Micro Finance; A Prescription for Poverty and Plight of Women in Rural Pakistan

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CONTENTS

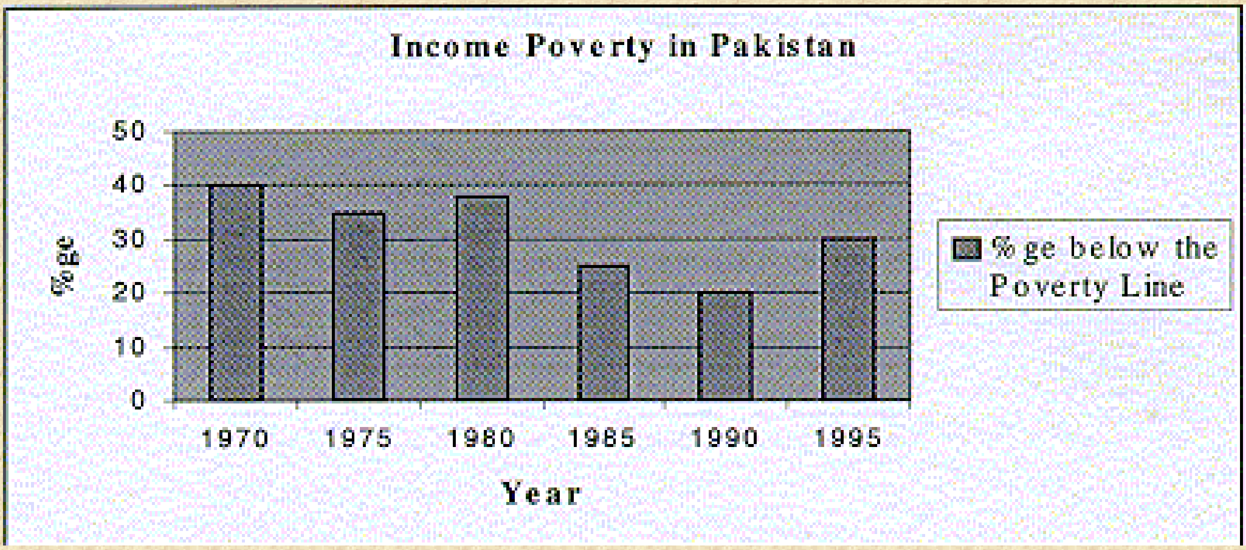
Abstract

The paper opens with a brief description of macroeconomic situation of Pakistan followed by a general poverty profile and particular plight of women in the society. Failure of requisite social safety networks, and trickle down effect of economic growth and a couple of other factors make a case for intervention. A situation analysis of formal and informal finance shows the bias of the formal finance towards the rich. It also reveals that major credit demand of the rural poor is being met by expensive and unsteady informal sector. Inability of the poor to serve collateral has been identified as a major hurdle in reaching the poor. Grameen model of group-based guarantee, introduced in Bangladesh and successfully replicated in other countries is prescribed for an effective and sustainable institutional intervention.

Introduction

Pakistan is a large country with a population estimated at 135 million. The economy still has a low income of US$ 470 per capita, with an estimated purchasing power parity of $ 2500[1]. The economy has shown a good trend growth rate of 5% in the last three decades until 1992-93. Despite this high trend rate of GDP almost a quarter of the population still remains poor. This suggests that the structure of the economic growth process in Pakistan constrain its capacity to reduce poverty[2]. A cross-country comparison also suggests the same. Indonesia, for example, with a growth rate close to Pakistan has been able to reduce the percentage of its population below the poverty line from 58% in 1972 to only 17% in 1984[3].

Poverty has always remained a major development problem of Pakistan but the situation has worsened especially after 1992-93. The growth rate nose-dived to 2.3% in 1992-93 due to natural disasters coinciding with a series of structural adjustment measures and external shocks to the economy[4]. The growth rate has averaged 3.5%[5] since then, merely keeping the high population growth rate of 3% while the calorie-based poverty[6] has started rising again.



Source: Human Development Center Islamabad, March 1998

About 70% of these poor in Pakistan live in the rural areas. They include land less labor, tenant farmers, small farmers cultivating marginal land and those engaged in numerous informal livelihood activities.

