

Rural developmet through microcredit development assignment



This assignment takes issue with claims made by range of development agencies development. Three options for the provision of micro credit to the rural poor are presented. In some developing countries the state has provided micro credit. These schemes have frequently collapsed because they were often motivated by political, rather than financial considerations. Over the last few decades, neo-liberal theorists have re-examined the role of the much-maligned money lender.

They have argued that the ostensibly exorbitant rates of interest charged, are actually legitimate reflections of the opportunity cost of the loans. They suggest that the work of the money lender be facilitated through the removal of legislative and other restrictions. In recent years innovative Development Finance Institutions (Dips) have begun to provide micro loans to the rural poor. They have introduced a range of novel mechanisms to provide micro credit.

Although there is variety in the workings of the Dips, they commonly: supervise their loan recipients intensively; lend to groups who are jointly and severally liable for the debts of individual members, and require proof of savings before they provide loans. The putative success of many of these Dips, in combination with the rise to romance of neo-liberal thought, has lead to the vigorous promotion of micro credit as a rural development intervention. On closer examination, micro credit is quite limited as a rural development intervention. Credit is only one ingredient in the mix of factors necessary for a successful enterprise.

To respond to a potential demand for a good or service, a rural micro entrepreneur may need access to one or more of the following: transport, communications, power, water, storage facilities, a legal system for enforcing contracts and settling disputes, etc. Apart from infrastructure, micro entrepreneurs need access to information about market trends and skills to run their micro enterprises. Capitalist enterprises require a specific set of social relationships. In some rural societies such a culture may be absent, or the existing set of social relationships may hinder the development of rural micro enterprises.

If one of the aims of rural development is to assist the ‘poorest of the poor’, then micro credit is not always the most appropriate intervention. A comprehensive study of micro credit schemes indicates unanimously that the benefits of the micro credit schemes under study were not scale neutral – the upper and middle income poor tended to benefit more than the poorest of the poor (Helmet et al: 1996). Micro credit schemes often treat the symptoms and not the causes of poverty. Poverty is frequently the result of powerlessness.

Those who promote micro credit schemes as a panacea for rural poverty ignore the complex matrix of power relations that circumscribe the capacities of the rural poor to run micro enterprises. This assignment concludes that lack of recognition of the limitations of micro credit schemes may have unfortunate consequences. On a micro level, it may result in the inappropriate and unsuccessful use of micro credit. At worst it may result in the turn of a ‘blueprint approach’ to rural development, where micro credit is promoted causes of rural poverty or the conditions that entrench it.

<https://assignbuster.com/rural-developmet-through-microcredit-development-assignment/>

Introduction Micro credit as a tool of rural development through the development of micro enterprises was introduced to the economy because formal credit institutions (capital markets) and informal lending system either failed to deliver the goods or not very much conducive to the growth of micro enterprises. As we know the economic giants of the world developed their economies by relying on formal credit institutions through the development of their capital markets. But these formal credit institutions have on the whole failed to provide credit to the poor in the underdeveloped countries for many obvious reasons.

In recent years, most of the countries across the globe are in a sweeping mood to promote micro finance institutions not only as a positive rural development intervention but also as a rural development panacea. Allured by the success of micro credit institutions in developed countries, the developmental economists in under developed and developing economies have increasingly become enthusiastic in the promotion of micro credit as a rural development intervention by tying it neatly to post-liberal development ideology.

However, Microcredit has gained international respect and respect from its borrowers for its contribution to poverty alleviation and social empowerment for the poor. It is believed that with this high social respect it has the potential to also be successfully used as a growth-generating tool, particularly in the pursuit of rural development in Bangladesh. Background A system of credit provision is a sine qua non for capitalist development.

Entrepreneurs need credit to begin their organizations, and generally need

credit wrought the life of their enterprises to fill the lag between purchasing inputs and receiving payment for outputs.

In developing countries rural people have often not been able to obtain formal credit, leading many writers to see credit as a panacea, Walt Roosts, spoke of modernization causing compound growth that would move continually forward and never backward . Echoing similar optimism Mohammed Yuan’s, founder of the famous DIF, the Grahame Bank, spoke of the establishment of a virtuous circle, “.... Low income, more credit, more investment, more income” (as cited by Helmet et al 1996: 108).

