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THESIS

**HOW DO MICROFINANCE PROGRAMS CONTRIBUTE
TO POVERTY REDUCTION?**

by

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September 2016

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REDUCTION?**

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ABSTRACT

The purpose of this thesis is to address if microfinance institutions (MFIs) facilitate poverty reduction in Bangladesh. The research begins with an overview of the historical, institutional, and political underpinnings of poverty in Bangladesh and then surveys quantitative findings to determine the extent to which the rural poor's income can be augmented. Resources furnishing this analysis include panel data drawn from MFI borrowers in randomly selected villages that have branches serviced by Grameen Bank, Association for Social Advancement (ASA), and Bangladesh Rural Advancement Committee (BRAC). In addition, by addressing development indicators, microcredit's non-economic outcomes—or spillover effects—are also measured, including literacy and infant mortality. In order to address MFIs' more difficult-to-measure spillover effects, this thesis also treats the notions of civil society and women's empowerment as relevant areas that pertain to poverty mitigation.

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LIST OF ACRONYMS AND ABBREVIATIONS

AL	Awami League
ASA	Association for Social Advancement
BNP	Bangladesh Nationalist Party
BRAC	Bangladesh Rural Advancement Committee
MFI	Microfinance Institution
NGOs	Nongovernmental Organizations

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I. INTRODUCTION

Over the past two to three decades, microfinance—the provision of loans and other financial services to those, typically the poor, who lack access to traditional financial intermediaries—has become a major form of assistance through which development agencies have attempted to aid poor nations, especially with the goal of raising millions above the poverty line. The concept of microfinance was pioneered in Bangladesh by Muhammad Yunus, who created the Grameen Bank in 1976 in order to create credit opportunity for the poor.¹ Since then, there have been hundreds of similar “Grameen-like” banks established. Despite having had a great deal of this and other forms of developmental assistance, Bangladesh continues to face high levels of poverty and other developmental challenges. In fact, one-third of Bangladesh’s population continues to live in extreme poverty.² As a response to the nation’s poverty level and the lack of opportunity available for its poor, 686 microfinance institutions now exist within the country.³ Given this setting, this thesis addresses if microfinance loans lead to a reduction in poverty and, if so, under what conditions.

This thesis uses the terms microfinance and microcredit interchangeably, and examines “microentrepreneurs,” who come from low-income households.⁴ The topic is addressed by surveying outcomes on poverty reduction and further determining which variables condition the effects of microfinance on poverty reduction. This is done by looking at case studies that track the income of borrowers and non-borrowers within the village level in Bangladesh.

¹ David Lewis, *Bangladesh: Politics, Economy and Civil Society* (Cambridge: Cambridge University Press, 2011) 115.

² Ibid., 158.

³ Microcredit Regulatory Authority, “List of Licensed MFIs as of March 01, 2016,” accessed March 23, 2016, http://www.mra.gov.bd/images/Licensed_NGO_MFIs/licenced250216en.pdf.

⁴ Grameen Bank for Small Business RSS, “What Is Microcredit,” last modified March 2, 2012, <http://www.grameen-info.org/what-is-microcredit/>.

A. RESEARCH QUESTION

The primary research question is:

How do microfinance programs contribute to poverty reduction?

The impact of microfinance on poverty reduction is a significant area of study, particularly for development practitioners and academics interested in the aggregate effect of such programs on poverty reduction. Despite being a major element of development practice for decades, there is still much to be learned about the extent to which microfinance programs actually reduce levels of poverty across different economic classes—and under what conditions this occurs.

Daniel Lewis argues that “Bangladesh is at a crossroads of sorts, and faces a number of pressing dilemmas,” including its poverty level.⁵ The outcome of Bangladeshi development schemes is important for practitioners to study because it may enable them to better address specific development needs. Tracking the outcomes and possible spillover effects of specific types of microlending programs provide a lens through which progress can be measured. For example, we can analyze if there are any positive gender-related outcomes that may contribute to expanding the rights and role of women, which in turn, perhaps indirectly, encourages poverty reduction. By contrast, we can also seek to find if there are any unintended effects of mobilizing microloan programs within particular communities of the low-income population. A study of microlending offers an opportunity to consider how to increase the quality of life of the world’s poorest. In turn, more prosperous societies in which human security is guaranteed tend to be more secure and less violent, thus creating indirect connections to broader international security concerns.

⁵ Lewis, *Bangladesh*, 9.

B. THESIS STATEMENT

This thesis contends that microcredit can alleviate symptoms of poverty. Research to support this claim includes how microcredit programs augment income levels for poor rural households while in the non-economic spillover effects of microcredit will be analyzed.

Microfinance is a significant research topic for policy makers and academics to consider, as the burgeoning microcredit market is helping to reimagine ways financial tools and instruments can couple with social and development programs in the developing world. An overview of the origins of microfinance demonstrates that the poor lack sufficient opportunity to raise themselves out of poverty, and advocates such as Dr. Muhammad Yunus believe that microcredit programs offer hope to those poor.

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II. LITERATURE REVIEW

This chapter reviews current literature on microfinance as a form of poverty alleviation. The focus is to draw attention to the breadth of views regarding how microfinance can and cannot be used—for example, is it a development tool, or is it a way to reform social constructs?—and, if these hold true, to determine if there is a link to poverty reduction.

A. DEFINING “MICROFINANCING”

Addressing the outcomes of microfinance on poverty reduction requires first defining what it is. One widely used definition suggests that microfinance is made of “small scale transactions in credit savings designed to meet the needs of small and medium-scale producers and businesses.”⁶ Then there are structural mechanisms to consider, in which the main characteristics of microloan schemes can vary. The course of this thesis will also delve beyond this definition, addressing several other attributes of microcredit—such as that it is a tool that allows for savings and insurance, it is a form of empowerment, and borrowers are taught valuable skills and knowledge.

Thus, microfinance was intended as a means to allow the poor to help themselves, with particular focus on financial credit services. One reason the poor living in Bangladesh have not been able to secure loans has been that they do not have acceptable collateral, as well as for the fact that the costs associated with vetting poor loan candidates (who often live in the rural outskirts) are too high to make lending to the poor profitable.⁷ Thus, since the 1970s, the poor in Bangladesh gained greater access to credit because of the creation of microfinance programs.⁸

⁶ Shahidur R. Khandker, “Microfinance and Poverty: Evidence Using Panel Data from Bangladesh,” *The World Bank Economic Review* 19 no. 2 (Oxford University Press, 2005): 263, <http://www.jstor.org/stable/40282216>.

⁷ Lewis, *Bangladesh*, 115.

⁸ Niels Hermes and Robert Lensink, “The Empirics of Microfinance: What Do We Know?” *The Economic Journal* 117 no. 517 (2007), F1, <http://www.jstor.org/stable/4625473>.

Poverty, or those living within poverty, is defined as those living with incomes of less than one dollar a day.⁹ To begin addressing what poverty is, I address Banerjee's and Duflo's discussion of poverty, as some critics believe poverty cannot be reduced because of the notion of the "poverty trap." Economists such as Jeff Sachs argue that "the poor are poor because they are poor."¹⁰ He contends that this may be circumstantial, such as being landlocked geographically, or because of bad luck. As a response to these conditions, he states the poor need a "big push" (economically speaking) that will enable them towards a more profitable future.¹¹ However, within the literature of poverty traps, other critics such as William Easterly believe poor individuals need to search for their own solutions, while aid is only a corrupting influence. In addition, the free markets and incentives will compel the poor to be creative in solving their problems.¹² He further cites the phenomenon of poor countries becoming rich and vice versa. Thus, if the conditions of poverty can be altered, then the notion of a poverty trap is not feasible.¹³ Microfinance, then, is a concept that may bridge these two schools of thought.

There are a handful of possible causal factors that contribute to microfinance lowering levels of poverty; the goal of this thesis is to explore which mechanisms of microfinance institutions affect different elements of poverty reduction outcomes. A great deal has been written about this topic and this thesis synthesizes state of the art literature, applying it specifically to Bangladesh to assess Bangladesh's experience with microlending. For example, Authors Abhijit Banerjee and Esther Duflo discuss what microfinance is in order to demonstrate the parameters of how, and under what circumstances, microlending programs can be used to facilitate poverty reduction. To do this, they examine the nature of microfinance, both its different applications and intentions. In addition, the authors give examples of saving behavior to explain

⁹ Ibid., 462.

¹⁰ Abhijit Banerjee and Esther Duflo, *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty* (New York: Public Affairs, 2011) 9.

¹¹ Banerjee and Duflo, *Poor Economics*, 9.

¹² Ibid., 4.

¹³ Ibid., 10.

mechanisms that allow certain borrowers to be successful while other borrowers are not able to utilize lending programs.¹⁴

Banerjee and his collaborators address the conditions under which microloans are effective. One theory Banerjee suggests is the fact that microloans are effective in facilitating increased income for small business owners who already have income, as the additional loan funding contributes to the ability to build assets.¹⁵ However, this conflicts with Lewis's discussion that only the core poor benefit from microcredit, and there is insignificant change for those who had income generation capacity.¹⁶ Another strand of thought includes that targeting of participants contributes to levels of success. For example, a third theory around microfinance states that targeting women leads to higher success rates than solely targeting men.

Research on these questions includes a number of quantitative studies, which this thesis utilizes. Economists Shahidur Khandker and M. Jahangir Chowdhury point to the income creating aspects of microloan programs; further illustrating the impact of increased income on consumption and household well-being. Khandker contends that microloans, as forms of poverty interventions, help the poor access self-employment opportunities and thus generate increased levels of income.¹⁷ Meanwhile, Armendariz and Morduch demonstrate that the poor are motivated to invest borrowed credit in their business, growing the potential that microfinance institutions (MFIs) offer.¹⁸

Further findings illustrate the effect of microfinance programs in creating an interdependent network of responsibility, which indirectly has a push and pull effect on

¹⁴ Banerjee and Duflo, *Poor Economics*, 9.

¹⁵ Abhijit Banerjee et al., *The Miracle of Microfinance? Evidence from a Randomized Evaluation* (Cambridge: National Bureau of Economic Research, 2013), <http://economics.mit.edu/files/5993>.

¹⁶ Lewis, *Bangladesh*, 115.

¹⁷ Khandker, "Microfinance and Poverty," 266; M. Jahangir Alam Chowdhury, "Poverty and Microfinance: An Investigation into the Role of Microcredit in Reducing the Poverty Level of borrowing Households in Bangladesh and the Philippines," *The Whitehead Journal of Diplomacy and International Relations* (2008) 28–30, 34.

¹⁸ Beatriz Armendariz and Jonathan Morduch, *The Economics of Microfinance*, Second Edition (Cambridge: The MIT Press, 2010) 145.

borrowers.¹⁹ The outcome of this effect is increased participation that facilitates repayment and therefore leads to increased access to credit and services, which may facilitate poverty reduction. However, there are academics, including Beatriz Armendariz and Jonathan Morduch, who question the role of microcredit as being limited to an intervention tool: they believe it can serve a broader role towards economic development. They contend that small scale lending reduces the inefficiency in production and consumption that are the result of imperfect credit markets. By reviewing how the poor save and build-up assets, the authors examine how microfinance organizations contradict institutional deficiencies. In addition, the authors address challenges that microfinance groups face with regards to delivering financial products at costs that the poor and providers can both afford. In turn, these challenges have been addressed by innovative payment schemes, which will be addressed in Chapter III.

Furthermore, Armendariz and Morduch believe microfinance is successful in reducing poverty because of two main features. First, microfinance is an innovative tool within the credit market. Secondly, microfinance serves as a development agenda.²⁰ This research aligns with the views of Sayantan Bera, who contends that the lending products have transitioned from credit intervention towards “livelihood finance.” He asserts that it is this transitional process that has allowed microfinance to be able to adapt and thus lend to positive effects for the poor.²¹

B. INNOVATION

The innovation aspect of Armendariz and Morduch’s discussion is relevant to this thesis because it focuses on how microfinance has overcome market failures in order to reach the poor. While state-run banks have failed in providing credit access to the poor—which in effect has exacerbated poverty levels—microfinance has created innovative ways to reduce costs associated with lending. Because these costs have been lowered,

¹⁹ Shahidur Khandker, Review of *The Economics of Microfinance: Economic Development and Cultural Change* 56, no.2 (University of Chicago Press, 2008) doi:10.1086/523604.

²⁰ Khandker, Review of *The Economics of Microfinance*, 484.

