and borrowers, such as through joint liability and those rigid weekly payments. These kept microcredit on the conservative side of the fuzzy

[53] Sinha (2006), 79.

boundary between safe and unsafe lending. However, the arrival of *competition* has at times severely tested these methods by enabling people to quietly borrow from more than one MFI at a time. That in turn has created severe challenges for MFIs wanting to protect their bottom lines as well as clients' welfare. History has shown that microcredit markets are like forests. Just as certain fast-growing tree varieties thrive in a recently reforested areas only to give way to sturdier, slower-growing species as the forest matures, lending methods that work for a solo MFI expanding into microcredit-free territory can fail once the MFI is joined by competitors and they together grow to saturate the local market.

In particular, as loans grow—remember from chapter 5 how MFIs reward full repayment with new and larger loans—and as MFIs multiply, it becomes easier for people to borrow from several lenders at once. The situation is analogous to that in rich countries, where people routinely carry several credit cards, except more dangerous. Many developing countries have no credit bureaus (centralized agencies through which lenders share information about borrowers), or least have none that cover poor people. This blinds MFIs to the true debt loads of their borrowers.

The history of modern microfinance is lightly dotted with crises that show these concerns to be more than theoretical. In the 1990s, Bolivia became an early exemplar of microcredit—and of the pitfalls of multiple lending. A crisis hit in 1999. Years of rapid growth in microfinance attracted a new breed of creditor, the consumer lender, which extended credit to people with salaries, primarily to help them buy goods such as televisions and refrigerators. The consumer lenders sprang onto the scene in the late 1990s and then collapsed almost as quickly—but not before strewing overindebtedness in Bolivian cities and infecting MFIs with repayment problems. Elisabeth Rhyne of Acción International describes the dynamics:

> Poaching clients from other institutions through the offer of larger loans has proven to be an extremely successful marketing technique in Bolivia, as elsewhere. And it has been shown repeatedly that clients are not good judges of their own debt capacity. Apparently credit is like good food: when seated at the table in front of a feast, many people eat too much and regret it later….The truly unfortunate dynamic is that if over-lenders are successful at luring clients away from more responsible lenders, the responsible lenders are virtually forced to follow suit. The pressure to lend more to keep good clients is nearly as irresistible as the client's desire to borrow more. Worse, if clients begin using one loan to pay off another, the game becomes…"Who collects first?" In short, the sector as a whole starts to become one big Ponzi scheme.[54]

The financial recoil caused a political one too. Protesters demanded debt forgiveness, pelted microfinance bank windows with trash, and took the government's Superintendency of Banks hostage. Multiple borrowing was also common in Bangladesh by the late 1990s, and may have contributed to the payment troubles Yunus acknowledged at the Grameen Bank.[55] In India more recently, multiple borrowing appears to have fed the Andhra Pradesh contretemps in 2006, as well as more recent political backlashes in the Indian state of Karnataka.[56] An article by the Microfinance Gateway documents how a Nicaraguan MFI that does individual microcredit dealt with such troubles in 2009:

> Gabriel Solorzano, president of Banex, explains, "Our policies have been a reaction to the environment here in Nicaragua. It's not easy to be on the front page of the newspaper five days in a row. It's not easy to have the president of the country telling people they don't have to pay."
> …
> "In a country of only five million people, there are 350 MFIs and just about every donor on this planet. There was a level of market saturation, about to explode," says Solorzano. In Nicaragua, over-indebtedness has become a serious problem, Solorzano explains, "so we changed our credit policy not only to request credit information from the new credit bureau, but also to tighten the liquidity of the client."
> Banex significantly lowered its threshold for a client's debt-to-net income ratio. As a result, they now reject 80% of all loan applications (up from a previous rate of 20–25%). Though this more conservative position stopped the MFI's growth (they had previously enjoyed a 74% compounded annual growth), Banex recognized it as a necessary step.[57]

Multiple borrowing is a particular challenge just where failure to manage it can harm the most: for the poorest microcredit clients, who take group microcredit. Group methods are

[54] Rhyne (2001), 155.
[55] Prevalence in late 1990s from Chaudhury and Matin (2002).
[56] [Siddhartha Chowdri, Managing Director, Country Manager for India, Acción International, "Consequences of Overindebtedness: Lessons from India," Center for Financial Inclusion blog, bit.ly/8aub7.]
[57] Microfinance Gateway, "Turning Principles into Practice," July 13, 2009, bit.ly/472UCr.

designed to offload the job of monitoring borrowers onto the borrowers themselves. Eschewing such labor helps lenders control costs and makes the littlest loans to the poorest people economical. But it also amounts to an enforced ignorance about how much their customers do and should borrow. As a result, in group credit it has traditionally been up to borrowers to keep tabs on how many loans their peers have, how much they owe, and whether they can keep up with the payments. The solvency of major group microcreditors and their clients depends on the good judgment those clients. Unclear is how reliable that judgment remains as multiple borrowing becomes the norm. The global financial crisis has made obvious that human beings are eminently capable of collective delusion about the value of financial claims. The worry is that where borrowing becomes common, an upward will bias creep into people's intuitions about how much debt their peers can handle. "Everyone is borrowing from multiple MFIs," they may think, "and nothing bad has happened to them, so it must be OK."