The title of a feature on the Grahame Bank in an article in The Independent newspaper reads “ Mohammad Yuan’s believes that he can eradicate world poverty, all by means of one simple idea [credit]. Now the world’s leaders take him seriously’ Lois 1996: 15). The article then proceeds to describe the work of Yuan’s Mohammed and how his model of micro credit is being taken as a panacea for rural underdevelopment and poverty. Mohammed Yuan’s heads the mostly World Bank financed Consultative Group to Assist the Poor (GAP), to “ propagate his vision worldwide”.

Bill Clinton has cited his experiment as a model for building America’s inner cities (Ibid.). With the rise of neo-liberal development ideology in the early ‘ ass a great deal of emphasis has been placed on the development of micro enterprises. State sponsored development initiatives have been characterized by neo-liberals as inefficient. This has generated a great deal of interest in the prospect of rural micro enterprises, which has in turn focused on the question of credit provision to rural micro entrepreneurs.

Rural development generally refers to the process of improving the quality of life and economic well-being of people living in relatively isolated and sparsely populated areas. Education, entrepreneurship, physical infrastructure, and social infrastructure all play an important role in developing rural regions. Rural development is also characterized by its emphasis on locally produced economic development. Rural Development planned change towards the improvement of the economic and social lifestyle of the rural poor through increased production, equitable distribution of resources, and empowerment.

In general, a planned change can be of two major kinds, rural institution building and advancement in technology. Although agricultural development constitutes a major part of it, rural development is a much reader process which aims at the development of the rural economy as a whole. In fact, it is a process that encompasses the entire gamut of technical, economic, political and social changes related to private and public efforts geared towards increasing the well being of rural citizens. Specific targets of rural development in today's Bangladesh include the rural poor, especially the more disadvantaged groups of women and children.

Rural development aims at building the capacity of these target groups to control their surrounding environment accompanied by wider distribution of benefits resulting from such control. The key elements of rural development in Bangladesh are: (a) poverty alleviation and raising the living standards of the rural poor; (b) equitable distribution of income and wealth; (c) wider employment opportunities; process, benefit sharing, evaluation of rural development programmer, and (e) 'empowerment' or more economic and

<https://assignbuster.com/rural-developmet-through-microcredit-development-assignment/>

political power to the rural masses to control the use and distribution of scarce resources.

Definition of Micro-credit Microcircuit is the extension of very small loans (microcosms) to impoverished borrowers who typically lack collateral, steady employment and a verifiable credit history. It is designed not only to support entrepreneurship and alleviate poverty, but also in many cases to empower women and uplift entire communities by extension. In many communities, women lack the highly stable employment histories that traditional lenders tend to require. Many are illiterate, and therefore unable to complete paperwork required to get conventional loans.

As of 2009 an estimated 74 million men and women held microcosms that totaled IIS\$38 billion. Grahame Bank reports that repayment success rates are between 95 and 98 per cent. Microcircuit is part of micromanage, which provides a wider range of financial services, especially paving accounts, to the poor. Modern microcircuit is generally considered to have originated with the Grahame Bank founded in Bangladesh in 1983. Many traditional banks subsequently introduced microcircuit despite initial misgivings.

The United Nations declared 2005 the International Year of Microcircuit. As of 2012, microcircuit is widely used in developing countries and is presented as having “ enormous potential as a tool for poverty alleviation. ” Microcircuit programs in Bangladesh is implemented by Nags, Grahame Bank, state-owned commercial banks, private commercial banks and specialized programs of some ministries of Bangladesh government. Nobel laureate

Muhammad Yuan's, the founder of Grahame Bank, which is generally considered the first modern microcircuit institution.

The origins of microcircuit in its current practical incarnation can be linked to several organizations founded in Bangladesh, especially the Grahame Bank. The Grahame Bank, which is generally considered the first modern microcircuit institution, was founded in 1983 by Muhammad Yuan's. Yuan's began the project in a small town called Cobra, using his own money to deliver small loans at low-interest rates to the rural poor. Grahame Bank was followed by organizations such as BRACE in 1972 and AS in 1978.

Microcircuit reached Latin America with the establishment of PRODDDED in Bolivia in 1986; a bank that later transformed into the for-profit Bannocks. Microcircuit quickly became a popular tool for economic development, with hundreds of institutions emerging throughout the third world. [3] Though the Grahame Bank subsidies, it later became a corporate entity and was renamed Grahame II in 2002. Muhammad Yuan's was awarded the Nobel Peace Prize in 2006 for his work providing microcircuit services to the poor. Capital markets and the poor Developed countries have developed capital markets that rely on formal credit institutions.