²¹ Sayantan Bera, “Programme Design and Impact Assessments: ‘Success’ of Microfinance in Perspective,” *Economic and Political Weekly* 43, no. 32 (2008): 77, <http://www.jstor.org/stable/40277833>.

microfinance has catered to the needs of the poor to a greater extent than formal banks. In addition, savings and insurance programs offered to the poor through microfinance programs are an outcome of this innovation. This innovation then, enables microcredit lenders to reach and help more people living in poverty, and nuances tied to changing shifting behavior may set the stage for long-term poverty reduction.²² Bera affirms that microfinance serves those with limited or no assets, and it also serves the income poor. In addition, this target market is made of informal networks that rely on social ties and cultural proximity. As a consequence, there is less likelihood of issues with information and enforcement. This then culminates into a joint liability structure, which relies on social trust. The Grameen Bank attributes its successful repayment record on the fact that this self-selection process bypasses adverse selection problems. In addition, this selection process results in peer monitoring that does away with moral hazard issues.²³

Supporting the notion that microcredit is successful because it is innovative are studies that reflect upon the conception that, by fostering a creative market for lending tools, commercial banks too are now entering the microlending sector. Hermes and Lensink believe this entry will generate a more competitive lending market. They also argue, while on one hand, that this will lead to reduced lending to the poor, it may mean more income levels can participate in lending schemes. In turn, this may improve overall financial sustenance.²⁴ To support these claims, they associate the availability of credit access to increased incomes in Bangladesh, which allows for a rise in investments that will allow for greater income potential.²⁵

The joint liability feature of microfinance is another innovative design that allows small scale lending to be successful in reducing poverty. However, some analysts believe the effectiveness of programs goes beyond just this element. Bera believes the resultant incentive mechanism that is derived from joint liability is what drives success, not the

²² Ibid., 485.

²³ Bera, "Programme Design and Impact Assessments," 79.

²⁴ Hermes and Lensink, "Impact of Microfinance," 462.

²⁵ Ibid., 463.

joint liability feature alone.²⁶ In order to verify this claim, Bera suggests using impact evaluation methodologies. He narrows his assessment to the relationship between high repayment rates and outcomes.²⁷ Niels Hermes and Robert Lensink also address the incentive mechanism of joint liability. They contend that incentive mechanisms are social outcomes that arise out of joint lending. When a group of borrowers are jointly responsible for repayment of a loan, individuals are inclined to monitor one another. If a person is suspected of being a high-risk borrower, they are kicked out of the group, which has direct communal consequences. Individuals' desire to avoid the shaming element of this phenomenon is what contributes to microfinance being an effective program.²⁸

Bera also discusses incentive structures. In practice, microfinance lenders employ an array of incentive mechanisms that are designed to ensure repayment and sustainability. These include "sequential financing," "progressive lending," "contingent renewal," and "regular repayment schedules." An ability of these features to help facilitate poverty reduction is the fact that they can be applied in non-homogenous urban populations as well as rural communities.²⁹

C. DEVELOPMENT AGENDA

Authors Armendariz and Morduch further contend that even more significant than the financial spectrum of microfinance to reduce poverty is its development agenda.³⁰ While formal banks do not reach the poor, they certainly do not reach the core poor, moderately poor, or poor women. Microfinance, thus, has a development aspect, because its targeting mechanism allows for prospective borrowers to be more responsible in how they utilize credit and repay loans. In turn, the joint lending mechanism activates good behavior, especially within female-based borrowing groups, as they are more vulnerable or susceptible to social pressures.³¹ Another way microfinance resonates with the poor to

²⁶ Bera, "Programme Design and Impact Assessments," 77.

²⁷ Ibid., 79.

²⁸ Hermes and Lensink, "Impact of Microfinance," 463.

²⁹ Bera, "Programme Design and Impact Assessments," 80.

³⁰ Khandker, Review of *The Economics of Microfinance*, 485.

³¹ Bera, "Programme Design and Impact Assessments," 79.

contribute to development is the way in which it inculcates social trust. Under this context, because joint lending is an explicit communal process, it has become an instrument for building social capital. This is possible because of the creation of horizontal networks, where forms of reciprocity are shared; further enabling individuals to trust one another. As a consequence, this trust element becomes embedded into the village network. In order to maintain this trust, the structure of microfinance involves participants having to interact repeatedly with their associates, developing social trust and thereby replacing individual norms with shared norms.³² Armendariz and Morduch further allude to microfinance as a tool that mobilizes savings and serves as an insurance against income and consumption risks. Goals they address out of this include lowering vulnerability, hedging risk, and accomplishing greater levels of efficiency. These attributes, then, are ways poverty reduction can be enhanced through microfinance.³³

Other authors also consider the development aspect of microfinance within poor households. Pitt and Khandker consider the effects of group-based credit programs on labor supply and schooling.³⁴ The study finds that credit programs have a wider effect on the behavior of women, who—through increased empowerment- are more likely to spend on investments related to their household (such as education) than are men. They also agree with the notion that social pressure establishes conditions conducive for poverty reduction.³⁵ Furthermore, after studying consumption habits, the authors further agree women are better suited to partake in microlending programs than are men.³⁶

An attempt can be made to correlate this suitability to the role of empowerment, which Dr. Abdul Basher undertakes in his study of the spillover effects of microcredit. Basher articulates the possibility that microcredit programs have effect on non-economic activities, thereby having a spillover effect on aspects that may contribute to poverty

³² Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize” 533.

³³ Khandker, Review of *The Economics of Microfinance*, 485.

³⁴ Mark Pitt and Shahidur R. Khandker, “The Impact of Group-based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter?” *Journal of Political Economy* 106, no. 5 (University of Chicago Press, 1998): 958, doi:10.1086/250037.

³⁵ Ibid., 962.

³⁶ Ibid., 958.

reduction. For example, the paper studies the phenomenon of participants of lending programs having reduced rates of fertility. As a result, it may be assessed that smaller family sizes reduce the economic footprint of a household. Basher also acknowledges the empowerment of women through microcredit programs and he addresses the gap in literature that describes *how* female borrowers are empowered. It is common for analysts to describe such achievement on the basis of changing economic behavior, such as the ability to spend more on food. Instead, Basher seeks to study empowerment by means of non-economic activities, such as the ability to contest social values.

Other analysts have also found that gender-based targeting of microloan programs has a positive influence on poverty reduction. For example, Khandker reports of instances of women who acquire small loans experience improved levels of household and individual welfare, referring to the occurrence of “consumption smoothing” leading to increased quality of life.³⁷

Meanwhile, Khandker offers a critique to the effects of income generation, stating that even if its effects on household income are positive, because microfinance only reaches about a quarter of the population within Bangladesh, only about 1% of the population will be lifted out of poverty.³⁸ To this point, authors Armendariz and Morduch ultimately find that available research does not lend to the fact that microfinance can provide substantial gains for borrowers. However, the Grameen bank, along with other World Bank sponsored programs, would disagree. Their findings demonstrate that microfinance can serve as a valuable tool in decreasing poverty rates, empowering women, and facilitating other features of development.³⁹

Oksan Bayulgen offers yet another dimension, reflecting on ways in which microfinance contributes to activating the poor and thereby empowers them towards action that helps them help themselves out of poverty. He argues that the link between microcredit and empowerment of the poor is self-efficacy and social capital. He accepts

³⁷ Khandker, “Microfinance and Poverty,” 276.

³⁸ Ibid., 266.

³⁹ Ibid.

that these are fostered through the lending structure of group-based programs, where borrowers share the responsibility of loan repayment. Along this line, then, capital is shown to be used more effectively, when applied towards education and improving human capacity.⁴⁰ While there are disagreements about the actual outcome of microfinancing on societal constructs, what is generally believed is that microfinance services can lead to individual instances of empowerment. According to Bayulgen, this is possible by fostering the development of entrepreneurial programs, which in effect can lead to increased income that remains within the control of women. Another positive outcome is that such increased income, then, will have spill-over effects that can include increased health, nutrition, higher rates of literacy, better housing conditions and lower rates of mortality of women and their children.

Bayulgen's discussion supports the notion that microfinance is a development agenda which creates the conditions for empowerment. First, he argues that microfinance allows for perceived self-efficacy, which is defined as the "belief in one's own efforts to control desired outcomes, as opposed to luck or influence of others."⁴¹ Secondly, political empowerment is facilitated by the ability of microfinance to lead to public good delivery within society. This notion aligns with Dean Karlan and Jacob Appel's view that for microcredit systems to work effectively, social capital and communal interactions are required. In particular, group lending dynamics benefit from these mechanisms.⁴² Thus, because of its ability to deliver public goods, microfinance is able to contribute to forms of poverty reduction.

D. CHALLENGES

Other authors doubt the ability of microcredit to significantly curtail poverty. While others have already cited that banks deliberately do not service the poorest, some critics further argue that the poorest deliberately choose not to partake in microfinance programs. These reasons include that the poor lack confidence, or they deem the loans to

⁴⁰ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize," 531.

⁴¹ Ibid., 533.

⁴² Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize," 534; Dean Karlan and Jacob Appel, *More than Good Intentions* (New York: Penguin Group, 2011), 107, 119, 138.

be high-risk. In this view, the core poor—the poorest of the poor—are too risk averse to be able to invest in their future. In other instances, other members of their respective borrowing community perceive the core poor as high risk. In other instances, staff of lending institutions may choose to exclude the core poor for the same reason.⁴³

There are challenges that microfinance structures face as well, which limit how well it can be implemented to reduce poverty. Kalpana points to the instance of poor villages reverting to self-protection measures of evicting members who are close to defaulting. Creating a perception of “bad-risks” within a village is an outcome that hinders microfinance programs to work effectively.⁴⁴ Kalpana further demonstrates that this is due to the structural mechanisms of loan programs, of which the hard repayment deadlines do not take into consideration stress events that limit the ability of borrowers to pay loans on time.⁴⁵

Similarly, Lewis raises concerns that MFIs, as large as they have become, are running parallel efforts to the government of Bangladesh, thereby weakening the state’s ability to serve the poor. He also points to the fact that individuals are not receiving loans at every poverty level; and among those who are, only those categorized as “extremely poor” are able to generate increased levels of income, not the “moderately poor.”⁴⁶ The question of whether this intervention can reduce rates of growth, and thereby escalate rates of poverty⁴⁷ is an area of future research in its own right.

E. CHAPTER SUMMARY

Advocates of microfinance believe that the income generation and savings aspect of microfinance can marginally alleviate poverty, while making it easier for the poor to endure income shocks. Furthermore, progressive payment functions augment the earning capacity over a period of time. In addition, the social aspects of microcredit programs

⁴³ Hermes and Lensink, “Impact of Microfinance,” 463.

⁴⁴ K. Kalpana, “Shifting Trajectories in Microfinance Discourse,” *Economic and Political Weekly* 40, no. 51 (2005):5403, <http://www.jstor.org/stable/4417553>.

⁴⁵ Ibid., 5401.

⁴⁶ Lewis, *Bangladesh*, 119.

⁴⁷ Ibid., 110.

complement economic reform—through links between increased household income, and increased education and healthcare access for children of borrowers. Meanwhile, innovative features such as joint lending help to build socially progressive environments, while offering women economic opportunity's that cater to their cultural environment. There are, however, risks tied to microlending, as—like commercial loans—they are a form of debt, and MFI programs are functioning independent of central regulation, at times duplicating Bangladesh's government's efforts.

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III. RESEARCH OVERVIEW AND HYPOTHESIS

This chapter briefly reviews significant arguments of microfinance that question its effectiveness at poverty alleviation. Meanwhile, the research design is explained in order to set boundaries as to how information was collected, while the arguments are then assessed in Chapter V to determine if microcredit is successful in mitigating poverty.

A. MICROFINANCE THEORY ASSESSMENT

This thesis considers three major implications about microfinance. The first assessment addresses Khandkar, Pitt and Chowdhury's argument that microcredit is effective in alleviating moderate poverty. In turn, another argument addressed is that only poor borrowers benefit, because they are going from "nothing to something." From this angle, it is examined if there are other beneficiaries of MFIs that exist beyond the core poor. Finally, the third argument addressed includes that pre-conceived conditions allow for microcredit to work most effectively, which includes targeting mechanisms. This possibility leads the thesis to consider how microloans are reaching women, and includes an assessment of whether women borrowing in comparison to men serves as a variable in household poverty reduction.

Gender based targeting is a variable relevant to consider because of inherent cultural and social dynamics that affect debt. Women tend to face greater constraints when selecting investments, and are more easily influenced by peer pressure. This dynamic, however, has meant that women are more likely to repay loans, leading the success of their loans to be more likely, and in turn, allowing women to borrow greater amounts. Moreover, when compared to men, the lifestyles of rural women are less mobile, which means the proximity they maintain within their communities makes monitoring easier. This lower rate of mobility also reduces instances of default, as fear of social sanction is more prevalent amongst women than men.⁴⁸

Relatedly, individual empowerment is analyzed with regards to financial empowerment as well as political empowerment. In addition, this research seeks to

⁴⁸ Bera, "Programme Design and Impact Assessments," 80.

establish if there is a relationship between microfinance borrowing, investing and savings. Because microfinance options have introduced flexible savings options, households are able to accumulate assets at a greater level. Not only that, but seasonal consumption needs are smoothed out, while larger expenditures are made possible and borrowers are able to protect themselves against shocks. In this way, the deposit feature of microfinance schemes makes poverty reduction possible, and is a feature that is arguably just as valuable as credit services.⁴⁹ Thus, the savings mechanism is a variable within microfinance that reduces risk, further lending to lower rates of poverty.

