The Importance of Microcredit Programs in Sustainable Development

Poverty alleviation is one of the primary goals of developing countries and international assistance agencies. The eradication of poverty and the promotion of sustainable development represent two of the most important challenges facing the world in the 21st century. Under sustainable development all human beings will have the opportunity to satisfy their basic needs in an appropriate way, to enjoy equal access to resources, to have a say in the social and economic development process as it affects them, and to participate in political decision making.

At the 2002 World Summit in Johannesburg, South Africa, participants reached a consensus to reduce the number of people in the world living on less than US$1 per day by 50 percent by the year 2015. Representatives of 189 nations attending the conference reiterated their desire to help two billion people around the world emerge from the depths of poverty.

Achievement of this goal requires attention to a variety of objectives such as raising education levels, offering comprehensive medical services, improving lifestyles and providing loans to small and micro-sized enterprises. The combination of low economic growth, poor family planning and uneven distribution of wealth that leads to poverty is endemic to areas with stagnant economies. Capital is needed to foster economic development and microcredit is a key strategy in poverty alleviation. It makes self employment possible, and helps families emerge from the vicious cycle of poverty.

I. How Microcredit Reduces Poverty

Poverty alleviation programs provide material, funds, information and project services for people with no income or work opportunities. Because of the credit risks and relatively high costs associated with small loans, the traditional banking system is general-

An International Success Story: Grameen Bank

Dr. Yunus established Grameen Bank in 1983 in Bangladesh, with the goal of assisting the disadvantaged by providing deposit and microcredit services for individual customers and groups. The bank promotes the concept of savings, which reduces the reliance on outside funds. It also offers microcredit through group loans, which not only abolishes the need for collateral but also reduces costs. To date, the bank has experienced a high savings rate and an excellent recovery rate for loans. In only a decade, the unit has developed from an experimental organization into a financial institution that has branches throughout Bangladesh.

Grameen Bank's recovery rate of 90 percent (with 94 percent of its loans made to women) is high compared with that of the Bangladesh National Bank, which only recovers 25 percent of its loans. Grameen Bank's innovative design, open door loan policy, commitment to gender equality, and its poverty alleviation potential has attracted interest from governments and international assistance agencies throughout the world. The Grameen Bank model is now being used as a reference in planning microcredit programs in other countries.

ly not willing to implement a microcredit system. The borrowers have no collateral to put up against loans and often are refused the needed capital because of the high risk of default. If they resort to underground sources, they are often charged exorbitant interest. This quick fix solution does not address the main structural problem: a lack of proper funding channels.

International agencies and governments have implemented numerous initiatives to address poverty alleviation, but the results from these policies are limited. One of the main reasons is that, because of improper resource distribution, only a small portion of the allocated funds reaches the poor themselves. Among all the failed experiences, however, there is an astounding success – the microcredit program designed by Dr. Yunus for Grameen Bank.

The main goal of microcredit programs is to compensate for the inadequacies of regular financial institutions by providing small loans in nontraditional economic sectors. Flexible repayment procedures and reasonable interest rates are features of the program. A small amount of money can contribute significantly to poverty alleviation, as attested to by the many successes, particularly amongst women, in villages and in remote areas.

II. Methods in Extending Microcredit

A successful poverty alleviation program needs to fulfill two conditions: efficient resource distribution and self sufficiency. Experience indicates that subsidized preferential loans are not the answer. When limited funds are available, the available capital flows mainly to companies with relatively strong relationships with banks, while micro sized companies or the poor are left without funding. Thus, there is no mitigation of poverty. Even when some funds reach the underprivileged, high interest rates and poor savings practices result in a low recovery rate. This reinforces the decision to restrict lending to the needy. The situation is further complicated by the traditional low level of efficiency at state run banks, which are often too passive or lacking in management ability, leading to a low quality of banking service and the gradual erosion of preferential loan plans.

To overcome this problem, participating organizations implemented a special system of limiting the amount of each micro loan, to ensure that funds to reach the hands of the poor. In addition, compulsory deposits, group loans or the use of machinery as collateral are helping to reduce transaction costs for financial institutions. The adoption of such measures, combined with a flexible repayment system, has led to a low default rate.