On the other hand, Bangladesh's example seems reassuring: more than a decade of multiple (group) borrowing has not led to a meltdown. Exactly how well people are managing their multiple loans, though, is unclear. A quiet repayment crisis in the late 1990s triggered Grameen II.[58] In 2002, BRAC's Matin and fellow researcher Iftekhar Chaudhury found that in a handful of villages in Tangail district 90 percent of BRAC-only borrowers were regular loan repayers, compared to just 50 percent of those who borrowed from BRAC and at least two other MFIs. As usual with such figures, what is causing what is unclear. Borrowing from several MFIs may have gotten people into debt trouble or trouble may have led them to borrow from several MFIs, like people juggling credit card balances. The seeming good news was that most people did eventually paid off their loans. But here too the interpretation is uncertain. Behind statistics

[58] [cite]

showing full repayment may lie a haphazard pattern of paying off old loans near the end of each one-year cycle, possibly via bridge loans from moneylenders, in order to quickly obtain new ones.[59]

The best way for lenders to monitor and manage multiple borrowing is to share information about borrowers among themselves; normally this is done through a credit bureau. Microcreditors are increasingly computerized, so that it ought to be possible for them to share information for cheap. Group credit is a technology that largely predates the ongoing revolution in digital technology, so perhaps there is room for a high-tech makeover to allow even group creditors to economically track their borrowers. But the problem is not just the lack of such credit bureaus or other system to share information. In many countries the foundation on which to build them is missing too. The informational vacuum makes it easier for people to borrow from different MFIs under different names. India, for one, has no national identification system. But it has just launched an ambitious project, with Infosys cofounder Nandan Nilekani at the head, to build one. The system will reportedly use biometric technology such as digital fingerprinting. It will be interesting to see how quickly or slowly the national authority identifies the state's tens of millions of poor people—and to see how easy or hard it is for microcreditors to latch onto the system. And if it works in the world's most populous poor nation, perhaps it can work anywhere.

The evidence on microcredit and freedom

So far in our inquiry into whether microcredit enhances freedom, we have focused on what creditors do: what interest rates they charge, how they disclose costs, how reliably and flexibly they serve customers. This exploration has led to some rough conclusions. Interest rates *can* be

[59] Chaudhury and Matin (2002).

harmfully high, but once one factors in the general downward trend and high the cost of lending to low-income people, abuse appears exceptional. Other aspects of creditor behavior may matter more today. Creditors, for example, often hide the true cost of their services. The greatest threat to the freedom of clients may lie in the combination of the easy credit where multiple MFIs lend and the strong repayment pressure placed on people with unsteady financial lives.

In examining creditor behavior through the “development as freedom” lens, we have relied on mostly reasonable theories about what is good for the customer: gouging monopoly is bad, honest pricing is good. But whether microfinance in its various forms in fact extends the boundaries of people’s freedom is also, as scientists say, an empirical question, indeed one that researchers have provided some useful, albeit fragmentary, data.

We noted at the beginning of this chapter that it is in the essence of financial services to give people more control over their financial circumstances. Accepting this fundamentally freedom-expanding nature, however, leaves us with important empirical and moral questions. Broadly, the main empirical questions that emerge from decades of debate are two: How often does microcredit lead borrowers into debt traps? And how effectively does microfinance empower women, giving them more voice in household and community affairs? These we explore now. Then we come to the moral question: how do we evaluate an intervention that predictably expands the freedom of most clients while restricting that of a minority?

Debt traps

How often do poor people get into trouble with debt, meaning that repayment becomes a severe or impossible burden? We can be sure that the answer is not “never.” Bad luck throws even the wisest borrowers off track sometimes. Entrepreneurs take risks, and even good bets do not always pay off. But in reading through the academic studies, I found it hard to go beyond this

elementary certitude. There appear to be almost no good studies of how frequently microcredit borrowers fall into debt traps. One hindrance is people's reluctance to reveal their mistakes and misfortunes, especially to foreign strangers.

That leaves us with little more than stories. One can find stories of people *not* getting in trouble with microcredit. Microfinance promoters provide plenty. For more nuance, I asked Stuart Rutherford, in Bangladesh, whether he had met people in severe trouble with microcredit. He struggled to recall many. Once, he and his colleague S.K. Sinha had gone looking for just that by visiting villages and chatting with people. The best example he found was a woman who borrowed in order to pay for treatment for her gravely sick husband. The microcreditors were after her because she was unable to repay. Yet she saved her husband, so it did not seem such a bad trade.[60]

But there are unhappy stories too. *BusinessWeek* reporters found the one quoted at the start of this book, of Eva Yanet Hernández Caballero, who struggled to keep up with a 105 percent APR loan. David Hulme of University of Manchester, a longtime observer of microfinance and associate of Rutherford, hinted at horror stories as he exhorted researchers to fill the vacuum of information on people who drop out of microfinance programs:

> Because of circumstances beyond their control (sickness, flood, drought, theft and so on), lack of skills and knowledge or taking bad decisions, a proportion of poor borrowers encounter great difficulties in repaying loans. While MFIs suggest that such problems are overcome through "social support" in some painless way this is often not the case—talk to the dropouts of MFIs! Many (though presently we have little understanding of exactly what proportion) report being threatened by group members and MFI staff or having their possessions (pots and pans, roofing iron) seized. In Bangladesh, MFI debtors have been arrested by the police (this came to light in 1997 when a police vehicle carrying such debtors crashed and the individuals concerned were killed), are threatened with physical violence…Many poor people are very frightened about getting into debt: this is a rational response to the dangers that arise from indebtedness to MFIs and not a 'misunderstanding'.[61]

[60] Interview with author, Dhaka, March 3, 2008.
[61] Hulme (2007), 19–20.

One person who in effect responded to Hulme's call is sociologist Muhammad Rezaul Karim. What he found suggests that many borrowers do run into trouble—perhaps a small fraction, but not so small as to be ignorable. In his 1998 Ph.D. thesis at the University of Tsukuba in Japan, Karim calculated that drop-out rates at a Grameen branch he studied was 42 percent over nine years.[62] Walking away from microcredit need not be a bad thing; the question is whether borrowers are exercising their freedom to move on or are essentially going bankrupt (perhaps forcing their peers and successors to cover their debts so that the MFIs' repayment rates stay high). To probe deeper, Karim talked to 124 female drop-outs, gathering stories and compiling statistics on whether they or their husbands made the decision to leave and why. Among the 49 women who said that they, rather than their husbands or Grameen or other group members, made the decision to go, the two commonest reasons were "related to husband," cited by 24, and "related to problem in loan repayment," cited by 23. (Some probably cited both reasons, since they could list up to three.) A story fleshes out that "related to husband" header, though with a case in which Grameen rather than the woman ended the credit relationship:

> Shukzan, took Tk. [taka] 2,500 as 1st loan and gave to her brother. Her brother supplied repayment instalments. There was no problem. She herself used 2nd loan of Tk. 3,000 in goat raising, yielded a profit of about Tk. 1,400. By this time, Shukzan's husband became drug addicted and gambler. Shukzan handed over 3rd loan of Tk. 5,000 to husband for investment. Husband spoiled the money in drug and gamble. Shukzan, with severe hardship, repaid the loan herself with help from natal family. Shukzan took 4th loan of Tk. 5,000 and, again, gave to her husband. This time also, husband spoiled the money in same way. He didn't supply the repayment instalments. This caused severe conflict between husband and wife. Shukzan tried to repay loan through working in others house and receiving help from natal family. Yet she failed. Finally, the authority expelled her though she was not intended to dropout.[63]

Another woman dropped out because her own investment did not pay off; another because pregnancy kept her away from meetings; and another because she could obtain a housing loan from Grameen. Karim's two findings—that drop-out has been common and that it is often a sign

[62] Karim (1998), 175.
[63] Karim (2005), 1110.

of difficulty rather than empowerment—combine to suggest that microcredit leaves at least a minority of borrowers with less control over their lives instead of more.

Another researcher named Karim—Lamia Karim—spent a year in Bangladesh and in 2008 published some equally disturbing stories about people falling into debt traps with group credit:

> I saw that credit-related strife amongst members and their families were routine occurrences. Women would march off together to scold the defaulting woman, shame her or her husband in a public place, and when she could not pay the full amount of the installment, go through her possessions and take away whatever they could sell off to recover the defaulted sum. In circumstances when the woman failed to pay the sum, which happened several times a month in the NGOs I studied, the group members would repossess the capital that the woman had built with her loans. This ranged from taking away her gold nose-ring (a symbol of marital status for rural women, and removing it symbolically marks the "divorcing/widowing" of a woman) to cows and chicks to trees that had been planted to be sold as timber to collecting rice and grains that the family had accumulated as food, very often leaving the family with no food whatsoever. The women who committed these acts did so at the exhortations of NGO officers, but they also considered these acts to be "protecting their investments", and the defaulting woman as someone who had "broken faith with the community". These acts were committed with the full knowledge of NGO officers, but the officers did not participate in these collective acts of aggression. Instead, they threatened to withhold future loans unless the defaulted money was recovered.
>
> In instances where everything had been repossessed because of a large default, members would sell off the defaulting member's house. This is known as house-breaking (*ghar bhanga*) and has a long history in rural society.[64]

She recounted a conversation with a prosperous moneylender and microcredit client:

> Jahanara proudly told us that she had broken many houses when members could not pay. 'We know when they cannot pay, so we take a carpenter with us to break the house.' When I asked Jahanara, "Why do you break the houses of kin?" Jahanara became indignant at first. Her initial comment was "Why shouldn't we? They have breached their trust with us. If they cannot pay, then we will have to pay. Why should I pay for them?" Then she became quiet and said after a while:
>
>> It is not good to break someone's house, but we are forced to do it. This is how we get loans from Grameen Bank and other NGOs. They put pressure on us to recover the money, then we all get together and force the defaulting member to give us the money. We don't care how we do it.[65]

I have quoted such stories in part to counterbalance the sunny anecdotes found in the speeches, articles, and web sites of microfinance promoters. But it is important to remember that

[64] Karim (2008), 18–19.
[65] Ibid., 23. On housebreaking, see also Ito (1999), 159.

all stories, good and bad, should be discounted in the same way, as single data points with debatable representativeness. It is exceedingly hard to determine from the evidence at hand—most of which comes from one country and concerns one form of microfinance—the extent of debt trouble among microcredit clients generally.[66] Most likely the reality is what common sense would suggest: just as in rich countries, most of the time borrowers in poor countries manage their debt loads without capsizing. Through storytelling, microfinance promoters have disarmed this commonsense, persuading the public that, as in the title of one book, "the poor always pay back."[67] The reality is more complex.

Empuzzlement

[IMAGE study in South Africa. See Anton Simanowitz e-mail in devfinance with Pronyk response and Kim et al. study. Seems to show most benefits from plus in credit-plus]

It is often suggested that microfinance does not merely finance: it empowers. When a woman brings credit into the home she may gain leverage with her husband in deciding how money is earned and spent. For many women, the opportunity to do business in public is an opportunity to defy cultural restrictions on their gender. And doing credit though groups sometimes creates solidarity among members, which they can marshal to gain power in their communities. But as ever, credit's two-sided nature complicates the picture. In order to obtain the credit that enlarges their possibilities for action, clients in a sense disempower themselves. In particular, if they borrow through groups, they subject themselves to pressure from their peers to substitute for collateral.

And as usual, the empirical question is not binary but nuanced, not whether microcredit empowers or disempowers, but how much it does of each in various contexts. And I want to distinguish between the effects of *obtaining* credit as distinct from *using* it. If a Malawian

[66] On the fragmentary but worrying data on drop-outs, see also Montgomery (1996).
[67] Dowla and Barua (2006).

woman obtains a group loan for her fish trading business, which merely breaks even, the experience of borrowing through a group could empower her in ways just outlined. Or the group experience might do little for her while a successful fish trading business gave her more power in her family.

One source of difficulty in addressing this empirical question is that the meanings of "empowerment" are as diverse as the contexts in which people make choices. This complexity is perhaps clearest in the work of Syed Hashemi (quoted earlier on Andhra Pradesh), Sidney Schuler, and Ann Riley, who in the mid-1990s set out to quantify empowerment so that they could statistically measure its relationship with microcredit. Such indexing is artificial, but does force one to be explicit about what one is measuring. The HSR trio's metric includes no less than eight headings, each elaborated with subtle details about when a woman gets one point for this and two for that. (See Table 1.) A borrowing woman might gain "ability to make small purchases" but not "political and legal awareness," so that whether we deem her "empowered" depends on what we mean by that.

