**Social Studies 10-1**

**Unit Four: Economic Globalization**

**Microfinance Selected Reading Annotations**

**The Evolution of Microfinance**

Professor Mohammad Yunus at Kalampur village in Dhaka, Bangladesh, Jan. 21, 2004. (AP Photo/Pavel Rahman)

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*By Rob Krieger*

In most Western or developed countries, it's relatively easy to obtain credit through large banks or money lending institutions. But in the developing world, where many people lack steady employment, credit history or collateral, there's often no way for legitimate small businesses to receive a loan.

In many ways, microfinance changed all of this. Generally defined as small lending to the rural poor in developing countries, microfinance has made great strides in the latter half of the 20th century. The 2006 Nobel Prize awarded to Dr. Muhammad Yunus, one of the founders of modern microfinance, has helped to push the industry even further into the spotlight. But the idea of microfinance has existed for hundreds of years -- in many regions and in many forms.

**The Origins of Small Lending**

Microlending often starts in small villages, where family members and friends get together in money-sharing groups. Mary Coyle, director of the International Institute at St. Francis Xavier University in Nova Scotia, Canada, has studied the history of microcredit and says that these savings clubs can be traced to all parts of the world. "They have operated for centuries -- probably since the introduction of currency."

From region to region, these clubs developed their own names. In West Africa, they were known as "tontines;" in Bolivia, "pasanaku;" and across Mexico and Central America, "tandas." Tanda means "shift" in Spanish and works on the premise that members of the group contribute to a pool of money, which shifts to a single member that has the most need. The tontines of West Africa can be traced back to 17th-century Europe and are named for the Italian banker Lorenzo de Tonti.

An early version of microlending was the Irish Loan Fund system, introduced in the early 1700s, by writer and nationalist Jonathan Swift. Swift's early success helped the Irish when many were living in impoverished conditions. Swift's original system was standardized in 1837, when hundreds of independent loan funds were brought under the control of the Loan Fund Board. By law, no loan could be more than £10 or run for longer than a 20-week term, with weekly repayments. As with many contemporary microcredit institutions, interest rates were low – in this case around 8 percent per year – much lower than those charged by local profiteers.

**The Pioneers of Modern-Day Microfinance**

The concept of microloans took a big leap in the 1960s and 1970s, when groups such as ACCION International, in Venezuela, and Yunus's Grameen Bank, in Bangladesh, began to institutionalize the process. By formalizing and expanding the basic concept of sharing programs, these microfinance institutions helped to build capital for small businesses rather than just loaning for basic necessities such as food, water and clothing.

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The next step was setting up a consistent on-the-ground program. In the case of the successful institutions, this meant sending a representative, or "field manager," to the prospective region to educate and advise and to oversee the loans locally.

After a few members of the group were accepted for a loan, the rest had to wait for that initial loan to be repaid before they could obtain their own loans. "Peer pressure" from other members of the group to repay the initial loan helped to set the bar high.

In 1961, another early pioneer, ACCION, opened its doors in Caracas, Venezuela, when law student Joseph Blatchford raised $90,000 to start a community development program to help the poor jump-start their own businesses.

Over the next two decades, ACCION set up scores of independent microfinance institutions and expanded across Latin America. It, too, offered people a choice besides the local loan shark, who would charge rates as high as 500 percent a year and often pushed people into permanent debt.

Like the founders of ACCION, Yunus realized that if individuals who wanted to start their own businesses could not free themselves from start-up debt, they would never be able to grow.

Since the Grameen Bank was founded, it has paid out more than $5.7 billion in loans, and more than $5.1 billion of that has been repaid -- a recovery rate of approximately 98.9 percent. It has made more than 950,000 loans and has 6.7 million members, around 96 percent of whom are women.

In October, the Norwegian Nobel Committee said of Yunus and his work, "Yunus's long-term vision is to eliminate poverty in the world. That vision cannot be realized by means of microcredit alone. But Muhammad Yunus and Grameen Bank have shown that in the continuing efforts to achieve it, microcredit must play a major part."

Following the success of these early institutions, other microfinance organizations began to launch throughout the developing world. Among the largest is FINCA International, established by economist and Fulbright scholar John Hatch. Hatch believed that using locals' knowledge rather than bringing in outsiders was key to building successful local economies. Using an approach he has always stood by, Hatch said, "Give poor communities the opportunity, and then get out of the way!" By 2005, FINCA had 400,000 clients in 21 countries across Latin America, Africa, Central Asia and Eastern Europe.

One year after the United Nations called 2005 the International Year of Microcredit, the World Bank estimates that there are more than 7,000 microfinance institutions now operating around the world.

**Microfinance Has Its Detractors**

Despite the fact that microcredit has become something of a cause celebre for its potential to help the developing world, there are some serious and credible criticisms of its success.

Critics of microcredit say that many of the poorest of the poor still do not qualify for a loan, because they pose too much risk; and those that do qualify use much of their loan, not for business, but for simple needs such as food for their families.

"Grameen borrowers are staying poor," said Gina Neff, an economic journalist writing for the *Left Business Observer* in 2006. "After eight years of borrowing, 55 percent of Grameen households still aren't able to meet their basic nutritional needs."

Others insist that microfinance is not a complete solution, charging that those who have benefited from the industry overstate its value in order to keep the model going. Institutions like the World Bank and the International Monetary Fund have also come under fire for funneling into microcredit institutions money that could have gone to funding for education, health or other basic social infrastructure needs.

In Jonathan Morduch's book, *Does Microfinance Really Help the Poor?*, he questions the real impact the industry has had in helping the poor.

Morduch, who is professor of public policy and economics at New York University, writes, "Households that are eligible to borrow and have access to the [microfinance] programs do not have notably higher consumption levels than control households, and, for the most part, their children are no more likely to be in school."

Morduch also found that microcredit doesn't reach those who are truly destitute, and those who benefit most are already above the poverty line.

There's no doubt that microcredit has reached the poor in many places overlooked by mainstream banking sources. And even when the rate of return is less than 100 percent, as is the case for most if not all microlending institutions, putting capital into the hands of small businesses can have benefits for the future.

"The real outcome will manifest itself in the education and choices that will open up for their children," says Maria Otero, president of ACCION International. "The power of putting capital in the hands of poor people enables them to create their own wealth and invest in their children."

*SOURCES: World Bank; Grameen Bank; The Consultative Group to Assist the Poor; ACCION International; Globalenvision.org; BBC;* The New York Times*; The Year of Microcredit; Clinton Global Initiative Fund;* Does Microfinance Really Help the Poor? *By Jonathan Morduch;* Left Business Observer*; United Nations Development Program.*