The individual empowerment assessment begins by considering the influence of microfinance on political economic development, and its impact on political empowerment. The World Bank defines empowerment as “the process of increasing the assets and capabilities of individuals or groups to make purposive choices and to transform those choices into desired actions and outcomes.”⁵⁰ Bayulgen has made the argument that microcredit can increase the level of political empowerment that is felt by borrowers; under the World Bank’s framework, he contends that political empowerment provides the poor with information to make political decisions along with the agency to act on this information. As a result, the politically empowered poor are more equipped to influence the course of their livelihoods, along with the communal decisions that affect their community.⁵¹

B. RESEARCH DESIGN

This research aims to deliver insight into microfinance mechanisms that contribute to poverty reduction in Bangladesh. To accomplish this, the research design is a single country case study of Bangladesh. In order to adjudicate among the competing hypotheses mentioned above, the research focuses on three major microfinance programs in Bangladesh: Grameen Bank, the Association for Social Advancement (ASA), and Bangladesh Rural Advancement Committee (BRAC). These groups have been selected

⁴⁹ Ibid., 80.

⁵⁰ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 532.

⁵¹ Ibid., 532.

because they are amongst the largest microcredit providers within Bangladesh.⁵² The success rates of these different programs vary, while the types of clients and means of targeting also vary. Thus, these programs will be treated as a whole, in order to allow impacts to be measured in a way that can determine if microfinance is a successful tool in poverty reduction.

In order to conduct a relevant survey, research was furnished using academic reports, journals and articles that have been published by leading scholars within the microcredit field. For this reason, the thesis especially considers research by current MIT Poverty Lab directors Abhijit Banerjee and Esther Duflow, and the work of Dean Karlan and Jacob Appel, who have conducted field reports on microfinance in Bangladesh, citing specific case studies within village environments. Their case studies are compared against quantitative panel data from World Bank analysts and economists to provide context for various theoretical explanations expressed in Chapter V.

In addition, the thesis draws from scholarly review of historical property rights to survey legacies that shaped Bangladesh's current economic position. The intent of drawing on those findings is to introduce how MFIs can play an intermediary role in addressing the needs of Bangladesh's poor. Factors of MFI influence that are examined include development indicators, such as literacy and infant mortality. In addition, this research seeks to establish intermediate mechanisms: for example, are levels of consumption smoothing linked to changes of objective or subjective poverty? Moreover, non-economic outcomes are measured by applying quantitative data that supports qualitative anecdotes.

C. CHAPTER SUMMARY

The section discussed which of the microfinance arguments are addressed in this thesis. The goal of the research analysis is to assess the overall outcomes of program participation in order to find how poverty rates can—if at all—be affected. In addition, mechanisms that help explain those outcomes are also addressed.

⁵² Lewis, *Bangladesh*, 110.

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IV. THE ECONOMIC IMPACT OF PRE-COLONIAL BRITISH INSTITUTIONS

Chapter IV of this thesis begins by explaining why Bangladesh is poor, building on legacies that have contributed to entrenching the nation into its current state of poverty. This background information is pertinent because it provides insight into how microfinance can be tailored to improve economic standing. Chapter V includes definitions of microfinance and draws a boundary of how poverty reduction is being measured. Chapter V is further comprised of a thorough survey of the literature on microfinance which lays out more fully how and why microfinance works or does not work to reduce poverty. This constitutes a survey of empirical outcomes of programs run by the three major MFI's in Bangladesh. Furthermore, causal relationships are discussed to highlight the conditions under which microfinance may be more productive. Chapter VI then highlights real-life qualitative examples in order to contextualize broader information about the development trajectory of other countries that are following in Bangladesh's footsteps through use of MFIs. Finally, Chapter VI takes stock of the findings of comparative research and evaluates which of the hypotheses appears most supported by the evidence, as well as assesses which facet of MFIs' operations appear most significant.

A. WHY BANGLADESH IS POOR TODAY

Chapter I introduced the level of poverty Bangladesh is facing, emphasizing the fact that half of its population lives below the World Bank's poverty threshold, while one-third of its population lives in extreme poverty. Illustrating the significance of the poverty level is the Economist Intelligence Unit's (EIU) ranking of Bangladesh as the 106th country, out of 160 other countries, in its "quality of life" index, making Bangladesh the lowest ranked South Asian country. The EIU arrived at this rank by taking into account Bangladesh's "income poverty, life expectancy, levels of corruption and the condition of the country's institutions."⁵³ This chapter, then, considers the

⁵³ Lewis, *Bangladesh*, 158.

symbiotic relationship between these factors and how they contribute to Bangladesh's poverty.

Contributing to Bangladesh's income poverty is the fact that Bangladesh's economy is based on an agrarian structure, employing roughly 60% of the labor force and making up almost 25% of the nation's GDP.⁵⁴ The agrarian population is significant for this study because 75% of Bangladesh's population lives in rural areas; with per-head income levels one of the lowest in the world, it is their poverty level that contributes to Bangladesh's poverty as a whole. Moreover, with regards to Bangladesh's institutions, village level institutions continue to play a significant role in the daily lives of the rural population, creating challenges for state institutions in reaching the poor.⁵⁵ This relationship between village institutions and Bengali citizens, however, highlights the capacity at which microfinance programs can fill the absence of the state's capacity in alleviating rural poverty levels.

In order to provide the contextual background against which to address poverty reduction through micro-finance initiatives in Bangladesh today, this chapter study looks at the causes of poverty and the unequal distribution of wealth in South Asia writ large. In addition, historical factors that have contributed to Bangladesh's corruption and its link to rural poverty levels—including land appropriation, productivity challenges, and resource extraction—are addressed. One key feature of this section illustrates Daniel Lewis's assertion that "land has been the key structural asset that has...defined social class" within Bangladesh; further serving as a key reason why those without land remain poor.⁵⁶ In order to address factors contributing to Bangladesh's poverty, three key time periods are examined. The first examination includes the time period during the colonial rule of the British Raj, the second time frame considers Bangladesh during its existence as East Pakistan. The last background section then examines Bangladesh post-independence.

⁵⁴ Ibid., 21.

⁵⁵ Ibid.

⁵⁶ Ibid., 14.

B. INTRODUCING LANDHOLDING POLICIES AND RESOURCE EXTRACTION IN BANGLADESH

Abhijit Banerjee and Lakshmi Iyer address the conditions that set poverty trends in motion, arguing that historical institutions shaped long-term effects on the economic performance of Bangladesh. The authors draw a correlation between the existence of particular historical property rights under the nineteenth century British Raj, and modern economic and development outcomes.⁵⁷ Substantiating this connection to Bangladesh's current economy, is Lewis' finding that "by the 1980s, landholding census data indicated that at least half of Bangladesh's rural households were now identified as "functionally landless," reflecting the loss of landholdings as a result of forced sale or because of land fragmentation.⁵⁸ Banerjee and Iyer's study finds that historically landlord-held areas have experienced lower distribution rates of public goods as well as reduced levels of agricultural productivity, leading to instances of increased poverty. Furthermore, the authors find that the existence of particular institutions within the Bengal Presidency of India led to explicit administrative policy choices, which have indirectly affected present day economic outcomes of pre-colonial states.⁵⁹ The following section will consider how these outcomes set the conditions for poverty within Bangladesh today. By understanding the causes of poverty, we can then better determine how to facilitate economic development through microfinance.

Banerjee and Iyer measure how tenure systems within pre-colonial India and colonial-India differ across districts in order to demonstrate the correlation between property rights and the lack of economic and public development within colonial India. They find that there is a measurable relationship between economic performance and development of a region, and the type of tenure system used during the regions colonial rule as compared to pre-colonial rule.⁶⁰ This examination is relevant because it addresses

⁵⁷ Abhijit Banerjee and Lakshmi Iyer, "History, Institutions and Economic Performance: The Legacy of Colonial Land Tenure Systems in India," Massachusetts Institute of Technology Department of Economics Working Paper Series, 02-27 (June 2002): 3, <http://economics.mit.edu/files/511>.

⁵⁸ Lewis, *Bangladesh*, 15.

⁵⁹ Banerjee and Iyer, "History, Institutions and Economic Performance," i.

⁶⁰ *Ibid.*, 5.

how lack of economic development in modern Bangladesh is an inheritance of colonial rule. Thus, in order to convey Banerjee and Iyer's findings, the following sections analyze outcomes of pre-colonial land policy in comparison with colonial land policy.⁶¹

In addition to land distribution policies, Bangladesh's poverty can also be tied to legacies of resource extraction. To support this claim, Hamza Alavi argues that Britain's plundering and interference of India's medieval⁶² cotton industry devastated India's long term economic prospects, while manifesting into a one-sided dependence on an "import substitution strategy" of industrialization.⁶³ In addition, Hamza Alavi and S. Zaidi argue that commercialization of India's agriculture—an outcome stemming from Britain's desire to monopolize India's cotton market—also contributed to destabilizing India's economic structure.⁶⁴ The outcome of these practices was the extraction of resources, disruption of India as the region's premier supplier of cotton, and destruction of India's self-sufficiency.⁶⁵ Land-holding policies and resource extraction are not mutually exclusive toward contributing to Bangladesh's poverty—both have shaped Bangladesh's economic prospects.

1. Background on Landholding Policies

The area that constitutes modern day Bangladesh was subject to British rule between 1757 and 1947 and formed part of Pakistan until Bangladeshi independence in 1971. The British colonial government secured significant amounts of revenue by extracting land tax throughout different regions. While in some instances, tax collection was a continuation of pre-colonial practices, other areas were introduced to this concept during the Raj.⁶⁶ Supplementing this process of the tax collection was industrialization of

⁶¹ Ibid., 5.

⁶² Hamza Alavi and John Harriss, *Sociology of "Developing Societies" South Asia* (New York: Monthly Review Press, 1989), 6.

⁶³ Ibid., 10.

⁶⁴ Alavi and Harriss, *Sociology of "Developing Societies" South Asia*, 13; S. Akbar Zaidi, *Issues in Pakistan's Economy: A Political Economy Perspective*, Third ed. (Karachi: Oxford University Press, 2015), 18.

⁶⁵ Ibid., 6–7.

⁶⁶ Banerjee and Iyer, "History, Institutions and Economic Performance" 4.

sectors that the Raj thought were profitable. Thus, the British regime began development campaigns in India through the English East India Company. While these trade networks led to the building of factories, the profits further enabled successful military campaigns. Consequently, battles during the 1700s included the capture of Bengal Presidency, which resulted in expanded political control of the Raj, and the expansion of Britain's institutions, which included its tax collection practices.⁶⁷

In these taxed areas, local landlords were made responsible for collecting payments from the peasantry. In systems that contrasted with this landlord-based system, such as individual-based systems, it was the British government that was responsible for extracting revenue from agricultural cultivators. Another type of system included the village-based system, where the entire community endured the burden of taxes.⁶⁸ Out of these models, it was the landlord-based system that institutionalized tax collection, fostering the regime's ability to expand in other administrative dimensions. By 1841, 60% of the British regimes revenue was collected through "land revenue systems" or "land tenure systems," both systems referring to the practice of collecting revenue from the peasant class. Those responsible for land tax were the implicit holders of the property rights of the respective land (also known as *zamindari*).⁶⁹

The landlord-based system led to a monopoly of economic and political power because this system distributed the wealth of Bangladesh away from the peasant class and into the hands of the zamindars.⁷⁰ Thus, the following section will focus on the zamindari landlord based system because it is a significant cause of poverty within Bangladesh.

2. Landlord-Based Systems of Tax Extraction

The landlord system was effective for the British in that it capitalized on the use of property right titles. In turn, these titles served as a vehicle that allowed the landlord-based system to effectively eliminate the need for the British administration to have

⁶⁷ Ibid., 6.

⁶⁸ Banerjee, and Iyer, "History, Institutions and Economic Performance," 4.

⁶⁹ Ibid., 7.