Another dimension of variation embedded in the empirics of empowerment is in the lending method. The major forms of microcredit differ fundamentally in the power relationships constructed among lender and borrowers. So whatever generalization we make about the empowering effects of solidarity group credit, say, may not extend to individual loans. This is why I have organized the review of the evidence by credit method. This review cites *all* of the studies that I have found that I judge both relevant and credible.

Solidarity group credit

Unsurprisingly, empowerment effects have been studied most thoroughly for solidarity group microcredit in Bangladesh. The consensus view from this work is surprisingly negative.

Table 1. Description of an exercise in measuring empowerment of women

Mobility: The respondent was presented with a list of places (the market, a medical facility, the movies, outside the village) and asked if she had ever gone there. She was given one point for each place she had visited and an additional point if she had ever gone there alone.…

Economic security: One point was given if the respondent owned her house or homestead land, one point for any productive asset, one point for having cash savings, and an additional point if the savings were ever used for business or moneylending.…

Ability to make small purchases: One point was given for purchasing small items used daily in food preparation for the family (kerosine oil, cooking oil, spices), one point was given for purchasing small items for oneself (hair oil, soap, glass bangles), and one point for purchasing ice cream or sweets for the children….[O]ne additional point was given if the purchases normally were made without asking for the husband's permission, and another [if] made at least in part with money earned by the respondent.…

Ability to make larger purchases: One point was given for purchasing pots and pans, two points for children's clothing, three points for saris for oneself, and four for buying the family's daily food. An additional point was given…if the purchase was made, at least in part, with money earned by the respondent herself.…

Involvement in major decisions: One point was given for making a decision (individually or jointly with the husband) within the past few years about house repair or renovation, one point for a decision to take in a goat to raise for profit, three points for deciding to lease land, and four points for deciding to buy land, a boat or a bicycle rickshaw….

Relative freedom from domination by the family: The respondent was asked if, within the past year, money had been taken from her against her will; land, jewelry or livestock had been taken from her against her will; she had been prevented from visiting her natal home; or she had been prevented from working outside the home….

Political and legal awareness: One point each was given for knowing the name of a local government official, a Member of Parliament, and the Prime Minister, and one point each for knowing the significance of registering a marriage, and knowing the law governing inheritance….

Participation in public protests and political campaigning: The respondent was classified as "empowered" if she had campaigned for a political candidate or had gotten together with others to protest: a man beating his wife, a man divorcing or abandoning his wife, unfair wages, unfair prices, misappropriation of relief goods, or "high-handedness" of police or government officials.

Source: Hashemi, Schuler, and Riley (1996), 638–39.

Some studies have approached the subject quantitatively. Though they are susceptible to many of the methodological concerns aired in the last chapter, they deserve mention. One early and influential article, "Who Takes the Credit?", by Anne Marie Goetz and Rina Sen Gupta, focused on whether borrowing women decided how their loans were used, or whether their

husbands or brothers took control once the women returned home with the cash. Goetz and Sen Gupta judged that 63 percent of the women in their sample exercised partial, very limited, or no control over the use of loan funds.[68] The finding suggest that to a large extent credit flows along existing power channels within the family rather than cutting new paths across the terrain. On the other hand, that 37 percent of women in a sexist society *did* retain full or significant control may have been a victory for empowerment. It is particularly hard to interpret this study without a sense of the "counterfactual," what life would have been like for the women studied in the absence of microcredit. Logically, Goetz and Sen Gupta could not compare borrowers and non-borrowers on their power over loan use.

Hashemi, Schuler, and Riley improved on Goetz and Sen Gupta's work by using their much broader definition of empowerment and applying more sophisticated (though no trandomized) analytical methods. In the early 1990s in Bangladesh, the trio's research team interviewed 120 households in BRAC- or Grameen-served villages thoroughly enough to apply the detailed yardstick of empowerment in Table 1. Having measured freedom for both borrowers and non-borrowers, they attempted to determine whether microcredit made a difference. They concluded that BRAC lending did empower women and Grameen lending even more so. They supplemented such findings with quotes from in-depth interviews, such as this:

> Several of the women…told the field investigators that through Grameen Bank they had "learned to talk," and now they were not afraid to talk to outsiders. In both programs some members have the opportunity to play leadership roles. One woman told the researchers, "I have been made the [borrowing group] Chief. Now all of the other women listen to me and give me their attention. Grameen Bank has made me important."[69]

Still, the skepticism I voiced in chapter 6 about the capacity of non-experimental quantitative analysis to determine *average* effects—weighing in the experiences of all who gain

[68] Goetz and Sen Gupta (1995), 49. Rahman (1999a,b) has similar findings.
[69] Hashemi, Schuler, and Riley (1996), 648.

or lose—apply full force to this work. The three authors do take steps to rule out reverse- and omitted-variable causation (defined in chapter 6), but express appropriate humility about the limitations thereof. It is hard to rule out competing explanations for the correlations they find between microcredit and empowerment. Perhaps, for example, the Grameen Bank found it easier to assemble borrowing groups in villages where women already had more power. Then too, weekly messages from loan officers about the importance of unity and hard work and the evils of dowry may have indirectly coached borrowers in the "right" answers to the researchers' questions.

