



## Unintended Consequences of Micro-Credit in Bangladesh: An Evaluation from Human Security Perspective

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### Abstract

With the objective of evaluating the performance of micro-credit and its impact on poverty reduction in Bangladesh from a human security perspective, this paper identifies three unintended, yet fundamental, consequences: the exclusion of the hardcore poor from the program, producing hardcore poverty through irresponsible operation and the erosion of the value of charity. Embracing the norm of human security in micro-credit would be helpful in addressing these counter-consequences. This would require NGOs to redesign micro-credit operation in order to include all the poor, to develop social safety nets for the borrowers so that they are not pushed downwards in times of lose, and to identify alternative sources of fund so that the NGOs can continue providing charitable welfare services for the poor.

**Keywords:** Micro-credit, Unintended Consequences, Human Security, Exclusion, Hardcore Poverty, Values of Charity, Bangladesh.

### 1. Introduction

Recently micro-credit program, particularly the Grameen Bank model in Bangladesh, has become enormously popular in the development discourse owing to its apparent success in poverty reduction. The greatest accolade for micro-credit has come about with the declaration of 'Nobel Peace Award-2006' which is given jointly to Dr. Muhammad Yunus and Grameen Bank for micro-credit's contribution in poverty reduction and hence world peace. Many people are likely to be surprised for micro-credit being awarded Nobel peace award for its economic contribution in poverty reduction. But the development discourse, particularly human security perspective, has recently identified poverty as a root cause behind various kinds of deprivation that lead to terrorism and violence. Thus, poverty reduction is conceptualized as contributing to sustainable peace for the world. Hence the Nobel peace award to micro-credit and its architect Dr. Yunus. However, critics of micro-credit have questioned the manner in which micro-credit programs work. The most common charge is that while the richest of the world- top-notch corporate can get loans at interest rates as low as two to three percent, the poor rural women can only access finance at 18 to 24 percent. It is also claimed that the loan providers coerce the borrowers to repay the installments without considering any emergency. The objective of this paper is to evaluate the performance of micro-credit and its impact on poverty reduction in Bangladesh from a human security perspective. Special attention is given to the unintended consequences of micro-credit operations with an aim to propose few practical solutions in order to improve micro-credit's capacity in poverty reduction and ensuring human security. Since all the NGOs in Bangladesh by and large follow Grameen Bank's micro-credit model, the analysis is primarily based on Grameen Bank and its micro-credit operations.

### 2. Theoretical Framework

Helping the poor has long been regarded as a humane value. Most of the philosophies, including all world religions, place greatest values in activities that aim to help those who are in need of help to overcome problems related to their survival. Since the poor are deprived of the most fundamental rights as human beings, to help them grow out of the poverty-trap has been espoused as the goal of the whole development discourse. And consequently, those devoting their efforts in poverty alleviation are greeted with honor and prestige in human society. Micro-credit is perhaps the latest weapon in the existing arsenal to fight against poverty. Its contribution towards poverty reduction throughout the developing world has been recognized over the last decade. However, poverty is still found lingering in several parts of the developing world where micro-credit has been operating. This calls for a critical examination of the whole range of consequences that micro-credit produces in its area of operation.

Basing on a critical evaluation of peace keeping operations worldwide, Aoi *et. al.* (2007) argue that all interventions in human society produce both positive and negative consequences. While positive results are always appraised and desirable, the negative ones undermine the ultimate goal of these operations despite the fact that those effects are unintended. Therefore, they urge for an understanding of why and how unintended consequences result and how to improve strategies to tackle these undesired outcomes effectively. From a complex system perspective, they share the idea that human society is essentially a complex set of “non-linear relationships” and therefore, unintended consequences are only understood within the context of “dynamic, non-linear, complex system that is constantly self-regulating through multiple feedback mechanisms” (2007:11). Thus, unintended consequences are conceived as “natural outcomes” of any action. This makes any attempt to infer results from the intentions and expectations difficult, if not impossible.

Among the array of reactions to a particular intervention, Aoi *et. al.* (2007) define unintended consequences as “all those reactions that fall outside the scope of the response we wanted to elicit” (2007:6). Therefore, they differentiate between unintended consequences- the impacts that are not anticipated when a mandate is made- from intended consequences- the impacts for which the mandate is meant. They further single out unintended consequences from a “failure to achieve the intended consequences” and “mixed motives” of the actors involved (2007:8). They argue that unintended consequences are not fundamentally destructive and observe three different types of unintended consequences with regard to their impact: those that have positive impacts, those that are neutral, and those that have negative implications. They stress mostly on those unintended consequences that have harmful impacts, because such consequences may cause difficulty in achieving the intended goals, weaken the concept in operation, and may even undermine the legitimacy of the organization involved.