⁷⁰ Ibid., 26.

contact with the peasant class. For instance, in Bengal, landlords were made responsible for extracting taxes, and in some areas, the Colonial regime mandated the permanence of these revenue commitments, as evidenced by the “Permanent Settlement” act of 1793.⁷¹ However, there was flexibility in other areas, where temporary settlements were enacted. For these regions, “the revenue was fixed for a certain number of years, after which it was subject to revision.”⁷² In effect, the landlord-based system required less administrative oversight in present day Bangladesh. For this reason, investment in production and development of infrastructure seldom took place. This pattern continued, as the costs associated with making adjustments to the tax collection mechanism sustained the longevity of the landlord system.⁷³

The existence of landlord based systems led to a handful of economic outcomes. One such consequence was the creation of unequal distribution of wealth, which was the result of the absence of judiciary protection that set a ceiling to the amount landlords could extract from the cultivating class, thus landlords were ideally “position[ed] to appropriate most of the gains in productivity.”⁷⁴ Relatedly, colonial powers created laws that granted landlords judicial support in coercing payments in order to extract the maximum amount of rent from the peasant class.⁷⁵ With laws and historical extraction practices in their favor, landlords during the nineteenth century—a major period of increased economic productivity—grew wealthier while peasants stayed poor, causing the rate of inequality to increase.⁷⁶ Furthermore, this hierarchy of authority became entrenched by the fact that zamindari-owned land was very fertile, which led to the creation of rent significant enough to entrench a “landlord-tenant-laborer hierarchy.”⁷⁷

⁷¹ Banerjee and Iyer, “History, Institutions and Economic Performance,” 7; Ratna Ray and Rajat Ray, *Zamindars and Jotedars: A Study of Rural Politics in Bengal*, *Modern Asian Studies*, Vol. 9, No. 1 (Cambridge University Press, 1975): 82.

⁷² *Ibid.*, 7.

⁷³ Banerjee and Iyer, “History, Institutions and Economic Performance,” 9.

⁷⁴ *Ibid.*, 12.

⁷⁵ *Ibid.*, 13.

⁷⁶ *Ibid.*, 13.

⁷⁷ *Ibid.*, 12.

The historical distribution of wealth and power in present day Bangladesh is significant because it determined the size of the peasantry that could accumulate enough capital to be able to invest and further increase productivity. Meanwhile, the distribution of wealth created an imbalance between those who cultivated land for their own use, versus those who cultivated land for others. Under this context, the latter group experienced incentive problems, as ownership and gains belonged to another party. As a consequence, agricultural investment and productivity within this group declined. In turn, this outcome led to diverging interests between the elite and peasantry within Bangladesh, with the elites supporting political programs that safeguarded their land-holding rights while peasants focused on land reform.⁷⁸ Out of these opposing interests, peasant property became endangered because the poor felt their land would be expropriated, which discouraged them from investing in their land.⁷⁹ Thus, because peasant property rights were poorly protected, Bangladesh's peasants had lower rates of productivity, and experienced a decline in their economic performance.

The nature of political power during the British administration serves as another institutionalized element that affected economic outcomes in Bangladesh. In turn, the asymmetric balance of power between the landed elite and poor established an environment that weakened social trust. Moreover, with the zamindar and peasant interests misaligned, it is conceivable that the poor minimally concentrated their political support towards long-term platforms that offered public goods; and it is these goods—such as schools, electricity and running water—that would have allowed for advanced development of Bangladesh. Instead, the poor allied behind political promises of land reforms, as these platforms addressed more immediate concerns of the peasant population. The zamindari structure, however, presented a series of administrative layers that prevented the grievances of the poor from being heard by the British administration. Thus, the landed elite did not augment living conditions within rural villages, as their

⁷⁸ Ibid., 14.

⁷⁹ Banerjee and Iyer, "History, Institutions and Economic Performance," 14.

own stakes were limited. In this way, the institutionalized hierarchy of political power prevented development within Bangladesh.⁸⁰

By comparison, non-landlord areas did experience levels of development. This can be explained by the fact that—unlike the fixed revenue commitments of the landlord based system found in many parts Bangladesh—the British administration could raise rents in non-landlord areas, thus providing an incentive to ensure productivity. For this reason, the state established “irrigation, railways, schools and other infrastructure. [In] this context...almost all canals constructed by the British were in non-landlord areas.”⁸¹

This assessment is supported by empirical data collected by Banerjee and Iyer, who find that between 1891–1946, “while non-landlord controlled Madras and Punjab showed the greatest increase” of agricultural investment and productivity, the landlord based system of the Bengal Presidency experienced a decline in gross agricultural output.⁸² Correlating to this study, Punjab also experienced increased government sponsored development, resulting in an expansion of irrigated areas.⁸³ The institutionalized land based systems, then, led to particular economic outcomes, with areas that had greater amounts of landlord control effectively having less productivity, which inherently resulted in a relative decline in development. On the other hand, in areas where the British administration felt they could extract greater rents, (non-landlord based systems) peasants were more productive and therefore successful. Over time, these differences persisted, even after the landlord class was abolished in Bangladesh.⁸⁴

Further borrowing from studies conducted by Banerjee and Iyer, they find that landlord areas with pre-colonial roots have had less investment in human capital than non-landlord areas. This trend has continued past the end of colonial rule, with empirical data showing that even in 1981, 21% of landlord areas still had fewer primary schools, “while the gap in middle school and high school availability are 60% and 43%

⁸⁰ Ibid., 14.

⁸¹ Ibid., 15.

⁸² Banerjee and Iyer, “History, Institutions and Economic Performance,” 18.

⁸³ Ibid., 19.

⁸⁴ Ibid., 3, 23.

respectively.”⁸⁵ Meanwhile, while less than 2% of all villages have direct access to primary health facilities, the presence of such centers in non-landlord area is 37% higher than landlord areas.⁸⁶

In addition, these differences have translated into a lack of human capital accumulation within landlord or former landlord-based systems. The same study finds that literacy rates are between 5 to 16 percentage points higher in non-landlord areas. The economic and health outcomes in these areas can also be considered under the context of infant mortality rates: the study demonstrated that landlord system areas have 40–70% greater rates of infant mortality, indicating a relationship between institutionalized property rights and development indicators.⁸⁷

In their conclusion, Banerjee and Iyer contend that, above the incentive structure of the state and inequity with regards to private investment, it was the political environment that played the most significant role towards shaping current outcomes of Bangladesh. They suggest policy—as demonstrated earlier with regards to political platforms that centered on land reform—as drivers of the conditions that have allowed for the lack of development of infrastructure, absence of public goods, and the unavailability of health facilities.⁸⁸ In turn, the democratic process within Bangladesh has continued to reflect a higher demand for redistribution of land and less attention has been paid to the delivery of public goods.⁸⁹ Bangladesh’s history has articulated this political character in the example of class conflict in West Bengal, where landlord areas have experienced statistically higher incidents of crime tied to class conflict.⁹⁰

Land tax systems under the British were also responsible for commercializing India’s agricultural sector, a phenomenon that led to multiple negative repercussions. These outcomes included a decline in self-sufficiency, loss of income of the poor,

⁸⁵ Ibid., 23.

⁸⁶ Ibid., 23.

⁸⁷ Ibid., 23.

⁸⁸ Banerjee and Iyer, “History, Institutions and Economic Performance,” 24.

⁸⁹ Ibid., 25, 26.

⁹⁰ Ibid., 25.

increased levels of rural debt, and loss of land. This next section then, will examine the British-led policies that led to these outcomes.

C. COMMERCIALIZATION OF INDIA'S MARKETS: ADMINISTRATIVE FAILURES

Upon implementation of its land tenure system, the British also introduced the concept of commercial agriculture and monetary tax, which had to be paid regularly and on-time. The obligation of the tax required producers to relinquish their harvest, which was initially intended for village-wide use. To make payments on time, producers sold their harvest in the market. This process led to the emergence of a commercial agricultural market, devastating the self-sufficiency of villages as well as interfering with cropping patterns.⁹¹

When revenue from commercial sales fell short of the tax obligation, landowning peasants sought loans from money-lenders, while others were forced to sell their land. If payment was not made, the British installed a civil system that ensured the forced extraction of the land.⁹² Stemming from the commercialization of agriculture, this trend entailed the services of both zamindars and *jotedars*.⁹³ While the role of zamindars has been addressed, the function of jotedars is also relevant towards understanding Bangladesh's socio-economic make-up

Jotedars were those within the village community that owned land, but also lent-out grain or money to peasants within the community. These well-to-do villagers developed a rural credit mechanism in which small farmers became "more indebted than the whole value of their stock."⁹⁴ In turn, borrowing peasants became beholden to the jotedars until (or, if at all) their loans were paid. This debt-based relationship fueled the political and economic power of jotedars; however, it was the commercialization of the agricultural industry that entrenched the indebted croppers and peasants into poverty.

⁹¹ Zaidi, *Issues in Pakistan's Economy*, 18.

⁹² Ibid., 18.

⁹³ Ibid., 18.

⁹⁴ Ray and Ray, *Zamindars and Jotedars*, 84.

Poor farmers who were unable to transport their goods to the commercial market were forced to instantly sell their produce at first harvest, taking the lowest price of the year. On the other hand, the buyers were often the jotedars, who had means of storage and transportation, and thus were able to wait for prices to increase before selling at a higher rate. This pattern of agricultural trade led to significant losses for the poor.⁹⁵ In these ways, British commercialization of agriculture and their tax policies led to increased rates of poverty in Bangladesh.

Another administrative failure that contributed to Bangladesh's poverty was Britain's ration policy during the great famine of 1943. Within the framework of World War II, the blockage of rice imports heading from Japanese occupied Burma worsened as the Raj diverted food supplies away from the countryside of Bengal. Instead, grain and food provisions were channeled to the city population and military troops stationed in Calcutta.⁹⁶ Furthermore, when the Raj did decide to divert food to Bengal, it was too late into the year, which led to food price increases that the rural population could not afford.⁹⁷ This lack of provision further induced hardship under the famine; in turn, these instances of divestment led to a decline of rural wages, leading many into destitution.⁹⁸ Consequently, the combination of poor policy and man-made famine⁹⁹ deprived rural Bangladesh, further contributing to its historical poverty levels.¹⁰⁰

D. COLONIAL RESOURCE EXTRACTION

Another historical legacy that has contributed to Bangladesh's current poverty level is the level of resource extraction the nation has experienced, starting with the British Raj and continuing under West Pakistan. Centuries before the colonization of India, medieval India enjoyed a thriving textile industry, which supplied cotton to the

⁹⁵ Ibid., 84–85.

⁹⁶ Barbara D. Metcalf and Thomas R. Metcalf, *A Concise History of India* (Cambridge: Cambridge University Press, 2002) 209.

⁹⁷ Amartya Sen and Satyajit Ray, "The Bengal Famine of 1943," Poor Economics, accessed June 7, 2016, http://www.pooreconomics.com/sites/default/files/14.73_Food_Lecture4.pdf.

⁹⁸ Sen and Ray, "The Bengal Famine of 1943."

⁹⁹ Ibid.

¹⁰⁰ Metcalf and Metcalf, *A Concise History of India*, 209.

Middle East, Africa and the Far East.¹⁰¹ In turn, this demand for Indian cotton resulted in the expansion of Indian textile production, becoming one of the colony's foremost commercial enterprises.¹⁰²

The British entered into the cotton manufacturing market only after India had established it; however, with their entry, the British also inculcated a practice of import substitution that mired India's long-term prospect. Once Indian imports began flooding Britain, the empire tried to industrialize production of cotton in order to develop its own capital good industries. There were two facets to their strategy: first British manufacturers attempted to improve their spinning technology in order to keep up with the quality and price of textiles made in India. Despite attempts to augment their spinning technology, the British were not successful in matching India's quality or price.¹⁰³ Thus, to counter India's lower prices, England imposed increasingly higher tariffs on Indian textiles.¹⁰⁴ By 1813, Indian imports into England—still priced competitively and better in quality—had import duties of 85 per cent. In turn, these import tariffs hurt foreign demand for Indian cotton.¹⁰⁵ Had the progressive tariffs not been applied, Indian textile manufacturers may have been able to compete with Britain into the 1820s, without the need of technological advancements.¹⁰⁶ Likewise, by the time Britain further enhanced its weaving machinery in the 1840s, India had lost the resources and market share that would have allowed it to compete; in turn, India's textile industry plummeted.¹⁰⁷

Other factors also devastated India's textile industry. While the East India Company exploited India's trade network, the advent of the Napoleonic Wars led to the closure of European ports, making entry of Indian textiles close to impossible. The closures adversely affected India because the colony had become dependent upon the

¹⁰¹ Alavi and Harriss, *Sociology of "Developing Societies" South Asia*, 6–8.

¹⁰² *Ibid.*, 8.

¹⁰³ *Ibid.*, 10–11.

¹⁰⁴ *Ibid.*, 11.

¹⁰⁵ *Ibid.*

¹⁰⁶ Indrajit Ray, "Identifying the Woes of the Cotton Industry in Bengal: Tales of the Nineteenth Century," *The Economic History Review*, New Series, 62, no. 4 (November 2009): 889.