To phrase the critique of the quantitative studies more constructively, since empowerment is among the hardest to quantify of the potential impacts of microfinance, it is particularly suited to "qualitative" research by people who spend months getting to know a small group of people. Remember how Helen Todd and her husband began their study of 62 women in two villages by surveying them about their influence in domestic decision-making, how the answers seemed to say more about the women thought they ought to live than how they did live, and how a year of watching and talking to people led Todd to much richer insight.[70]

Indeed, Todd had things to say about empowerment. She found inspiring stories of women clawing their way up economically, and gaining stature within their families. She describes a particularly successful woman, Habibah, as the brains of her household. Habibah's husband and son were exempt by virtue of their sex from the *purdah* restrictions that kept Habibah away from public markets. But that merely turned them into Habibah's "hands and feet." She instructed them on what to buy and sell and demanded a full account on their return. Habibah was also chief of her credit group, and continued to exercise power unofficially even

[70] Todd (1996), 87.

after Grameen's rules forced her to step down, pressing members to cover each others' payments when necessary in order to keep the credit flowing. As noted before, the caveat for generalizing about effects of microcredit on power is that Todd chose not to study dropouts. The borrowers she followed had all been with Grameen at least 10 years, and may have been an exceptional group. Habibah for example, "must have been a strong woman even before joining Grameen Bank."[71] Yet even with this optimistic assessment, Todd tagged as myth the idea that credit groups fosters solidarity that led women to look after each other in times of need and fight patriarchy with joined fists. Empowerment came through economic success not alongside it:

> The fundamental meaning of these two centers is not a collective one for their members. They go to the meetings and keep the discipline in order to keep open a regular line of reasonably priced credit. For the same reason, to keep their eligibility for loans, members would help others with repayment, so long as they did not ask too often, and pressure each other to follow the rules and keep the good name of the center. Their purpose is not a group purpose but an individual one, firmly rooted in self-interest and based squarely on their primary loyalty to their immediate family."[72]

Another qualitative researcher we met in chapter 6, Sanae Ito, arrived at a bleaker view of the empowerment link, perhaps because she did not tilt her sample like Todd, perhaps because she did not peer as effectively into households, and so dwelt more on credit group dynamics, where Todd too found less to cheer. The traditional microcredit group emerges from Ito's writing as an assemblage in which women placed strong pressure on one another when necessary while Grameen employers, many of them male, presided like more or less benevolent dictators. In running the mandatory weekly meetings, the branch managers exercised discretion created by the opacity of the loan approval rules. The managers turned the screws when necessary. Ito describes

> …two recent cases in which several centre members raided the houses of the members in arrears, under pressure from the branch manager. One of them was Kateja. She went into arrears when her son, who drove an auto-rickshaw in Dhaka, fell ill and could not send her remittances. Several members went to her house, took away her cow and yoked it at the front yard of the branch office

[71] Ibid., 55–56.
[72] Ibid., 175–76.

> as a punishment. Kateja could not stand the embarrassment for too long, She borrowed money from her brother, repaid her loan, got her cow back, and sold it immediately to pay her brother back. In Rehena's case, her husband spent her general loan on purchasing a motor to start a rice husking business. When the motor failed to work, Rehena immediately got into repayment difficulties. The branch manager at first threatened to ask the union chairman to intervene if she did not bring her repayments up to date, a standard tactic used by the branch manager in such situations. When it did not work, he went to the centre meeting and suggested that the members should go to Rehena's house to persuade her to repay. When members showed reluctance to do so, he reportedly declared: "All right then. All of you will pay back her loan together." Upon hearing this, several …went to her house, and verbally threatened to take away her assets. One of the members managed to steal a torch light [flashlight] from Rehena's house…though it was later returned through the mediation of the branch manager.[73]

A pair of studies commissioned by the international charity CARE and written by Md. Mehrul Islam and Sarah Gillingham used quantitative and qualitative methods to study how families in Bangladesh manage credit—one study in the northwestern part of the country, the other in the southeast. The most powerful pieces of the reports are the short anecdotes drawn from qualitative interviews. Some are happy:

> One woman, LB (husband GU) improved her economic condition by taking an NGO loan as well as a *mohazan* [moneylender] loan. She and her husband now own a cow, fishing net, and a boat. GU can fish in his own boat and does not need to share his fish with the boat owner.
> …
> Wife of AH reported that in the beginning they had no assets, but in seven years time they accumulated seven cows and two betel leaf gardens. She also mentioned that after receiving the loan, she wanted to buy a nose pin for herself but her husband said that "we cannot consume this money, we will buy a nose pin from the profit".[74]

But most are not:

> If the wives of the always poor and usually poor households fail to pay the NGO weekly installment, they are humiliated. NGO staffs and group members scold them, and the group members come to their houses to seize their assets. One woman of an always poor household related: "After being insulted by group members, I made a promise, in the name of Allah, that I would never take another loan. After a few years, my husband is again asking me to take a loan. He says that he will bear the sin of breaking my promise."[75]
>
> Most households take two meals a day instead of three for 9–12 months. For the two days prior to loan installment, they starve themselves or just take rice mixed with water. For paying off the *mohazans*, some households minimize their meals 7–10 days ahead of time.
> …

[73] Ito (1999), 159.
[74] Gillingham and Islam (2005a), 19.
[75] Ibid., 21.

> The participants informed that they do not mortgage or sell their land at first; they try many different options and use their land as a last strategy. They referred to one M.U., who first borrowed from a *mohazan* for his medical care and household food during his sick days. He failed to pay back the *mohazan* from his income and he borrowed from an NGO to clear the *mohazan* debt. Then he could not pay the NGO installments regularly, and his debt burden increased to the point that he sold three decimals of land and mortgaged out 10 decimals to repay NGO loan. Now he hardly can manage three meals a day.[76]

The most negative assessment I have seen of traditional Grameen group credit comes from Aminur Rahman, introduced in chapter 5, who also spent a year in a Bangladeshi village in the mid-1990s, in his case focusing on the connection between microcredit and violence against women in the home. He was distanced from his subjects by his gender. But he hired a full-time female assistant on the idea that she would draw out local women more easily. And compared to Todd and Ito, he was brought closer to his subjects by his native fluency in Bengali. Like Todd, Rahman found that certain members exercised more power within the credit groups: sometimes for the best, as when they arranged for one group member to lend money to another in order to cover a weekly payment; sometimes for more questionable ends such as exacting retribution in a personal dispute by blocking a loan request. Rahman's verdict is harsh: "In the study community, many borrowers maintain their regular repayment schedules through a process of loan recycling that considerably increases the debt-liability on the individual households, increases tension and frustration among household members, produces new forms of dominance over women and increases violence in society."[77]

A few instances convey the tenor of Rahman's writings. On the subject of bank-worker-orchestrated peer pressure, he reported that

> often there are one or two members in every loan center who, because they were unable to arrange their instalments, did not come to center meetings.…[O]ther regular members in the center are forced to sit on their bare feet on a mud floor for several hours until all instalments are collected. If the absent member is available in the village, her peers persuade her to come to the

[76] Idem (2005b), 26–27

[77] Rahman (1999a), 67.