This approach recognizes a moral and logical fallacy: that since aid may do harm, a decision not to give aid would do “no harm”. However, it goes beyond this proposition and argues that intervention with assistance should be there, because the outcomes of interactions between external aid and local communities are predictable. As such, what we need to do is “to explore ways in which we can improve our ability to anticipate and counter potential negative unintended consequences” (2007:17).

### **3. Human Security, Poverty and Micro-credit**

Human development report 1994 by UNDP is the first to make the specific claim that individuals should be the referent of security instead of the states since state’s security has become less vulnerable while that of individuals suffers even by their own state. Consequently, it proposes human security in terms of the safeguards against “the threat of global poverty traveling across international borders in the form of drugs, HIV/AIDS, climate change, illegal migration and terrorism” (UNDP 1994, p. 24). Looking at the strong correlation between poverty and terrorism in the third world, UNDP conceptualizes poverty as a structural cause of terrorism and hence a threat to security and world peace. The concept of human security, as UNDP develops, is built on four essential characteristics: universalism, interdependence of components, prevention rather than protection, and centered on people.

The UNDP report identifies seven potential sources of threats that include most, but not necessarily all, aspects of human security: economic security, food security, health security, environmental security, personal security, communal security and political security (UNDP 1994:25-33). The final argument of the report is that the root causes of all these threats to human security lies in the structural context of societies that provoke conflict, such as resource scarcity, low level of economic growth, inequitable development, and the impact of structural adjustment, in a word- “poverty” (Kong and MacFarlane, 2006:152). Accordingly, sustainable development has been espoused as the ultimate solution to conflict resolution and to ensure human security. At this point enters micro-credit program particularly that of Grameen Bank in Bangladesh which has successfully claimed its contribution in upholding human security through poverty reduction.

In 1976, Dr. Yunus founded the Grameen (a Bangla term meaning Village) Bank Project in Bangladesh for the purpose of offering micro-credit to the poor in rural Bangladesh. He organized this “socially conscious capitalist enterprise” in accordance with the following three principles:

- (1) Loans were to be repaid, and on time.
- (2) Only the poorest villagers (the landless) were to be eligible for loans.
- (3) Lending would primarily be to women, because women were socially and economically the most impoverished, and because the immediate beneficiaries of loans to women were generally their children.

In 1983 the Grameen Bank Project was transformed into a private independent bank- the Grameen Bank (GB) - by a Government Ordinance giving GB status of social welfare organization and hence, immunity from certain standard banking regulation by the government. According to the official Grameen Bank Website, the GB currently has 1,658 branches operating in 57,791 villages with a total staff of 14,989 as of 2006. The GB serves over five million borrowers

(96 percent are women) and has a loan recovery rate of 99 percent. Borrowers of GB own 94 percent of the total equity of the bank. Over 64 percent of these deposits come from the GB's own borrowers.

The standard Grameen Bank (GB) loan process is as follows (Note 1):

- A) To qualify for a GB loan, a borrower must demonstrate that her family assets fall below a certain threshold set by GB.
- B) A GB borrower is not required to put up collateral. Rather, she must join a five-member group of GB borrowers, attend a weekly group meeting, and encourage "loan discipline" within the group. This loan discipline includes the assumption of responsibility for the GB loans of all of her group members, and adherence to "sixteen decisions" such as keeping families small and not accepting (or paying) a dowry for a son's (or daughter's) wedding.
- C) A GB borrower's continued access to GB credit is conditional on prompt loan repayment by all of her group members.
- D) Most GB loans have been for two years periods with an annual interest rate of 20 percent (calculated on a declining principal), which is about four percentage points above the commercial rate in Bangladesh for similarly structured loans with collateral.
- E) GB never forgives loans, although it restructures them (extends their maturity) when necessary; and no free services are provided.

In spite of the enormous celebration of Grameen micro-credit program in fighting against poverty, a realistic evaluation would notice some undesired and unacceptable consequences of this program, too. With an intention to overcome such problems effectively, it is essential to identify those unintended consequences of micro-credit.

### 3.1 Excluding Bottom Poor (Note 2)

Before granting loan, creditworthiness of a potential borrower is determined by three criteria which are collective known as 'Three Cs of Credit'. These are following:

- (1) *Character* -means how a person has handled past debt obligations: From credit history and personal background, honesty and reliability of the borrower to pay credit debts is determined.
- (2) *Capacity* -means how much debt a borrower can comfortably handle. Income streams are analyzed and any legal obligations looked into, which could interfere in repayment.
- (3) *Capital* - means current available assets of the borrower, such as real estate, savings or investment that could be used to repay debt if income should be unavailable.