Poverty and Plight of Women

The weight of poverty falls most heavily on women in rural areas who have a very low level of education and who are subject to a multitude of cultural and other social constraints. A comparison of Male and Female Human Poverty index (HPI)[7] indicates that women in Pakistan, have always been poorer, less healthy and less educated than men. This gap has increased over time and women in 1995 are poorer, less healthy and less educated relative to men than they were in 1970.[8]

A Comparison of the Human Poverty Index

Year	HPI(Male)	HPI(Female)
1970	60.6	70.1
1975	56.9	67.0
1980	53.7	64.2
1985	50.0	61.8
1990	46.1	58.9
1995	41.0	55.8

1970-95 (% change)	32.3	20.4

Source: Human Development Center, Islamabad, Pakistan.

It is also estimated that 42% of the 22.8 million economically productive persons in agriculture are females, where more than 38% of these are unpaid family workers as compared to 6% who are self-employed.[9] Women are vital contributors to the economic survival of poor households and family reliance on women's earnings increases with the extent of poverty. A survey showed that the earnings of women in poor households of Karachi comprised half of the total family income[10]. Despite being active participants in the economically productive process, their efforts remain "invisible" and are not represented in the economic decision making.

A Case for Intervention

While Pakistan enjoyed the fastest rate of GDP growth in South Asia during the 1960-90 period, this did not register adequately in equally fast reduction of poverty. Obviously economic growth failed to trickle down to the masses because of the feudal hold over the distribution of income.[11] The role of the government in transferring income and opportunities to the poor has also remained marginal. The government in the past has transferred only 0.2% of the GNP (per annum) to the poorest of the poor through *Zakat* and *Bait-ul-Mal*[12].

A number of attempts by the government to use the institutional credit have largely been confined either to the agricultural sector or medium and large scale agro-processing ventures. The supply of such credit has increased from Pak. Rupee 1.6 billion in 1970s to Pak. Rupee 20 billion in the mid 1990s[13]. Despite a large increase in the number, the subsidized credit has failed to obtain the desired results. Credit Survey of 1985 testifies that three major institutional sources (the Agricultural Development Bank, commercial banks, and cooperatives) have provided credit to only a small proportion of rural households. The survey reports that there were 9.24 million rural households in Pakistan, of which 5.18 million were farming households and 4.05 million, were non-farm households. Only 32 percent of the households (2.95 million) reported taking loans, and 27 percent reported outstanding debt. Of households that borrowed, a mere 10 percent (240,000 households) borrowed from institutional sources (ADBP, 76 percent; commercial banks, 17 percent; and cooperative societies; 6 percent). The remaining borrowed from non-institutional informal sources (friends and relatives, 67 percent; landlords, 11 percent; factories, 2 percent; and moneylenders, 2 percent).

On the other hand richer rural households had better access to cheaper institutional credit whereas poorer households depended mainly on expensive non-institutional sources.[14] These institutions, as the critics have argued generally about the rural credit programs, failed because of the limited role of the interest rate and savings mobilization.[15] ADBP's loan recovery rate deteriorated from 55 percent in the year 1990 to below 50 percent in 1993 while the subsidy dependence has started rising since 1991.

ADBP Subsidy Dependency Index

(Percentage)

	1988	1989	1990	1991	1992
SDI	31.4	29.6	25.5	31.6	36.2
Interest Rate	11.8	11.9	11.9	12.5	12.2

Source: Rural Finance for Growth and Poverty Alleviation in Pakistan, World Bank.

Hence these institutions have failed at both the fronts of targeting and outreach. The major hurdle in achieving these objectives has been the inability of the poor to serve collateral. Another important reason for the failure of these institutions has been asymmetric information (adverse selection and moral hazard) and imperfect enforcement problems. These two problems, according to Hoff and Stiglitz[16], are endemic in developing countries.

Situation Analysis of Pakistan

A: Formal Finance

The international experience with government schemes to provide cheap credit to the rural poor has not been very encouraging[17]. Only 5 percent of poor farmers in Africa and 15 percent in Asia and Latin America have had access to such credit. Surveys carried out in Pakistan show that the poorest farmers has obtained less than 6 percent of their credit from formal sources[18].