> center. The appearance of the absentee…usually releases an outburst of anger toward her by fellow members and the bank worker."

One woman, Ramena, sat through those extra hours only to return home to a beating from a husband furious at having to wait so long for his breakfast. The husband had invested her loan in a brown sugar business that was not earning enough to cover the interest, which no doubt added to his stress.[78] In another case, a woman named Yuri had her husband get a two-week moneylender loan to bridge her from one Grameen loan, nearly repaid, to the next. But the center chief, a fellow borrower, blocked her request for the new Grameen loan. The reason? Yuri refused to pass part of her new loan to the chief's mother. Again the result was a beating for the cornered wife.[79] Toward the end of his time, Rahman surveyed 120 women in the village. *All* said that they experienced some violence in the home. Eight-four said they had suffered more since joining Grameen Bank while 18 reported less. Of course, the usual caveats apply: they may have tilted their answers according to what they thought Rahman and his assistant wanted to hear.[80]

Regardless of their generalizability, Rahman's conclusions about how some women experience microcredit seem fundamentally plausible. As noted, Sen's argument that freedom begets freedom also works in reverse: loss of freedom in one domain causes loss in another. In a society where domestic violence is endemic, when a woman loses financial freedom because of failure to stay on top of a loan, she can also lose the freedom of personal security. By the same token, though Rahman does not say this, when women like Habibah gain financially through loans, they probably also find home life more secure.

In sum, a fairly consistent picture of the empowerment effects of classic solidarity group

[78] Ibid., 72.
[79] Ibid., 73.
[80] Ibid., 74.

microcredit emerges from the most credible studies, the qualitative ones. Among women who succeed economically through borrowing, greater freedom from want probably spills over into other freedoms—greater health, better education for the children, less abuse from the husband. For those who fall into debt trouble, the opposite is true. Note though that these effects occur through the *use* of the loan rather than the group-based process of obtaining it. The social machinery of group credit itself, the peer pressure, appears more oppressive than liberating. Arguably this is to be expected of a lending system that intertwines people's burdens through joint liability. And arguably this is to be expected of a lending system that was designed in the first place not to empower women but to efficiently mass-produce credit for the poor.

Self-help groups

In contrast, the distinctive Indian variety of collective credit, the self-help group, appears to have been designed and implemented much more deliberately to help women perceive and attack the injustices done to them. As described in chapter 4, Indian non-profit organizations organize groups of 10–20 women at a time into SHGs. They help the members save into a shared bank account and then obtain a loan from the same bank. Using government or charitable funds, many of these non-profit "promoters" also invest considerable energy in teaching members to see themselves as victims of pervasive sexism who can find power in collective action. Here's an account from one middle-aged SHG member, related via sociologist Paromita Sanyal:

> [The program director] asked us, "Say for instance, the husband earns Rs [rupees] 50 and he thinks that his wife doesn't even earn Rs5. But that is not the case. Women too earn Rs50! But, from where? Let me see if any of you can tell me, from where?" Some of the women tried, some were incorrect, some couldn't even think of anything. Then he explained, "Consider this, women tend to their cows, goats and hens throughout the day. How much do they earn daily doing that? Or, consider how much you'd have to pay someone if you employed the person to do all the household chores? But husbands never have to pay their wives anything! That money is extra, so that is what women earn!" But we'd never thought in that manner before, we'd never perceived it in that way. Then he said, "OK let's take independence, men have all the freedoms. Why don't

women have any freedom? Because they can't protest!"[81]

In time for the U.N.-declared International Year of Microcredit, 2005, the U.N. Development Programme and a major banker to SHGs, ICICI, commissioned a book of qualitative studies of the groups.[82] Each chapter is by a different author, who wrote on a different promoting NGO, usually after visiting villages for a few weeks. Most of the chapters are studded with anodyne generalizations such as that women "view themselves with greater confidence than ever before" and "women report the enormous value of regular access to credit…to themselves and their families"—with little systematic documentation of the underlying evidence. That looseness plays into standard doubts about methodology: Were the study villages and the interviewees chosen by the researcher or the NGO to support an optimistic story? Did interviewees tilt their answers because NGO officers were in the room? How much did the writers view the world through ideology-tinted glasses?

An exception in my eyes is the chapter by Shashi Rajagopalan on an SHG promoter called Lokadrusti, which operates in one of the poorest parts of India, in the state of Orissa. Within 20 of the 146 villages in which Lokadrusti worked, Rajagopalan commendably chose 55 women *at random* to interview. She also held larger meetings in each of the 20 villages with representatives from all local SHGs, including some that had defaulted on their collective bank loans. Her report mixes good and bad news in a way that exhibits critical thinking. She concluded that "the women appeared to have gained very significantly in terms of mobility, self-confidence, widening of interests, access to financial services, building of own savings, competence in public affairs, and status at home and in the community."[83] On women's mobility, for example:

[81] Sanyal (2007), 13.
[82] Burra, Deshmukh-Ranadive, and Murthy (2005).
[83] Rajagopalan (2005), 281–82.