¹⁰⁷ *Ibid.*, 889.

European market, with 85% of its textile exports sent into Britain (in turn, Britain profited by re-exporting to Europe).¹⁰⁸

Another way in which the textile industry suffered is tied to the land policies discussed above. The extraction of cotton revenue by the British, along with their extractive appropriation of land revenue, affected domestic demand for India's main industry. While the activities of the East India Company and Raj administration led to an accrual of wealth, this wealth was redistributed abroad. Resultantly, resources belonging to local rural communities diminished, impoverishing Indian society. The cumulative effects of extraction and tax appropriation effectively led to a decline of domestic demand, while foreign demand also collapsed as a result of rising prices and the wars.¹⁰⁹

Tied to Britain's appetite for cotton is the ultimate role commercialization of India's textile sector played in shaping Bangladesh's current economy. Under colonial rule, India's initial ability to export cotton led to its growing importance in the empire's economy. This drove the process of altering agricultural crops to cotton, effectively changing cropping patterns and leading to a "shift away from subsistence production," reducing India's self-sufficiency.¹¹⁰ In addition, sharecroppers were brought in from elsewhere to work these fields, further stressing rural resources and the labor market.¹¹¹

A major push for this process came from the American Civil War, which motivated the colonial regime to develop schemes that cultivated, transported and exported cotton. These requirements resulted in the redistribution of Bengal's rural labor, increasing the number of landless laborers, while enhancing exploitative measures taken against sharecropping peasants. This cotton based colonial economy ultimately subjugated India's countryside labor; to cement this subordination, the British regime created policy that privileged the zamindars with the power to extract tax payments. In

¹⁰⁸ Alavi and Harriss, *Sociology of "Developing Societies,"* 9–11.

¹⁰⁹ Ibid.

¹¹⁰ Ibid., 13–14.

¹¹¹ Ibid., 13.

this manner, the zamindari served as a means to entrench extractive elements of the commercial process.¹¹²

E. ECONOMIC CHALLENGES BEFORE AND AFTER INDEPENDENCE

Upon its inception, Bangladesh had suffered both political and economic alienation under West Pakistan.¹¹³ The causes through which this occurred was based on ethnic fragmentation, lack of political and military representation, as well as long term resource extraction. In order to further explain why Bangladesh is poor today, it is necessary to consider how these post partition dynamics contributed to a legacy of poverty within Bangladesh.

After India received its independence from the British, the state that became West and East Pakistan inherited a weak central government. The instability of the era led to military takeovers of the state's administrative institutions. Of significance for East Pakistan (now Bangladesh), was the ascent of General Ayub Khan and his army. Under Ayub Khan's 1960s authoritarian regime, the Bengali economic trajectory was significantly affected because of the way in which political establishments were set up. To begin, Bengalis were under-represented in both the army and bureaucracy.¹¹⁴ In effect, this meant that Bengal's interests were represented only in the margins, if at all. This also meant that awareness of Bengal's poverty was undermined at a time when development agencies were being established. During this period, though the regime was successful in setting up development projects across Pakistan, the programs were asymmetric in their distribution and East Pakistan was continuously neglected.¹¹⁵ Table 1 demonstrates the level of disparity of development between the two sides of Pakistan:

¹¹² Ibid., 13–14.

¹¹³ Ian Talbot, *Pakistan: A New History* (Oxford: Oxford University Press, 2015) 80.

¹¹⁴ Talbot, *Pakistan: A New History*, 81.

¹¹⁵ Talbot, *Pakistan: A New History*, 82.

Table 1. Level of Development Disparity within Pakistan in the 1960s.¹¹⁶

Year	Spending on West Pakistan (in millions of Pakistani rupees)	Spending on East Pakistan (in millions of Pakistani rupees)	Amount spent on East as percentage of West
1950–55	11,290	5,240	46.4
1955–60	16,550	5,240	31.7
1960–65	33,550	14,040	41.8
1965–70	51,950	21,410	41.2
Total	113,340	45,930	40.5
Source: Reports of the Advisory Panels for the Fourth Five Year Plan 1970–75, Vol. I, published by the planning commission of Pakistan.			

The data in Table 1 reflects deliberate neglect of East Pakistan, a notion supported by the fact that, while East Pakistan housed 55–60% of Pakistan’s total population,¹¹⁷ East Pakistan’s share of the Central governments development budget was as low as 20%.¹¹⁸ The reasons that led to this asymmetric allocation of development funding are addressed next. During the Ayub regime, a climate of cultural bias facilitated the disparity of growth between West and East Pakistan.¹¹⁹ As such, funding networks privileged West Pakistan over those of East Pakistan, as investors either had no interest in East Pakistan, or were dissuaded based on pre-existing ethnic fragmentation. Thus, while there were a greater number of financial investments available to lead to rapid economic growth in the West, the East remained underdeveloped. Over a period of time, economic disparity between West and East Pakistan widened, and the two economies developed in parallel. This economic difference is illustrated in the Table 2, which highlights the overall decline in per capita income of East Pakistan during Ayub’s regime.¹²⁰

¹¹⁶ Ibrahim Ahmad, “How did the Pakistani Leaders Deprive East Pakistan During 1947–71 which led to the Liberation War?” accessed June 6, 2016, <https://www.quora.com/How-did-the-Pakistani-leaders-deprived-East-Pakistan-during-1947-71-which-led-to-the-Liberation-war>.

¹¹⁷ Rehman Sobhan, “The Problem of Regional Imbalance in the Economic Development of Pakistan,” Asian Survey 2, no. 5, (July 1962), 31; Mokerrom Hossain, *From Protest to Freedom: The Birth of Bangladesh: A Book for the New Generation* (Dhaka: Shahitya Prakash, 2010), 105.

¹¹⁸ Hossain, *From Protest to Freedom*, 105.

¹¹⁹ Talbot, *Pakistan: A New History*, 82–83.

¹²⁰ Talbot, *Pakistan: A New History*, 82–83.

Table 2. Overall Decline in per Capita Income in Pakistan under Ayub Regime, 1959–1960¹²¹

	1949–50	1959–60	1969–70
Pakistan	311	318	424
West Pakistan	338	366	537
East Pakistan	287	278	331
East–West gap	51	88	206

Source: Third Five Year Plan of Pakistan, p. 11, and Report of the Panel of Economists on the Fourth Year Plan (1970–75), p. 132.

Prices in rupees.

This pattern of growing disparity was further augmented by the fact that East Pakistan’s major jute export market earned the foreign exchange from which West Pakistan benefited from. During the Ayub regime, it was common for business earnings to be repatriated to the western side of the country, particularly from rice, flour and jute mills.¹²² The jute export industry alone accounted for 43% of total export earnings for Pakistan.¹²³ Thus, while profits from these industries were used to build infrastructure and fund welfare projects in West Pakistan, East Pakistan was losing resources.¹²⁴ This form of resource extraction served as a policy that maintained East Pakistan’s poverty levels. Furthermore, the outcomes of these economic policies were amplified after the Pakistan-India war of 1965, which resulted in the disruption of trade links that had existed between India and East Pakistan.¹²⁵ The grievances of East Pakistan that accumulated since Pakistan’s Independence would eventually serve as the basis for Bangladesh’s own independence movement.¹²⁶

¹²¹ Ahmad, “How did the Pakistani Leaders Deprive East Pakistan.”

¹²² Talbot, *Pakistan: A New History*, 82–83.

¹²³ Srinath Rachavan, *1971: A Global History of the Creation of Bangladesh* (Cambridge: Harvard University Press, 2013) 94.

¹²⁴ Talbot, *Pakistan: A New History*, 82–83.

¹²⁵ Rachavan, 1971: A Global History, 56.

¹²⁶ Talbot, *Pakistan: A New History*, 82.

During Bangladesh's war for independence, revolutionaries and Indian forces triumphed against Pakistan, but at a cost. The military strategy used at this time included dismantling key infrastructure within East Pakistan to undermine West Pakistani forces. This, then, included the destruction of roads, railways, bridges, waterways, ports, and powerplants.¹²⁷ This destruction not only damaged the jute industry, but, at the same time, West Pakistan continued to dip into Pakistan's foreign exchange holding to fund its military campaign against the East. Thus, financial reserves for Bangladesh's future quickly disappeared. For example, in March 1970, reserves held were in the amount of U.S. \$353 million, however, by September 1971, only U.S. \$20 million was left. The reality worsened as Bengali expatriates, out of fear that their remittances would end up being used by West Pakistan's military, stopped remitting payments to their family members in the East. This led remittance payments to drop to a third of their average in 1971.¹²⁸ Thus, while this strategy proved successful in countering West Pakistan's military operations, the wartime outcome hindered the "economic prospects of independent Bangladesh."¹²⁹

After the war, Bangladesh's economic standing was faced with setbacks. While the reconstruction of infrastructure and export markets proved difficult, the industrial and agricultural sectors struggled even further, with productivity falling behind prewar levels. Coupled with the international oil shock of 1973, Bangladesh's economy continued to languish.¹³⁰ The post-independence political environment did not fare much better. After the inception of Bangladesh, a series of political assassinations prevented the country from reaching a sense of normalcy. This tumultuous environment led to a handful of military coups, leading to years of emergency rule, and as a consequence, subverting development prospects. These events, then, contributed to the collapse of development within Bangladesh and institutionalized poverty within the state and country.¹³¹

¹²⁷ Rachavan, *1971: A Global History*, 262.

¹²⁸ Ibid.

¹²⁹ Ibid.

¹³⁰ Ibid., 271.

¹³¹ Ibid.

F. BANGLADESH'S INDEPENDENCE AND ONWARD: THE EFFECTS OF CORRUPTION AND EXTERNAL FACTORS

Since Bangladesh's independence in 1971, the nation's dependence on aid, and the subsequent clientelistic behavior that stemmed from this, have thwarted the country's economic stability. Related to this dependence, the nation has also been plagued from political turbulence and the dominance of domestic politics by a select few. Meanwhile, the nation is a geographic front line for the effects of climate change, reflecting an ecological inheritance that limits Bangladesh's ability to remain self-sufficient, while also serving as a primary reason why Bangladesh receives aid. These combined factors have left a mark on Bangladesh's economic livelihood.

Dependence on foreign aid and the domination of domestic politics by a few elites are outcomes stemming from Bangladesh's formative years. Introducing these factors as external linkages, Rehman Sobhan states that these links facilitated the eventual demise of Bangladesh's economy.¹³² Sobhan contends that the summation of foreign aid dependence and the elite's political monopolization led to the advent of a Bangladeshi bourgeoisie, a class whose entire fortune became linked to external resources intended for development projects within Bangladesh.¹³³ What came out of this was plundering behavior, which entailed the bourgeoisie circumventing the flow of development funding in efforts to sustain their personal wealth. As a result, not only did unequal distribution of wealth become a problem, but the nation as a whole was prevented from experiencing reproductive growth. Consequently, the bourgeoisie ensured that the public was kept away from the productive process, as public involvement threatened the elite's economic livelihood.¹³⁴

Bangladesh's access to aid has increased since the nation's inception, with justification based on its politics, history, and geography.¹³⁵ These geo-political inheritances are, in part, the result of becoming an independent nation state of Pakistan:

¹³² Sobhan, *South Asia*, 100.

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ibid.

after independence, Bangladesh inherited 10 million refugees who had been displaced or who had left during the war.¹³⁶ In addition, East Pakistan's development history (i.e lack of irrigation systems) and its geography, made it so that its soil was hardly cultivatable, while only a few natural resources were left to extract from. As indicated earlier, Bangladesh's export surplus had been diverted to fund the development of West Pakistan, creating a devastating starting point from which Bangladesh could build infrastructure and develop social programs.¹³⁷ The significance of its poverty level is exemplified in the fact that, three years after independence, the nation had only \$140 million to its name.¹³⁸ Thus, bureaucratic dependence on aid, coupled with constrained development capacity as a result of its diminished reserves, conditioned Bangladesh to depend on outside assistance.

Bangladesh's dependence dynamic is further illustrated by the fact that, as a result of the war, the number and proportion of landless Bengali's increased, as did Bangladesh's dependency on food. Reliance on aid deepened as the nation's revenue gap, savings gap, and foreign exchange gap grew. In the long-term, Bangladesh's inability to capture internal resources deteriorated as political constraints prevented the state's ability to expand its domestic reserves. Meanwhile, bureaucratic elites responsible for channeling aid into the economy used the funding to enhance their own material and political means. Thus, conditions within Bangladesh deteriorated as plundering of foreign funding led to corruption.¹³⁹ In these ways, the social engineering of Bangladesh's independence entrenched the nation's poverty.¹⁴⁰

In addition, the post 1971 political environment—riddled with confrontational politics, violence, and clientelism—further destabilized Bangladesh's economy. To begin, a social order of clientelism dominated political institutions, facilitating the proliferation of an illiberal democracy that lacked the capacity (and desire) to restore

¹³⁶ Ibid.