Source of Loans by Asset Quintiles

Asset Quintile	Formal Source (%)	Family and Friends	Informal Source (%)
Lowest	1.05	31.43	67.51
Second	4.83	49.53	45.63
Third	12.60	48.33	39.07
Fourth	29.62	35.44	34.95
Highest	58.36	20.10	21.54

Source: IFPRI, Pakistan Panel Survey, Round 13 1990, cited in Saeed Qureshi, Ijaz Nabi and Rashid Faruqee, 1996

It is evident from the above table that the lowest and second lowest asset holders have hardly been able to benefit from the formal sources. These households, instead, have relied heavily on the informal sources. These loans from the informal sources have not been generally for some income generating activities. According to 1990 IFPRI[19] Survey, informal loans have been predominantly for consumption and it is not clear whether these loans help recipients escape poverty or not.

B: Informal Finance

The credit needs of the majority of rural poor are met in large part by informal credit sources, based essentially on personal contact and local sanction. The informal market in Pakistan can be divided into four categories. Socially based arrangements, commercial arrangements, a land-based system, and moneylenders.

One-third of non-institutional credit comes from friends and relatives who do not charge interest and operate on the basis of reciprocity. Friends and relatives sometimes operate through a committee system. These committees are common in developing countries and termed as ROSCAs (Rotating Savings and Loan Associations).[20] Commercially based credit is linked with the supply of inputs or the purchase of output, and is common among the rural poor. The marketing intermediaries who extend the credit may be commission agents or village traders or shopkeepers. Credit from suppliers are quite popular even though the difference in prices for cash terms and credit terms may be substantial, implying a high rate of interest (ranging from 2% to 15% per month).

Land-based credit is the informal instrument used by tenants and subsistence farmers. It is widely used in Sindh, Baluchistan, and Southern Punjab. The credit is extended by the landlords for purchase of inputs and consumption. No collateral is required, but conventionally the credit constitutes the first charge on the produce. According to the 1973 rural credit survey interest rates for this type of credit were about 60 percent higher than institutional rates[21].

Since independence, professional moneylenders have not been a significant part of the credit system in the rural areas. Money lending is considered an unworthy profession in Islam and its does not constitute an important source of informal credit.

Informal credit has a low transaction cost and a short transaction time. But there are no standard terms and conditions, and there is great variation in interest rates and maturity periods. The informal market in Pakistan is undergoing structural changes in response to the evolving socioeconomic landscape. The role of landlords and moneylenders is declining, creating a room for some institutional mechanisms.

The main limitations of the market pertain to scale, space, and time. The market is segmented from the national financial system, reducing its capacity for financial intermediation. Informal finance is essentially a local phenomenon depending on local contacts. Its fragmented and local character is both its strength and weakness. It caters to temporary gaps in consumption, immediate unforeseen contingencies, and emergent situations. It does not promise the desired outreach and sustainable solution of credit provision to the poor and needy.

Justification of a special institution

The pivot of banking business is "collateral" which serves as an explicit guarantee against the possible risk associated with the inter-temporal trade of money. One who does not have this explicit or implicit guarantee is not considered bankable. The poor in the past have not been able to get credit from the existing institutions on these grounds. This denial of opportunity has bound them in a vicious circle. They are poor because they are already in a poverty trap of low initial endowments, low income, low savings and low investment. The poverty of opportunity, on the other hand, has worsened their ability to tap their capabilities in the direction of "self actualization".[22] These poor need credit as the markets have failed to provide credit to them. They have not been able to satisfy the collateral requirements grounded in individual property rights. The annual report 1996 of Kashaf Foundation (an NGO active in the Micro banking business in Pakistan) also emphasizes the necessity of banking with the poor in the following words

"*One very genuine reason to bank is that the financial markets are prone to neglect the needs of the* *rural poor women, simply because the existing criteria of financial worthiness requires contacts, collateral and accessibility.*[23]*"*

Furthermore, lending to the poor is also an important equity objective both because reduction in income inequality per se is often a social goal and because poverty reduction contributes to political stability and thus facilitates growth[24].