(Grameen Bank Website)

Therefore, it becomes evident that an individual must have some material possessions as well as social connections that define her as reliable, capable and able to repay from her own resources if her micro-business enterprise fails. Thus, the 'bottom poor' who "does not have needed assets, social relations and self-confidence" are excluded (Develtere and Huybrechts, 2005:175). In fact, only the relatively richer among the poor can qualify as creditworthy in this program.

### 3.2 Producing Hardcore Poverty

Grameen micro-credit paradoxically produces hardcore poverty within the relatively richer poor who get involved in it. A careful analysis of the economic activities of the borrowers, who are almost exclusively female, would clarify this point. The borrowers' major economic activities include poultry raising, animal husbandry, homestead gardening, small-scale trading and non-farm services (Ahmed *et.al.*, 2007). The market of these products in most rural areas in Bangladesh is only emerging, if not totally non-existent. Furthermore, all these informal economic activities are vulnerable to frequent natural disasters. Given the incipient market, disaster risks and women's limited access to the market due to the patriarchal social structure, very often the newly emerging poor female entrepreneurs experience loss in their economic endeavors. Then what happens to those losers? Sharif (1999) identifies five strategies that those unlucky women usually follow to cope up:

- (1) Borrowing from moneylenders,
- (2) Using savings or selling assets,
- (3) Reducing existing consumption level (know as tightening the belt)
- (4) Negotiating to reschedule the loans (but rarely succeed),
- (5) Simply default.

The net result of these strategies is a grim future for the failed entrepreneurs. A significant fraction of them are dropped out from the program (of course, after repaying loans anyhow). The annual rate of drop out was 15 percent in 1993 by a Grameen Bank estimate (Grameen Bank, 1994). This means at least 15 percent of the relatively richer poor who join

micro-credit program are pushed downwards to hardcore poverty. And surprisingly, there is no further data about the drop out rate garnered by Grameen Bank or any other NGO operating in micro-credit.

This poverty producing mechanism with the structure of micro-credit is best explained by Anu Muhammad, a prominent Professor of economics in Bangladesh. From his participation in several village studies on micro-credit in different part of Bangladesh, Muhammad (2006) summarizes some essential features of micro-credit. These are as follows: (a) its tiny amount keeps its use in limited areas mostly in retail trade or reinvest in credit market with higher interest. (b) The borrower of micro credit does not have to show any collateral but s/he has to be accountable to the group s/he belongs. (c) The borrower receives the amount minus some savings, about 10 per cent, and has to repay the loan in weekly installments with interest of around 20 per cent of the total. (d) Since more than 20 per cent return on the loan amount is essential to keep repayment regularly for every week, every month and every year without any break, if anything happens to break the payment or if the borrower cannot earn more or at least equal to the repayment amount, s/he becomes defaulter, which has chain effect. (e) It is assumed that, *ceteris paribus*, as standard practice in economics, other things remain same, meaning everything will be favorable for weeks, months and years. No natural disaster, no accident, no sickness. Reality does not follow this. If anything much less than above happens, the repayment gets stuck. That happens for the majority. (f) Further hidden assumption is that the property relations, power structure, market process all favor the poor, which is proved completely wrong. (g) For every breakdown of the wrong assumptions the borrower faces helpless uncertain and burdened situation. Defaulters therefore are on the rise among the poor who are compelled to take new loans from other sources at higher interest rates.

The stunning repayment rate of micro-credit, 99 percent, is presented as a sign of success of the women borrowers with the conviction that it is their successful entrepreneurial efforts that helps them make profit and repay loans. Otherwise, how come these poor women continue repaying the weekly installment of their loans? Karim (2008) identifies the answer to this question through her ethnographic village study in Bangladesh. She observes that “the honor and shame codes act as the collateral of these loans. It is the honor of the family that is at stake, and which the woman represents. If the woman gets publicly shamed, both by the group of borrowers and the NGO staff, the family is dishonored. In a face-to-face society, men and their families try to maintain the sanctity of their family honor by observing the honor of their women”(2008:10). This forces the borrowers to repay the loan by all means. This often results in selling out the family properties, or taking more loans from other lenders.

The ultimate result of taking micro-credits for several borrowers, hence, is further pauperization and shrinking towards hardcore poverty.