Formal credit institutions have on the whole failed to provide credit to the poor. Von Picked in his book, *Finance at the Frontier* (1991: 143 - 168) gives reasons for their failure. Firstly formal financial institutions are removed, in a number of respects, from the lives of rural people. One need simply enter the foyer of any commercial bank to get an immediate sense of this. For instance, formal financial institutions tend to require literacy and often have

little knowledge of how business operates in rural areas I. . The complex interaction of business and social obligations. For the rural poor, transacting with formal financial institutions often involves time consuming Journeys away from the village and transactions conducted during office hours with unfamiliar faces in unfamiliar surroundings (Devourer et al 1990: 11). When the formal financial institution is a state run or premarital organization, it may be driven by a range of socio-political considerations, in addition to considerations of the clients' ability to repay.

Credit provision for the development of rural micro enterprises may not be an appropriate way of facilitating rural development, and if he provision of credit is determined mostly by factors other than ability to repay the loan, it is unlikely that the micro-enterprise will be self-sustaining. In such a circumstance the state or premarital is likely to cease providing credit. The transaction cost of the provision of credit to rural micro enterprises may prove prohibitive to large formal financial institutions. Rural micro enterprises are often dispersed over large areas.

Transactions involve relatively small amounts and they require relatively large amounts of interested earning cash to serve their clients (Von Picked 1991: 147). Von Picked claims that The limits of micro credit as a rural development intervention “ Obligations to formal institutions may not be accorded very high priority..... Especially when institutions are not responsive to clients” (1991 : 147) . In some instance, the opposite may be true. For example, when a non- government organization (MONGO) that was known in the past for providing grants moves into providing loans, the recipients often see the MONGO as a soft target.

<https://assignbuster.com/rural-developmet-through-microcredit-development-assignment/>

Loan recipients recognize that the MONGO would be unwilling to put pressure on lenders who defaulted and would certainly be unwilling to force the sale of collateral. Formal credit institutions deal frequently with a large number of clients who are often information about their clients, for example, institutions that collect information on bad debts and organizations that give credit ratings. Such institutions do not exist in rural areas where information about credit worthiness needs to be extracted on a more personal basis.

In assessing an enterprise, formal financial institutions tend to rely on financial profitability and cash flow analyses. These are expensive and are often inappropriate ways of assessing rural micro enterprise projects. They do not take account of social factors influencing production and distribution in rural enterprise projects in developing countries. Unlike their larger formal counterparts, entrepreneurs who start micro enterprises typically lack assets, especially marketable ones to use as collateral for loans (Otter et al 1994: 13).

Many rural micro enterprise projects tend to be agricultural enterprises, and are dependent on such vagaries as the weather and are therefore risky. The loans are often used in purchasing seeds, fertilizers, pesticides and herbicides which cannot be recovered if the crop fails. Thus formal credit institutions have tended to stay clear of lending to rural micro enterprises. Two broad responses have emerged in response to this failure. The first response, a neo-liberal one, was to remove government legislation preventing informal credit institutions.

This usually involved the removal of those laws that restricted trade in credit e. G. Lifting the usury laws, removing state subsidized credit, etc. The second response was to facilitate the development of more innovative Dips to overcome the problems outlined above. “ We dedicate this book to the much maligned moneylender because of her ability to elk barefoot where bankers fear to tread” (Adams 1992) The vast majority of societies with money economies have, or have had, some form of informal money lending. Very often the money lender has been a despised member of the community.

In all societies with the malicious money lender myth, the money lender is usually believed to extract exorbitantly high interest rates because of the weak bargaining position of the borrower. Highly publicized cases of high interest rates have very often prompted governments to outlaw informal money lending through the passing of usury laws which set the ceiling on interest rates. Von Picked and other theorists of what has become known as the Ohio School, have argued that the high interest rates often charged by money lenders are a real reflection of the opportunity costs of the loan (Von Picked 1991: 175).

Lending to poor rural people is an extremely risky business. As mentioned previously, loans to rural people frequently tend to be for agriculture, a very risky enterprise dependent on climatic conditions. Rural people tend to be very mobile between rural and urban areas, which can facilitate debt evasion. Rural people often have a low life expectancy. Injunction with life insurance policies, such financial instruments are generally not available to

rural money lenders. Finally Von Picked believes (1991: 176) that people tend to overlook the rural lenders' relatively restricted loan portfolio.