Microcredit institutions perform strongly at the community level. Loan officers need to establish a close relationship with borrowers and understand both the proposed use for the capital and the borrowers' sources of income. A group mentality needs to be formed, so that "collateral" comes in the form of social responsibility. This focus on the group strengthens the guarantee for repayment and the long-term sustainability of the program. Operators of the program can play a strengthening role by participating in village organizations, assisting in establishing a simple accounting system and helping to form a mechanism for group decision making. Some loan-granting institutions also provide technical training and educational assistance, which helps to raise the ability of borrowers to repay the loans. Paying attention to the long term goals of borrowers, returning the loan mechanism to a basic market function, and ensuring proper institutional management and operation raises the success rate of microcredit programs.

III. The Achievements of Microcredit Programs

From the 1970s through the 1990s, the number of people who obtained microcredit grew from several thousand to about 10 million. The nature of the loans changed from subsidies to commercial

loans. The impact of microcredit programs established by international organizations in developing countries was far greater than that of subsidy style loans because microcredit organizations can usually provide interest rates that are lower than those of underground financing channels. In recent years, the importance of capital and technology provided by international assistance organizations to microcredit agencies in developing countries has risen and microcredit institutions are gradually becoming a formal link in the banking system. Indeed, as reported by the IDB, the profitability of some microcredit institutions was higher than that of commercial banks.

Experience shows that microcredit loans have the following characteristics:

1. The rate of repayment among the borrowers (especially women) is quite high, especially when financial institutions establish long term relationships with the community. Underprivileged people cherish the credit they are given.

2. The expansion of services by microcredit institutions shows that the belief that the poor do not save is inaccurate. Deposit services strengthen the overall fiscal stability of the institution.

3. Integrating loan interest rates with market interest rates increases incentives. When the loan interest rate is higher than the subsidized interest rate, borrowers will work harder to find means to repay the loan. Utilizing market interest rates also helps to determine quickly which borrowers are the most productive. This allows lenders to direct funds to people who are truly interested in working.

4. While borrowers do not provide collateral, financial institutions, if appropriately managed, can still generate operational profits. Where the banking environment is not mature, development organizations should work to strengthen the banking system before implementing loan programs.

5. Micro loans help the disadvantaged establish a cash economy by providing basic financial understanding and building credit standing for individuals. This strategy helps to achieve the institutional building effect and the long term goal of creating economic opportunities.

6. Microcredit and deposit services can strengthen social and labor resources for the poor, thus improving the infrastructure on a local level.

IV. ICDF Microcredit Programs

In the 1990s, the international community focused on poverty alleviation strategies, believing that this endeavor would also have a positive effect on economic development. One of the ICDF's prime objectives is to promote economic development in partner nations. To complement this strategy, the ICDF also participates actively in poverty alleviation.

Uneven distribution of wealth is a common problem in developing countries. Quite often, capital does not flow from large or medium enterprises down to small or micro ones. To ensure that the ICDF's assistance resources would indeed reach the hands of the poor, the organization created special microcredit programs and agricultural and industrial microcredit projects. These loans would help individuals or small or micro companies obtain employment opportunities or generate working income that would make a person self sufficient.

The ICDF's microcredit projects help individuals and small and micro companies in Africa, the Caribbean, Central America and Asia engage in economic activity by obtaining financing from financial institutions or nongovernmental organizations. In addition, the ICDF has microcredit programs devoted to agriculture, which are carried out in conjunction with technical missions. These provide small loans to help farmers or agricultural cooperatives obtain new technology, thereby expanding production. In order to ensure that these financial services can be sustained, the ICDF strengthens the structure of financial institutions (or nongovernmental financial agencies) by helping them to achieve financial soundness and increase their outreach. Cooperative programs with nongovernmental institutions that extend microcredit also help to expand service and increase the depth of support to the underprivileged.

Each country requires different poverty alleviation strategies. Recognizing these regional differences, the ICDF mainly carries out two types of small loan programs: microcredit loans and small scale agricultural financing schemes. The microcredit program first assists areas with insufficient banking services to establish a better financial structure with increased functionality, then provides financing for these institutions to extend microcredit. In some cases, the program includes plans to enhance the function of related institutions. Programs for small loans for farmers and some microcredit programs also emphasize training in production technology, which helps borrowers to boost their incomes more quickly.

The ICDF's microcredit and agricultural financing programs have gradually been introduced in half of all cooperating countries. While microcredit accounts for only a small portion of overall financing plans, the impact of leveraging has helped to extend the program to as many people as possible. In the future, the ICDF will continue to dialogue with cooperating countries in order to design the most appropriate microcredit programs. The paramount objective of the ICDF in its goal of reducing poverty and achieving sustained development is to make sure that its programs create jobs and raise the incomes of the underprivileged.