An institution need to be created that overcomes market failure due to the high risk and high transaction costs associated with lending to small borrowers. That institution should provide banking services for the rural poor. Provision of institutional credit will work not only for consumption smoothing but also to promote sustainable income generation activities. In the absence of access to formal source of credit, the poor are expected to remain at the mercy of exploitative and non-reliable sources of finance.

Micro Finance; the Prescription

As mentioned earlier, government efforts of targeting the poor through subsidized credit have not been successful in the past. Firstly, the cheap credit has leaked to the relatively richer rural households. Secondly, the subsidy dependence of these institutions required regular injection of government and donor funds and these institutions could not become sustainable. Thirdly and most importantly, only a fraction of the credit could flow to the women poor who are the most deprived of the poor. Hence these institutions have not been successful both in terms of outreach and sustainability.

The informal finance, as outlined earlier, has been expensive, exploitative and chancy with a fragmented market. This has necessitated some institutional mechanism that could reach the poorest of the poor in a sustainable manner. Some NGOs in Pakistan like Agha Khan Rural Support Program (AKRSP) and National Rural Support Program (NRSP) have tried in the past to cover these deficiencies by extending a package of social services and credit to the poor and met with limited success. But the problem with this approach is what has been mentioned (by Saeed Qureshi, Ijaz Nabi and Rashid Faruqee, 1996) that the *mandate of these programs is too broad.* Even the highly acclaimed Comilla Cooperative Model (in the East Pakistan now Bangladesh), which attained considerable success in the early years suffered serious repayment and viability problems when the government replicated it nationwide[25].

Grameen Bank of Bangladesh has emerged as a successful NGO credit program for rural poverty alleviation. It has inspired similar efforts not only in other developing countries, such as Malaysia and Indonesia, but also in the United States[26]. The success of Bangladesh's Grameen Bank in meeting the credit needs of the rural poor is due in large part to the bank's ability to control the often high transaction costs of lending to this segment of the market. Grameen Bank overcame this problem through a group-based lending program. This group serves as a social collateral and uses peer pressure to monitor and enforce contracts and to screen good borrowers from bad. The bank targets poor landholders with less than 0.50 acres of land. Borrowers are required to attend weekly meetings and discuss the viability of their project proposals in the group meeting. This enhances the transparency of the loan disbursement and reduces the adverse selection problems. The peer pressure and the group monitoring of the project almost eliminate the chances of moral hazard in the loan utilization process. Because the opportunity cost of the meetings is high and loan amounts are small (average loan is US $100), large farmers and other rural rich are excluded from the program. The Bank's principal target group is women (who constitute 94 percent of total bank membership and receive 80 percent of total lending). Along with loans, they receive training in maternal health, nutrition, and childcare as part of the Bank's comprehensive social development program.

Started in 1983, Grameen Bank has grown in terms of both members and outstanding loans in a short time. In 1994 there were 1,045 Grameen Bank branches covering 2 million members in 35,000 villages (more than half the villages in Bangladesh). Between 1985-1993, its membership increased 960 percent to 1.8 million members, 98 percent of whom are actually borrowers. Total loans outstanding increased from taka 244 million in 1985 to taka 11 billion in 1994. The bank also has mobilized rural savings, which increased from taka 115 million in 1985 to taka 8.97 billion in mid-1993. The bank has a loan recovery rate exceeding 95 percent. The program drop out rate is low, and borrowers, on average, save 19 percent of the loan amount they receive.[27] This model is being replicated now in 56 countries of the world[28].

Poverty and unemployment are on the rise in Pakistan worsening the misery of the poor and especially women. Human Development Report of South Asia has lamented that "*the changes which are required in Pakistan at the Macro level are the very changes that the ruling groups are likely to resist: for example, land reforms…"* The government has failed to provide institutional credit to the poor in the past. Social safety nets are almost non existent. Changing socio-economic conditions are reducing the chances of informal credit. The persistence of poverty in Pakistan is rooted in socio political inequalities. In such societies, individual based lending can "perpetuate and reinforce the existing socio-economic inequities and access to scarce financial resources"[29]. Under these circumstances there is a dire need of learning from the proven Group based lending of Grameen Bank. The size and modalities can be shaped according to the local sociopolitical factors surrounding the poverty.

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