### 3.3 Elimination of Charity from Social Welfare

A special editorial of the Daily Ittefaq (Note 3) on December 11, 2007 identifies a qualitative change among the NGO community in Bangladesh. It is observed with regard to NGOs' approach after an enormous natural disaster in Bangladesh that NGOs have moved far away from their original goal of providing welfare towards profit-making out of their programs.

The devastation by the cyclone 'Sidr' on November 15, 2007 is unprecedented in the history of Bangladesh: houses, crops, poultry and cattle, vegetation- literally everything is washed away in 12 South and South-Western districts. People could barely save their lives by taking shelter in cyclone centers. According to a World Bank estimate, the total amount of damage is approximately US\$3,043,480,000. However, none of the NGO organizers visited the cyclone-affected regions after the disaster. Contrarily, all the NGOs became more concerned about the repayment of loan rather than engaging in relief works (Note 4).

In spite of the massive criticism from every section of society in Bangladesh, NGOs continued to force their borrowers for repayment which was inconceivable of the welfare providers. However, NGOs- particularly medium and small NGOs- claimed that they could not afford delaying of repayment or writing off the loans, since they also borrowed the fund from other commercial banks and large NGOs, and their organizational functions including staff's salary depended mostly on the profits earned by micro-credit operations (Note 5). As such, they took shield under the special act 1983 which gave micro-credit program immunity from government regulation. So, the government could do nothing either to push the NGOs into immediate relief works or to save the devastated people from the coercive pressure by these NGOs. Several people started fleeing to other villages to escape the field-staffs of NGOs; even few incidences of committing suicide appeared in national media. The problem was finally solved for the moment when the Chief of Armed Forces of Bangladesh threatened the lenders and all NGOs declared recollection of loans postponed for next six months and some large NGOs declared partial writing off of loans (Note 6). However, eight months after their promise, Action Aid Bangladesh has found that none of those promises have been delivered and the NGOs have kept on squeezing the borrowers for repayment (Note 7).

## 4. Conclusion and Recommendations

Three fundamental problems within the structure of micro-credit program are identified in Grameen micro-credit program in Bangladesh. *First*, a human security approach demands that every individual must be incorporated and

assisted to be empowered by development assistance. However, Grameen micro-credit excludes a significant proportion of the dispossessed people who live below certain level of poverty and thus fail to qualify as creditworthy. *Secondly*, and more importantly, the ways micro-credit program operates produce hardcore poverty within its own operation. *Finally*, high returns from and greater dependence on micro-credit programs have shifted NGOs' orientation from welfare to business which ultimately undermines the moral basis of NGO operations in particular, and of development assistance in general.

It is evident from the analysis that mere good intension is not enough to ensure sustainable development and peaceful life. Any development intervention naturally generates multiple consequences along with the primary goal of helping the poor. The case has also been proved as true about of the micro-credit operations in Bangladesh. Along with the much celebrated impact on poverty alleviation, micro-credit also produces several other unintended consequences for the people it claims to benefit. A prudent analysis would consider these negative consequences as unintended, and undesirable, too.

Identification of the unintended as well as undesirable consequences is the first step to overcome these problems. However, concrete strategies are needed to improve the performance of micro-credit in poverty reduction. NGOs need to ensure transparency of their operations in order to emphasis the welfare of people. The criteria of creditworthiness that renders micro-credit a failure in including all poor should be abandoned to embrace the norm of human security. Grameen Bank's micro-credit program for the beggars provides is a startling example of how this universal inclusion may be ensured. However, to avoid the unintended consequence of producing hardcore poverty, NGOs must develop social safety net for the borrowers (not only for the lenders by creating different coercive mechanisms to ensure loan repayment) so that they may not turn hapless in the face of natural disasters and thus preventing downward mobility of the borrowers. Most importantly, to prevent diminishing charity-orientation, NGOs must develop alternative strategies for income generation and fund raising for the organization's survival and be prepared to provide emergency services to destitute people without charge so that the moral basis of their existence- charity- is not hurt.

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### Notes

- Note 1. Available: <http://www.econ.iastate.edu/classes/econ353/tesfatsion/grameen.htm> (retrieved on July 10, 2008)
- Note 2. Those who fail to qualify according to these criteria of creditworthiness.
- Note 3. The leading Bengali newspaper in Bangladesh.
- Note 4. National media in Bangladesh over the months of November and December, 2007 are replete with examples.
- Note 5. NGO representatives' arguments with government officials in a meeting on December 14, 2007.
- Note 6. The Daily Prothom Alo, December 14, 2007.
- Note 7. The Daily Ittefaq, July 03, 2008.