> Almost all women spoke of the widening of their world because of the SHG. They said that it was not as if they had not been out of their villages earlier. More than the geography, it was the agenda for which they now travelled [to visit a bank], and the fact that they travelled, not with family members, but with friends from other castes, that made them feel that their world had become larger.[84]

On their collective power when supported by the SHG promoter Lokadrusti:

> In one village, the local priest had felt threatened by the SHG and warned the women of tragedy befalling their children if they continued to work as an SHG, or used the community-cum-storage centre built for them by Lokadrusti. The women, despite their collective strength, felt overwhelmed, and were unwilling to challenge him. They did, however, work on him with Lokadrusti's help, did overcome their fears, and finally began to conduct meetings inside the new centre.[85]

But Rajagopalan's critical eye also picked up the SHGs' loose financial culture, which they acquired along with the loans from the government bank. One SHG member explained that:

> The government has taught us to ask for [30–40,000 rupees] under various schemes. When it says that such money is available and that we should try and access it, it is too much to resist, even though we are all conscious that we will not be able to absorb such a large loan. Also, the government has given indications that it does not expect its loans back; so those of us who know the art of accessing such "loans" do get such loans, and do not think of them as repayable.[86]

Not surprisingly, "default was not frowned upon by Lokadrusti, even though it was worried about it, as was true of many voluntary development organizations and government agencies….Most…do not have a system where a defaulter pays a price for default. Default is explained away: drought, illness, and so on."[87] It is easy to see how a tacit license to default would be empowering even if it sets a costly example of bringing financial services to the poor.

An excellent and more comprehensive work whose conclusions resonate with this portrait from Orissa is *Self Help Groups in India: A Study of the Lights and Shades* by Frances Sinha. Sinha and her research team drew on the experiences of 214 SHGs in four states. The report sets a worthy example by devoting a whole section to drop-outs, counting them and their reasons for

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[84] Ibid., 262.
[85] Ibid., 270.
[86] Ibid., 273.
[87] Ibid., 273.

leaving and telling their stories. Some of those stories are troubling (a woman loses her savings in an SHG because of fraud), some less so (a woman falls ill and leaves her SHG, taking her savings).[88] The report strikes a more positive note on the training that SHG-promoters provide. The studied promoter in Andhra Pradesh, for example, "appears to have been very successful in educating women about their rights, and raised their consciousness on dowry, desertion, domestic violence, property and other issues affecting women to their disadvantage."[89] The women sometimes turned those ideas into community action, if "not as frequent[ly] as might be hoped for."[90] The report tabulates instances in which members collectively intervened in domestic disputes, such as by confronting a wife-beating husband, or in community issues, such as by pressuring local leaders to shut down alcohol shops. An example from Andhra Pradesh:

> Kamala…was married to Narayana of Pantulapally village three years ago. Kamala brought with her a sum of [50,000 rupees] as dowry. Narayana, dissatisfied with the dowry, mistreated her and asked her to return to her parental home.
>
> His parents found him another match—with a dowry deal of [Rupees 200,000] cash, a vehicle and 120 [grams] of gold. The arrangements for the wedding commenced. On the advice of the NGO…Kamala told Narayana that unless he divorced her he could not remarry and warned him that if he went ahead with his second marriage, she would lodge a police complaint. Narayana ignored her and his family continued with his wedding arrangements. On hearing this, and irked by the greed for dowry, all the SHGs of Pantulapally went on a rally to the [local government] office in Nallabelly. They staged a *dharna* [protest], expressed solidarity with Kamala and demanded that justice be done to her. They submitted a memorandum saying that the matter was grave and action must be taken immediately against Narayana….Narayana was arrested and imprisoned for three months. After his release, he and Kamala resumed their married life, and they now have a child.[91]

As with Lokadrusti, the subsidized NGOs that formed the SHGs were central to organizing such actions: the actions did not generally arise spontaneously. Actually, according to the tabulation, SHGs rarely involved themselves in such domestic matters. But they did engage with community

[88] Sinha (2006), 51–52.
[89] Ibid., 79.
[90] Sinha (2007), 77.
[91] Ibid., 79.

issues in 40 of the 108 villages studied.[92] On the other hand, since studied SHGs were at least five years old on average, the total of 40 works out to roughly eight events per year in the 108 villages—and must be deflated further since Sinha's team went out of its way to include socially active SHGs in the sample. Meanwhile, as with Lokadrusti, financial management seemed lax: "In relation to financial transactions, books and records need to be well maintained with systems in place to verify the records and as a basis for transparency with group members. This is largely not happening."[93]

These studies of SHGs suggest that the training component of the SHG package is working to the extent that SHG members are standing up for themselves somewhat more. That programs *designed* to empower actually empower more corroborates the thesis of Linda Mayoux, a longtime writer on the subject. She argues that microfinance does not microfinance does not automatically empower, but can if designed from the ground up to do so.[94] Ironically, though, laxity within SHGs facilitates default, which is certainly liberating, but undercuts financial viability—or, at any rate, claims to the mantle of "microfinance" as that term is usually understood.

Individual microcredit

Individual loans, by not binding people to each other's debts, are inherently more freeing than group loans. In her writings, Naila Kabeer, like Helen Todd, brilliantly detailed the various effects of microcredit on women in a few villages in Bangladesh. But unlike Todd, Kabeer studied a program, the government-backed Small Enterprise Development Project (SEDP), that made subsidized individual loans to women with *at least* half an acre of land. Classic solidarity

[92] Ibid., 86.
[93] Sinha (2006), 107–08.
[94] Mayoux (2006).

group credit aims to minimize subsidy while serving those with less than half an acre. Thus Kabeer's study group began taking microcredit with better prospects, then lived free of joint liability.

Overall, Kabeer's assessment is positive. Despite the landownership minimum, many of her subjects were poor by any reasonable standard, and for them access to credit could still mean a great deal. Said one:

> If I had not gone to that SEDP meeting, had not taken a loan, had not learnt the work, I would not get the value I have, I would have to continue to ask my husband for every taka I needed. Once I had a headache, I wanted one taka for a bandage to tie around my head, I wept for eight days, he still would not give me the money. Just one taka.[95]

Kabeer saw little sign that borrowers became more active politically as a result of the microcredit, but many reported gaining more power and respect in the home. The few who were married to particularly abusive husbands either gained more independence from them or established a less violent power balance with them.[96] While Kabeer's work is hardly free of the standard sources of potential bias, several subtle and contrarian observations give the work credibility. For one, Kabeer questions feminist authors who equate empowering women with challenging cultural and legal norms. Some women (though not all) told her that they used loans to *comply* with *purdah*. They stopped working in the fields for day wages and instead bought and raised cows near home, elevating themselves in the eyes of their neighbors. They exercised their loan-bestowed freedom in order to confine themselves.[97] For another, Kabeer delineates how women's experiences with individual and group credit differed:

> …there was general agreement among SEDP loanees, including those who had previously borrowed from BRAC and Grameen, that there were greater stresses and strains associated with repayment of loans from poverty-oriented programs. These often spilt over into conflict, sometimes between husband and wife…sometimes between "irresponsible" loanees and other

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[95] Kabeer (2001), 71.
[96] Ibid., 74.
[97] Ibid., 69.