¹³⁷ Ibid., 101.

¹³⁸ The Global Economy, "Bangladesh: Reserves," accessed June 3, 2016, <http://www.theglobaleconomy.com/Bangladesh/Reserves/>.

¹³⁹ Sobhan, *South Asia*, 102.

¹⁴⁰ Ibid., 102.

order. The precedent that had been set during the colonial era and rule under Pakistan was a patron-client system that was “distant and top-down in character.”¹⁴¹ In addition, this tradition carried over into Bangladesh because only a few elite had been allowed to lead the initial political process. Further destabilizing the political arena was the fact that those who had experience running political institutions left Bangladesh after the 1971 war, as their bases were back in West Pakistan. This exodus of leadership created a political vacuum that led to a power-grab, and an outcome of this competition, then, was the development of class-based political relationships.¹⁴²

Without the existence of any political foundation, Bangladesh’s post war history began with the confrontational rise of Sheikh Mujibur Rahman, who emerged as a revolutionary hero out of the 1971 war. Serving as Bangladesh’s first Prime Minister, Rahman was armed with little political leadership experience; however, he and his party, the Awami League (AL), were faced with a host of challenges. Not only were these challenges in the form of colonial era legacies, but the leadership also had to establish law and order, repatriate armed freedom fighters, rebuild the infrastructure that was destroyed during the war, as well as improve the infrastructure that was limited to begin with. As leaders of a new nation, the AL was also responsible for instilling a sense of national unity. Just as important, however, this was a critical time for the political party to formulate policies that would address Bangladesh’s economic needs.¹⁴³

As a resistance leader, Mujib had shown himself to be capable; however, he and his party were not able to deliver effective leadership that addressed the above challenges. Within his appointment, the practice of clientelism became rampant, with AL representatives placing “its own leadership and party interests before those of the state, setting a strong precedent for Bangladesh’s future pattern of ‘politics of patronage.’”¹⁴⁴ As a result, rival claims on state resources grew, as competing patronage networks became the *modus operandi*. Another consequential outcome of this practice was a

¹⁴¹ Lewis, *Bangladesh*, 76.

¹⁴² *Ibid.*, 77.

¹⁴³ *Ibid.*, 76–77.

¹⁴⁴ *Ibid.*, 77.

precedent of weak accountability and responsibility, a phenomenon further stemming from the absence of political minority groups that could voice opposition. The lack of an established press, courts and political opposition cemented the power of political patronage networks.¹⁴⁵ In turn, these factors blunted the state's capacity to formulate and implement effective policy, opening the door for the plundering of state resources.¹⁴⁶

The corruption and instability within Bangladesh's political leadership triggered disaffection within Bangladesh's army. In August 1975, army officers assassinated Mujib, establishing the pattern for a series of violent military coups.¹⁴⁷ General Ziaur Rahman took power in 1976, and was assassinated in May 1981. After his death, a general election resulted in the majority appointment of Justice Abdul Sattar as president. However, the political system was still struggling, and after a several months, General H.M. Ershad raised a bloodless coup, rising to power by March 1982.¹⁴⁸ Due to these rapid changes in political power, the first decade of Bangladesh's history witnessed a massive disruption in security. Meanwhile, the first three leaders were removed while state policy was still forming. As a response to this, protest politics arose within Bangladesh, with one leader heading such a campaign being General Ziaur Rahman's widow, Mrs. Khaleda Zia; while another was Sheikh Hasina Wazed, leader of AL as well as Mujib's daughter.¹⁴⁹

Emerging as popular opposition leaders, Begum Zia and Sheikh Hasina offered Bangladeshi voters political alternatives to military rule. One outcome of their lobbying for the removal of military rule was a rise of a broad-based people's movement within Bangladesh, which included mobilizing students, workers and opposition parties to call to an end of Ershad's regime. After Ershad was eventually removed from power in 1990, Begum Khaleda won democratic election in 1991 under the Bangladesh Nationalist Party (BNP). Her administration implemented new rules of foreign investment, which

¹⁴⁵ Ibid., 79.

¹⁴⁶ Ibid., 77, 81.

¹⁴⁷ Ibid., 81.

¹⁴⁸ Ibid., 84.

¹⁴⁹ Ibid., 89.

encouraged outside ownership of industrial companies. Meanwhile, foreign exchange restrictions were lifted and new export-tax exemptions were implemented in order to support the garment industry. This momentum was further propelled by the fact that the U.S. government wrote off almost one-third of Bangladesh's debt. These implementations led to a degree of optimism for Bangladesh's economy; however, confrontational politics got the better of the ruling regime and the BNP's main opposition, the AL, began accusing the party of vote rigging, triggering street protests and stoppages.¹⁵⁰

By March 1996, the protests and stoppages had led to complete disruption of the BNP's power. This interruption, brokered primarily by a civil society group known as the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), was also an effort backed by civil servants, trade unions, NGO's, journalists and lawyers—all seeking the institutionalization of a caretaker government and a call for new elections. Begum Zia eventually obliged, and in June 1996, Sheikh Hasina's AL party came to power.¹⁵¹

Despite being democratically elected, Bangladesh's parliament continued to be boycotted by the BNP opposition, which argued that the AL (along with its ally Jatiya Party) was "abusing its majority to prevent discussion of important national issues."¹⁵² Though the political climate was still riddled with a lack of unity, the Hasina administration was able to implement an increase in Bangladesh's food-grain production, initiate a water-sharing treaty and establish the CHT Peace Accord of December 1997 with India; as well as build a large-scale. Despite these advances, the government was consumed with claiming the past glory of Bangladesh's independence, and the AL government was accused of corruption and inefficiency.¹⁵³

Between 2001 and 2009, both Khaleda Zia and Sheikh Hasina battled for political power; meanwhile, Bangladesh's political unity experienced further fragmentation with the introduction of religious-based political parties, the existence of paramilitary

¹⁵⁰ Ibid., 91.

¹⁵¹ Ibid., 93.

¹⁵² Ibid., 94.

¹⁵³ Ibid. 94.

members committing human rights violations, and episodes of military intervention of the government. These factors led to further political destabilization of the institutions responsible for forming Bangladesh's economic policy.¹⁵⁴ Thus, Bangladesh's inability to conduct "nation-building" and "state-building" activities facilitated the demise of its economy.¹⁵⁵ The nation's political history demonstrates how elites failed in "maintaining law and order, creating [an] efficient administrative capacity, and guiding the economy in favor" of constructive policy.¹⁵⁶ These practices have kept the political institutions of Bangladesh weak, further leading to the nation's reliance on development aid.¹⁵⁷

G. GEOGRAPHICAL CHALLENGES

Finally, Bangladesh's geography contributes to its poverty. A series of floods and cyclones, beginning in 1970 and repeatedly appearing over the course of the next twenty years, have plagued Bangladesh. Not only have thousands of people lost their lives, but several hundred thousand are left without shelter during each episode. The widespread damage that arises from natural disasters not only hurts Bangladesh's agricultural industry, but infrastructure is left crippled, with the 1988 monsoon flooding "wiping out 10% of Bangladesh's agricultural alone."¹⁵⁸ Furthermore, as addressed previously, historical precedent shows that aid meant to rehabilitate Bangladesh after such disasters is often plundered. In these ways geographically based factors have contributed to Bangladesh's poverty.

H. CONCLUSION

This chapter surveyed the causes of Bangladesh's poverty. Beginning with the exogenous factor of Britain's tax extraction policy, Bangladesh's rural population lost economic and political autonomy. In turn, this pattern led to a shift in incentives and purchasing power, reducing the breadth of population able and willing to invest in

¹⁵⁴ Ibid., 97.

¹⁵⁵ Ibid., 97.

¹⁵⁶ Ibid., 98.

¹⁵⁷ Ibid., 89.

¹⁵⁸ Ibid., 89.

agricultural development. At the same time, the British administration created civil law that gave zamindars power to extract the maximum level of taxes from the peasantry; such pressure led to peasants lobbying around land reform issues, which led to the neglect of public goods. In this way, land policies shaped the political environment that has promoted unequal wealth distribution and poverty in Bangladesh.

Another outcome of land policies that contributed to Bangladesh's poverty was the commercialization of Bangladesh's agriculture. Both peasants and landed elite were responsible for paying monetary taxes that were tied to a rigid payment schedule. The poor had difficulty in paying these dues because their flow of income was slower than the tax payment schedule. Adding to the difficulty of peasants was the lack transport that could enable the poor to bring their goods to market. In addition, farmers lacked the financial savings that would allow them to stock their harvest until they could sell at market value, which necessitated the sale of goods below market price. As a consequence, tax payments and commercial losses led to increased debt amongst the peasant class, which resulted in the forced sale or extraction of land within the rural population.

Tied to forced commercialization of Bangladesh's agriculture is Britain's interference in India's cotton industry. Once a thriving domestic and international market, British exportation policies led to the demise of India's textile market, which was challenged with progressively higher tariff rates and increased competition from copy-cat British manufacturers. This process also entailed shifts in cropping patterns and land usage, which deprived India's farmers of self-sufficiency. These administrative policies further led to the decline of domestic and foreign demand for India's textiles, crippling one of its primary industries.

Furthermore, extraction at the hands of the ruling authority continued during Bangladesh's history as East Pakistan. As addressed previously, Ayub Khan's regime purged East Pakistan of its wealth. After the 1971 war, with its major jute industry shattered and its foreign exchange reserves squandered, Bangladesh faced severe economic challenges. Furthermore, the nation's infrastructure, power facilities and public institutions were destroyed. These circumstances left the infant state very little financial

resources from which development could be funded; moreover, its leadership—enthralled in internal competition and corruption—lacked the means to develop and implement productive policy.

During its formative years, the international community acknowledged Bangladesh's challenges, prompting the flow of development aid. Despite the opportunity, elites and politicians found it lucrative to plunder from the state's aid resources, leading to the perpetuation of clientelism. Simultaneously, Bangladesh's geographic location made the nation vulnerable to a host of natural disasters. This fixed ecological inheritance has continuously devastated the country, creating a pattern of aid dependence and corruption. In turn, the focus of political parties remained "how to stay" in power, and was less about how to build the state. In these ways, a historically weak central government and the prevalence of corruption plagued Bangladesh, hindering the state's capacity to improve the nation's economic standing. Hence, a combination of policy, war and geography created a legacy of poverty within Bangladesh.

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V. POVERTY REDUCTION AND OTHER OUTCOMES OF MICROFINANCE PROGRAMS IN BANGLADESH

Chapter V begins by addressing the origins of microfinance in Bangladesh, the intent of its creation, and defines what microcredit is. The succeeding section B then introduces quantitative field research that measures the income performance of rural borrowers working with Bangladesh's largest microlenders, while the following section offers an analysis of the economic spillover effects, particularly with regards to savings, followed by a discussion of consumption smoothing. Section C is an analysis that addresses non-economic outcomes of microcredit, including political impacts and self-efficacy, and the development of social trust. The subsequent sections then turn to analyzing the effect borrowing from MFIs has had on women's empowerment. The final section of Chapter V, section G, conveys innovative features that set microcredit programs apart from commercial loans, and seeks to address if these mechanisms make microcredit more positive towards its mission.

A. MICROFINANCE BACKGROUND

Muhammad Yunus, the founder of Bangladesh's Grameen Bank, developed the concept of microfinance as a tool to mitigate levels of local poverty, with the intent of providing loans to individuals who are unable to secure credit from formal institutions.¹⁵⁹ He wanted for the rural poor to be able to pull themselves out of the "poverty trap,"¹⁶⁰ which he believes is exacerbated by the formal banking sector ignoring the underprivileged.¹⁶¹ This chapter analyzes specific outcomes that have evolved out of microfinance programs in Bangladesh—emphasizing especially the role of MFIs in increasing income for the poor. As suggested in chapter one, microfinance is not a "catch-all" silver bullet with regards to alleviating poverty, however, it can—to a limited extent—augment income levels for poor households.

¹⁵⁹ Lewis, *Bangladesh*, 115.

¹⁶⁰ Banerjee and Duflo. *Poor Economics*, 9.

¹⁶¹ Lewis, *Bangladesh*, 119.

Despite this small relative change, there are considerable additional spillover effects of microfinance, which this chapter surveys. The first section of this chapter considers the intent of microfinance. The second section presents empirical data from the three largest microfinance organizations in Bangladesh, and establishes the extent to which these programs affect village poverty levels. The third section will draw on aspects of behavioral economics to provide a connection between borrowing and saving, and borrowing and consumption. Section four reflects on the spillover effects of microloans, indicating how the nature of microfinance programs enable increased access to information, thereby facilitating social capital and development. The fifth section will treat gender-based lending as a separate facet of microlending, and will analyze the impact of microcredit on women. Section six will then consider innovative features of microfinance to highlight the conditions under which microfinance is fruitful, focusing on targeting female borrowers and group lending dynamics.