He writes: " First, the number of borrowers they can accommodate is limited by the amount of funds they have to lend. A lender with a loan portfolio of 50 loans of roughly equal size would lose two percent of his loans if one borrower did not repay. To cover this risk, the lender would have to raise the annual rate of interest on the 49 remaining loans by about two percentage points. If ten borrowers failed to repay the capital loss would amount to 20% of the portfolio, and the compensating rate increase for the remaining 40 loans would be about 25%.

Slow repayment because of a poor harvest, for example, also absorbs funds that the lender would want to recycle into new loans in the next season.

Inability to continue to lend would Jeopardize relationships with established borrowers, diminishing their incentives to repay outstanding amounts and raising the risk exposure on their entire portfolio (Von Picked 1991: 176). "

Other research, by Tuna Way (as cited by Von Picked 1991: 177) has shown that the mingle high rates of interest often include payment for a range of non-financial services provided by the money lender.

Tuna Way cites storage of produce and payment of market taxes as services provided by money lenders. In response to claims made by Boudoir and others of the rapacious nature of moneylenders, Dale Adams (1992: 18) writes that " ... Blaming money lenders for the financial difficulties encountered by a few of their clients is as illogical as condemning hospitals because they treat people who are ill and some of their patients pass away'.

Thus essentially Von Picked and members of the Ohio School argue that government intervention generally, and usury laws more specifically, have prevented many rural people from obtaining credit.

The simple solution is, for a start, to repeal the usury laws. This would allow different money lenders to compete openly for clients, which, through market forces, would cause the interest rate to reflect the undistorted opportunity cost of capital. The Microcircuit Regulatory Authority (MR.) established by the Government in August 2006. At the first time MR. received applications from 4241 MONGO-Miffs for licenses which the law makes mandatory for all MONGO-Miff. At that time MR. has decided to outstanding to BAT 4 million, subject to meeting institutional requirements.

However, till May 2014, MR. had approved licenses in favor of 742 Nags and canceled licenses of 44 Nags. There are another 43 applications under process for a final decision although they are mostly small organizations but with some potentiality to become viable in course of time. As of May 2014, 3456 applications have been rejected. Recently MR. has invited new applications for obtaining license to conduct microcircuit activities among which 92 institutions have been given primary approval. The impact of microcircuit is a subject of much controversy. Proponents state that it reduces poverty through higher employment and higher incomes.

This is expected to lead to improved nutrition and improved education of the borrowers' children. Some argue that microcircuit empowers women. In the US and Canada, it is argued that microcircuit helps recipients to graduate from welfare programs. Critics say that microcircuit has not increased

incomes, but has driven poor households into a debt trap, in some cases even leading to suicide. They add that the money from loans is often used for durable consumer goods or consumption instead of being used for productive investments, that it fails to empower women, and that it has not improved health or education. Population of 128 million. About 48% of the people live below the poverty line. Poverty alleviation has been given the top priority by the public sector and other development agencies. Micro-credit has emerged as small-scale financial services offered to the poor in order to reduce their vulnerabilities. Not only the Nags and Grahame Bank, the public sector agencies have also been giving priority to micro- credit program as an effective tool to combat poverty. In fact, the magnitude of growth of the micro-credit program undertaken by various agencies has brought Bangladesh at global focal point.

Over time, the micro-credit sector has grown to an industry and is unofficially treated as the third sector in the country. Basically, the micro-credit program in Bangladesh has turned into product diversification in terms of flexibility in savings and credit operations during the last couple of years. This has demonstrated significant changes in designing savings and credit policies for the poor people.. To eradicate illiteracy from the country, compulsory primary education, food for education program, education program for the old have been introduced by the government.

The government has set up hospitals and health centers at the than and union level. Green Umbrella Program is another initiative of the government in this respect. The government is encouraging the people to invest in the rural areas. Side by side with the government, many non-government

<https://assignbuster.com/rural-developmet-through-microcredit-development-assignment/>

organizations are also making concerted efforts to develop the rural areas. CARACAS, CARE, AS, BRACE, PROSAIC etc. Are the names of some famous organizations that are working for the development of the villages in Bangladesh. They are offering micro credits for farming, housing, education etc.