> group members worried about their future creditworthiness…but most often between loanees' families and program officers seeking to recover repayments.
> …
> The discipline built into poverty-related lending, which gave rise to the stresses remarked on by the loanees, reflected a concern with loan recovery and with long-term sustainability on the part of these programs. SEDP could afford to run a more relaxed lending regime because a concern with sustainability had not been built into program design while its loan recovery efforts were backed up by the perceived authority of a government bank. It was one of the constant ironies thrown up by the fieldwork that relatively well-off households could access loans at subsidized interest rates with greater flexibility built into their repayment schedules while all around us, poverty-focused credit organizations were lending far smaller sums of money to much poorer sections of the population at much higher interest rates with far more inflexible weekly repayment schedules. Indeed, the pressures of meeting weekly repayments was mentioned as the single most important source of the tensions generated by poverty-oriented lending.[98]

Conclusion

A simple question—does microfinance expand or contract freedom?—led us onto a vast and variegated terrain. The root of much of this complexity, noted at the outset, is debt's double aspect as a source of both possibility and obligation. The theory and evidence we have probed lead to several conclusions, some more certain than others:

- By decoupling when something is bought from when it is paid for, financial services inherently give people more control over their financial lives—more "agency" or "freedom" in Amartya Sen's terms.
- Savings and insurance services do so without imposing future obligations the way credit does, so they seem more benign in the development-as-freedom perspective *if* they are provided free of fraud, price-gouging, and recalcitrant disbursement.
- Thus loans threaten the freedom of the poor most, a truth embedded in the ancient proscriptions on usury. Yet the traditional referent for the definition of usury, the interest rate, is not the only characteristic of credit that determines its effects on borrowers' agency. Transparency, reliability, flexibility, group dynamics, and systematic forbearance from

[98] Ibid., 78–79.

overlending appear to matter at least as much in practice.

- Reliable evidence on how microcredit affects people's freedom is fragmentary and emanates mostly from Bangladesh. It tends to support a few generalizations: First, doing financial business with poor women empowers them mainly through any economic success they achieve rather than in parallel to it. Women gain more autonomy from successful investment or spending management than they do from entering into solidarity with jointly liable borrowers. Yet programs such as Indian self-help groups that go well beyond pure financing, running activities dedicated to organizing women to fight oppression, can leave a stronger imprint. The same may hold for the "credit plus" programs of BRAC and Freedom from Hunger, which train and teach as they lend (see chapter 4). Second, the more a microcreditor pursues financial self-sustainability the more it imposes on the freedom of its clients. The financially loose SHGs and the subsidized SEDP program that Kabeer studied seem to score best on empowerment. Finally, collateralizing one's reputation through group credit may be more oppressive than a more conventionally collateralized individual loan—for those who can afford the latter.

We arrive at a surprising conclusion: the most famous form of microcredit, the stripped-down solidarity group loan, appears least intrinsically empowering. Now, that is a relative statement. If all who enter into group credit borrow no more than they can handle, then by helping them manage mismatches between earnings and spending needs, credit still empowers them all. Yet as we have seen, some poor people do get in trouble with microcredit. The needs of the poor are indeed endless, or they would not still be poor. And the evidence does not suggest that empowerment "side benefits," those not transmitted through finance itself, compensate. They do not salve the wounds of the debt trap.

This reality confronts the charitably minded investor with a conundrum: should she support an activity that might help 90 percent of the people it touches while making 10 percent worse off—perhaps much worse off? The Hippocratic dictum to "first, do no harm" comes to mind at this juncture. Taken literally, it is impractical in fighting poverty: every effort to better a society trods on someone's toes. But the old doctor's oath is food for thought. Done right, savings and insurance approach the ideal of minimal harm more surely than credit. Since, as chapter 2 explained, savings especially can substitute for credit for many purposes, the pursuit of development as freedom seems best served by supporting savings more than credit. People rarely get caught in savings traps.

While I would hesitate to support microcredit—group credit especially—I would never say never to lending. Absolutism is rarely credible in social policy. I am convinced that millions of poor people live better because of microcredit. And it is much easier to set up an institution to disburse funds on credit than to collect them as deposits. Granting microcreditors a place in the portfolios of the poor, we should ask that they maximize their flexibility and transparency with respect to clients and take all reasonable steps to prevent overlending. And we should do everything we can to give the poor stronger alternatives to borrowing.

The need to deemphasize microcredit and the institutional challenges to doing so—institutions that would take savings and sell insurance properly face high legal hurdles—leads us to a quite different perspective on the contribution of microfinance to development. The next chapter looks at microfinance operations in terms of how they enrich the institutional fabric of societies by growing, competing, and innovating to serve the customer. That perspective tends to valorize businesslike operation, financial independence, and freedom from subsidy.

Yet this scrutiny of microfinance through the lens of freedom hints at an important

tension between the two perspectives. It appears that what is arguably easiest from an institutional point of view—making loans rather than taking savings or insurance premiums, passing the full costs of credit on to customers, assertively enforcing repayment requirements—is hardest on poor clients. There is a margin at which convenience for the institution and the needs of the client conflict That tension may be appropriate—it is inherent in the dynamics of any healthy market system—but it should be recognized. The moral onus remains on the microfinance industry to do not what is easiest but what maximizes poor people's freedom.