B. MICROFINANCE: THE INTENT AND THOSE IT SERVES

Despite the level of poverty within Bangladesh, its 169 million-person population remains one of the country's primary assets.¹⁶² As a response to its poverty level and size of its population, Bangladesh has become a testing ground for NGOs interested in trying new credit-based development strategies. Furthermore, the idea of civil society has shaped the way in which organizations perceive their role within Bangladesh.¹⁶³ So much so, that by 2005, a World Bank study cited the presence of 206,000 "not-for-profit" organizations within the country, with 90% of NGO field offices reporting that they provide some form of credit provision.¹⁶⁴ The World Bank further concludes that the NGO sector makes up 6 to 8% of Bangladesh's annual GDP that year.¹⁶⁵ The table below depicts the capacity at which microfinance institutions have captured credit markets: as of 2007, the three major microlending institutions in Bangladesh—Grameen Bank, the Association for Social Advancement (ASA), and the Bangladesh Rural Advancement

¹⁶² Lewis, *Bangladesh*, 9.

¹⁶³ *Ibid.*, 110.

¹⁶⁴ *Ibid.*, 109, 119.

¹⁶⁵ *Ibid.*, 109.

Committee (BRAC)—have captured a combined market share of 20 million borrowers.¹⁶⁶ This growing figure provides hope that microfinance can—among other things—reach the poor to facilitate poverty reduction. See Figure 1.

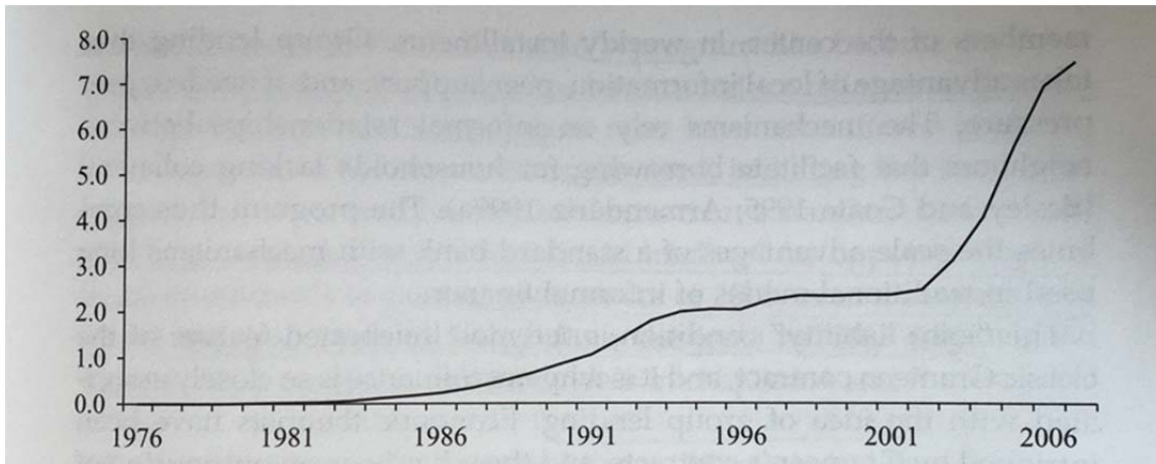


Figure 1. Growth in Grameen Bank Membership, 1967–2007.¹⁶⁷

Before addressing the outcomes of microfinance, it is beneficial to revisit the definition this study is referencing: “small scale transactions in credit savings designed to meet the needs of small and medium-scale producers and businesses.”¹⁶⁸ In addition, the characteristics of microloans can vary. The amount of the loan is one such example, with the dollar amount ranging from U.S. \$5 all the way to U.S. \$10,000.¹⁶⁹ Meanwhile, the maturity dates of these loans are relatively shorter than formal loans, with many loans maturing within a year. In some cases, repayment is expected daily. In order to cover the costs associated with these services, the interest rates of these programs can be higher than those rates within the formal sector, but still lower than the rates offered by informal

¹⁶⁶ Beatriz Armendariz and Jonathan Morduch, *The Economics of Microfinance*, Second Edition (Cambridge: The MIT Press, 2010) 3.

¹⁶⁷ Armendariz and Murdoch, *The Economics of Microfinance*, 13.

¹⁶⁸ Khandker, Shahidur R. 2005. “Microfinance and Poverty: Evidence Using Panel Data from Bangladesh,” *The World Bank Economic Review* 19 no. 2 (Oxford University Press, 2005) 263, <http://www.jstor.org/stable/40282216>.

¹⁶⁹ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize” 527.

moneylenders.¹⁷⁰ Despite the high interest rates, the loan repayment ratio for the Grameen Bank is reported to be 97%,¹⁷¹ while BRAC's was 98% and ASA's 99% in 2000;¹⁷² these figures convey that microcredit institutions claim lower losses than do formal banks of developed countries.¹⁷³ This low delinquency rate is credited to the lack of alternative opportunities that are available to the poor.¹⁷⁴ According to Muhammad Yunus:

The poor know that this credit is their only opportunity to break out of poverty. They do not have any cushion whatsoever to fall back on. If they fall afoul of this one loan, they will have lost their one and only chance to get out of the rut.¹⁷⁵

Thus, microfinance is a response to the demand for loans that support entrepreneurship among the poor. In this way, it differs from other transfer schemes, in that it entails self-sufficiency as well as favorable market conditions.¹⁷⁶ In addition, microcredit institutions specifically generate opportunities for the poor. Thus, since the 1970s, the poor in Bangladesh have garnered interest in securing access to credit.¹⁷⁷

Today, Bangladesh houses 686 microfinance organizations.¹⁷⁸ Generally, these microcredit organizations receive financial support from the World Bank, donors in the West, and other NGOs or commercial lenders, who often lend at below market rates.¹⁷⁹ In turn, microfinance establishments offer credit schemes to poor borrowers or small

¹⁷⁰ Ibid., 528.

¹⁷¹ Lewis, *Bangladesh*, 115.

¹⁷² M. Jahangir Alam Chowdhury, et al., "The Impact of Micro-credit on Poverty: Evidence from Bangladesh," *Progress in Development Studies* 5, no. 4/10 (2005): 299, doi: 10.1191/1464993405ps116oa.

¹⁷³ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize," 528.

¹⁷⁴ Ibid., 528.

¹⁷⁵ Ibid., 528.

¹⁷⁶ Khandker, "Microfinance and Poverty," 264.

¹⁷⁷ Hermes and Lensink, "The Empirics of Microfinance."

¹⁷⁸ List of Licensed MFIs as of March 01, 2016, accessed March 23, 2016, http://www.mra.gov.bd/images/Licensed_NGO_MFIs/licenced250216en.pdf.

¹⁷⁹ Neils Hermes and Robert Lensink, "Impact of Microfinance: A Critical Survey," *Economic and Political Weekly* 42, no. 6 (2007): 462, <http://www.jstor.org/stable/4419226>.

companies.¹⁸⁰ In addition to providing loans, microfinance institutions offer other valuable services. This includes offering skill-based training for jobs,¹⁸¹ agricultural development, health and educational services, while also offering “rural community organizing”¹⁸² along with “consciousness-raising training to empower the poor.”¹⁸³

1. The Economic Impact of Microloans at the Village Level

Over the last thirty years, analysts have begun compiling data to assess if microfinance or microcredit programs have been successful in combating poverty. This section surveys particular assessments that have tracked Bangladesh’s largest microfinance programs: Grameen, Association for Social Advancement (ASA), and the Bangladesh Rural Advancement Committee (BRAC). Given the scope of their recipient base, this analysis will focus on income generation of village-level borrowing households to track if microfinance is effective toward combating extreme and moderate poverty levels.

Empirical assessments conducted by Shahidur Khandker and Mark Pitt find substantial net reductions of moderate poverty for borrowers of microfinance programs. In addition, these programs benefit non-borrowers as well. Khandker and Pitt compiled World Bank data from 1991/92 and 1998/99 to assess the impact of microloans, covering 1,798 households across 87 villages, incorporating eight randomly selected thana’s that were canvassed by BRAC, Grameen Bank, and the Bangladesh Rural Developments Board’s Rural Development; while also selecting five additional non-program thana’s.¹⁸⁴ Their “data on consumption and the consumption poverty line showed that moderate poverty in the sample villages declined overall by 17 percentage points between 1991/92 and 1998/99 and extreme poverty by 13 percentage points.”¹⁸⁵ For those areas that had a microfinance program offered (non-borrowing samples were taken out of the survey), the

¹⁸⁰ Hermes and Lensink, “Impact of Microfinance” 462.

¹⁸¹ Khandker, “Microfinance and Poverty,” 263.

¹⁸² Lewis, *Bangladesh*, 114.

¹⁸³ Khandker, “Microfinance and Poverty,” 263.

¹⁸⁴ *Ibid.*, 271–272.

¹⁸⁵ *Ibid.*, 282.

moderate poverty levels dropped approximately 18%; meanwhile, after year one, between 1991/92, borrowers living in non-program areas also experienced a 19% reduction in poverty.¹⁸⁶

Over the seven year timeframe, the data collected reflects a per year poverty level decrease of 3%, with a total decline of 20% between year one and year seven. When broken down even further, taking into account household level marginal impact and per capita expenditure of nonparticipants,¹⁸⁷ Khandker and Pitt find that moderate poverty fell by 1.6% annually, while extreme poverty levels fell by 2.2% annually.¹⁸⁸ Furthermore, they conclude that more than half of the 3% annual decrease of moderate level poverty is the direct result of microfinance schemes. Looking at the larger picture, the aggregate decline in moderate poverty caused by microfinance was about 1%, while extreme poverty levels fell a bit more at 1.3%.¹⁸⁹ These figures illustrate the way in which microfinance, as a whole, has led to an overall decline of moderate poverty in rural Bangladesh by 40%.¹⁹⁰

M. Jahangir Chowdhury conducted a similar study across 205 village households in Bangladesh, which included a random sampling of comparison non-borrowing households and randomly selected households who were part of a Grameen program.¹⁹¹ These Grameen program members were further grouped on the basis of their length of time in a particular program, ranging from 2–4 years, 5–7 years and 8 years or greater. Chowdhury based the poverty line on the cost of a minimum 2,112 calorie diet that includes 58 grams of protein—food intake amounts deemed necessary to lead a productive lifestyle for an adult male. If the weekly cost of such a diet for an adult male of a household falls below 147 taka, the household is considered poor. Based on the relationship between calories and household expenditure, empirical data demonstrates

¹⁸⁶ Ibid., 283.

¹⁸⁷ This was done in order to find the yield poverty rate before there was intervention of microfinance programs; Khandker, “Microfinance and Poverty,” 283.

¹⁸⁸ Khandker, “Microfinance and Poverty,” 283.

¹⁸⁹ Ibid., 284.

¹⁹⁰ Ibid., 284.

¹⁹¹ Chowdhury, “Poverty and Microfinance,” 28–30, 34.

that the number of households reporting to live at the poverty level decreased the most for those who were in the program for longer periods of time, with the percentage of households in poverty going from 55.56% to 47.44% for those in a program between 2–4 years. For the second group, those households borrowing between 5–7 years, poverty level households started at 59.17% but fell to 40.83%. Meanwhile, the third group—households in a program for a minimum of 8 years—experienced a change in poverty status as well, starting at 61.54% and falling to 38.46%. The comparison group had a poor household to non-poor household ratio of 64.47 to 35.53%. Despite the promising data, Chowdhury finds that the poverty alleviation for program members began to taper off after a duration of 5 years. Nonetheless, Chowdhury’s overall findings conclude that the variation in poverty status between Grameen program households and the non-borrowing comparison group reflects how microfinance can decrease village level poverty for borrowing customers, while such alleviation is enhanced with the “increase of microcredit program membership and the duration and microcredit loan size.”¹⁹² See Table 3.

Table 3. Distribution of Poverty Status of Program Households and Comparison by Membership Duration (Bangladesh).¹⁹³

	Poor	
	Number of Households	%
Comparison Group	127	64.47
Program Groups		
12-48 Months	37	44.44
49-84 Months	49	40.83
85-Above Months	40	38.46

¹⁹² Ibid.

¹⁹³ Ibid., 29.

Jahangir Chowdhury, Dipak Gosh and Robert Wright conducted another experiment in 1999 to evaluate microcredit impacts at the village level. Sampling 909 village households, this study randomly selected borrowers from Grameen, BRAC and ASA. These households were indiscriminately selected based on geographic branches, and then grouped based on duration of membership, which included less than 2 years, 2 to 4 years, 5–7 years, and 8 years and above. Placing particular focus on the impact of duration within a program, the researchers measured results against two poverty lines. The first was an objective poverty line, which is based on the cost necessary to maintain the standardized 2,112 calorie diet that was referenced previously.¹⁹⁴ The second was subjective, as “a household was defined as being poor if the household head answered ‘yes’ to the following question: ‘Do you consider your family poor based on your current yearly income?’”¹⁹⁵ See Table 4 and Figure 2.

Table 4. Objective and Subjective Poverty Rates.¹⁹⁶

Sample	N	Objective Poverty (%)	Subjective Poverty (%)
'New' members			
Loan not received	45	68.9	86.7
Duration <1 year	220	55.3	90.9
Subtotal:	265	65.3	90.2
'Old' members			
Duration 1-2 years	103	55.3	64.1
Duration 2-4 years	214	54.2	52.3
Duration 5-7 years	300	46.3	39.0
Duration 8+ years	27	40.7	48.1
Subtotal:	644	50.2	47.9
TOTAL:	909	54.6	60.2

¹⁹⁴ Chowdhury, et al., “*The Impact of Micro-credit on Poverty: Evidence from Bangladesh*,” 301–303.

¹⁹⁵ Ibid., 303.

¹⁹⁶ Ibid. 302.

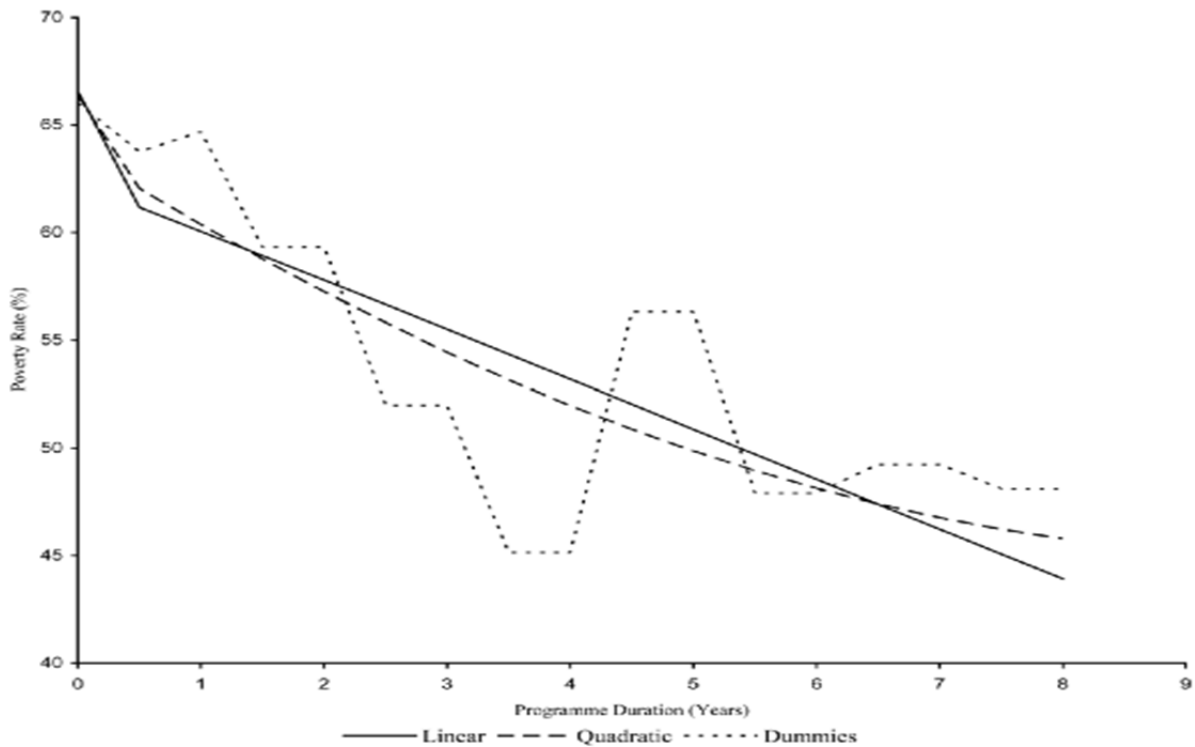


Figure 2. Program Duration and Objective Poverty.¹⁹⁷

The statistical analysis conducted by Chowdhury, Gosh and Wright finds that both objective and subjective poverty rates decreased as the duration of program membership increased, with objective poverty rates falling 2.5% per program year; while subjective poverty declined by approximately 6.5% per program year. Meanwhile, “newer” members experienced higher objective poverty than “old” members, surveying at 65.3% poverty and 50.2% poverty, respectively. Similarly, the subjective poverty rate of new members was higher at 90.2%, while 47.9% of veteran borrowers stated they were living in poverty. With regards to the tapering off of poverty alleviation effects, Chowdhury, Gosh and Wright reached a conclusion similar to Chowdhury’s earlier survey, finding that poverty alleviation leveled off after about six years into a program, while objective and subjective poverty rates were still relatively high by year 8 at 45%.¹⁹⁸

¹⁹⁷ Ibid., 307.

¹⁹⁸ Ibid., 303, 307.

2. Microfinance Allows the Poor to Save Money: Explained by Behavioral Economics

Microfinance advocates contend that small credit programs for the poor facilitate poverty reduction by allowing borrowers to save. Traditionally, the poor afford major investments by pulling funds from savings, selling assets or borrowing from informal networks. Microcredit allows the poor to borrow instead and thereby invest without having to jeopardize their savings. This notion is supported by studies of behavioral economics, which reflect that individuals are more willing to borrow than to dip into their savings.¹⁹⁹ Banerjee relates conditions that support this, contending that saving is difficult in the first place because the “human brain processes the present and the future very differently,” as humans “buy what we want today [while we] plan to [spend] money in more responsible ways tomorrow.”²⁰⁰ Karlan and Appel suggest this is the case because money is fungible—meaning that it gets spent one way or another before making it into a savings account,²⁰¹ citing an example of an indebted man named Philip who buys a rice cooker as soon as he has paid a certain level of debt (though not all), because, in his mind, “his debt had ceased to be the deepest hole.”²⁰² Under this context, microfinance allows for borrowing to complement saving. Moreover, securing credit enables the poor to save to a greater extent than they would otherwise, as weak self-control inhibits commitment to saving. Microloans make this possible because mechanisms such as Grameen’s “structured savings accounts” require regular and timely fixed deposits, hedging against poor spending habits and serving as a form of insurance, promoting long-term welfare of borrowing clients.²⁰³

The savings feature of particular microfinance programs help the poor save in greater quantities, as well as provides an effective way to hold onto wealth, enabling a major investment to take place in the future. Rather than drawing against savings to

¹⁹⁹ Armendariz and Murdoch, *The Economics of Microfinance*, 16.

²⁰⁰ Banerjee and Duflo, *Poor Economics*, 194, 195.

²⁰¹ Dean Karlan and Jacob Appel, *More than Good Intentions* (New York: Penguin Group, 2011) 100.

²⁰² Karlan and Appel, *More than Good Intentions*, 104.

²⁰³ Armendariz and Murdoch, *The Economics of Microfinance*, 16–17.

address immediate needs, loans provide an alternative that guards a poor person's future income. In this way, both saving and borrowing alleviate long-term poverty levels. For example, microlender Shakti Foundation for Women, a Bangladesh-based bank modeled after Grameen, requires savings in the form of a 5% group tax on the loan principal, while requiring a weekly deposit of 10 taka (approximately 20 cents). Half of this weekly deposit is channeled into a personal account, while the other goes into a central fund. Within this structure, the individual account can be drawn upon at any time; however, the central account can only be accessed after a minimum of five years, and only if the borrower is leaving the program. This feature is intended to condition discipline in saving,²⁰⁴ and has proven particularly beneficial for female account holders; meanwhile, empirical evidence points to actual improvement in the livelihood of female borrowers who contribute to this form of savings plan. Borrowing from a similar loan model facilitated in Kenya in 2006 and 2007, analysts find that female account holders with the Grameen based approach "increased [their] average daily productive investment by about 40 percent."²⁰⁵

Furthermore, the savings that are fostered by microloan programs are of particular relevance to nuclear households within Bangladesh, which include multiple generations living in one household. Multigenerational households traditionally have low levels of savings since the transfer of income and wealth transfer from one generation to the next, presenting little motivation to save. However, problems arise as young families split off to form their own household. Under this context, savings plans become more important. To address this, Grameen has a scheme called the Grameen Pension Scheme, which, despite the name, allows any borrower holding a minimum loan amount of 8,000 taka (138 dollars) to deposit at least 50 taka (86 cents) per month. If held for 10 years, the bank will pay compound interest at a rate of 12% per year. Both Grameen and ASA have additional savings schemes that cater to shorter-term holdings. All of these savings plans,

²⁰⁴ Karlan and Appel, *More than Good Intentions*, 95.

²⁰⁵ Armendariz and Murdoch, *The Economics of Microfinance*, 172–74.

however, have features of low minimum payments, monthly due dates and a minimum time required which further instill a commitment to saving.²⁰⁶

3. Other Economic Outcomes of Microfinance: Consumption Raising and Smoothing

Microfinance is also thought to encourage “consumption smoothing,” whereby households can attempt to maintain relatively constant spending and living standards even though earning and other income streams are not linear. Similarly, levels of borrowing allow the poor to survive income shocks while protecting their savings. These savings, then, allow the poor to hedge against future risk, whether that be due to deteriorating health or instances that result in income loss.²⁰⁷

The Khandker and Pitt study referenced above examines the relationship between microfinance borrowing, income, consumption, and savings. Data extracted from borrowing households between years 1991/92 and 1998/99 found that, over the seven year timeframe, “total household annual per capita expenditures grew by 34.6 percent over”²⁰⁸ for participating borrowers. This equates to a real expenditure increase of approximately 5% annually for program participants, reflecting long-term raised consumption.

In addition, Khandker and Pitt find that credit obtained by households within a village has positive influence over per capita expenditure of households, both in terms of direct effect on borrowers, and spillover effects on non-borrowers living within the same village.²⁰⁹ For example, panel data isolating individual borrowers finds that “a 10 percent increase in women’s individual current borrowing increases [their] household’s per capita expenditure by 0.06 percent,” while finding that men’s borrowing has “no such effects.”²¹⁰ Meanwhile, panel data extracted for the village as a whole reflects that “a 10 percent increase in the village average of women’s current borrowing from microfinance

²⁰⁶ Ibid., 176–78.

²⁰⁷ Ibid., 276.

²⁰⁸ Khandker, “Microfinance and Poverty,” 273.

²⁰⁹ Ibid., 281.

²¹⁰ Ibid., 281.

programs increases household per capita total expenditure by 0.68 percent, food expenditure by 0.50 percent, and nonfood expenditure by 0.97 percent.”²¹¹ Thus, with regards to outcomes, microfinance leads to an increased standard of living, in that it provides for increased calorie consumption within households while allowing for greater consumption of non-food items. A finding for further research is that consumption increase as a consequence of microfinance is more prevalent amongst female borrowers than male borrowers.²¹²

Subsequently, increased consumption levels also lead to positive village level spillover effects. As indicated in the Khandker and Pitt study, village-level spillover outcomes of microfinance transfer income to non-borrowers as well. However, the income that transfers correlates with the amount of credit acquired by all borrowing village residents.²¹³ This is supported by the same panel data, which demonstrates that, for a 20 household village community, a 10% growth in borrowing—while leading to a direct 0.06% increase in per capita expenditure for borrowers—also equated to 0.034% per capita expenditure increase for non-borrowers.²¹⁴

4. Assessment of the Economic Impact of Micro-Lending on Poverty Reduction at the Village Level

Furthermore, there is a linear relationship between reduced objective poverty and the duration of time participants have been within a particular microcredit program. Put simply, participants are better off the longer they are part of a program; however, there is a point when the momentum of income generation tapers off. This trend suggests micro-lenders need to consider additional schemes that help sustain prolonged economic benefits to borrower households.

²¹¹ Ibid., 280.

²¹² Ibid., 284.

²¹³ Ibid., 280.

²¹⁴ Ibid., 280.

C. NON-ECONOMIC SPILLOVER EFFECTS OF MICROFINANCE: SOCIAL DEVELOPMENT

1. Political Impact and Self-Efficacy

This section analyzes some of the major spillover effects of microcredit programs to convey how microcredit programs are successful. These effects include political outcomes that result from borrowing, such as increased political activism and self-efficacy.

Oksan Bayulgen makes the argument, for example, that microcredit can increase the level of political empowerment that is felt by borrowers. The World Bank defines empowerment as “the process of increasing the assets and capabilities of individuals or groups to make purposive choices and to transform those choices into desired actions and outcomes.”²¹⁵ Under this framework, Bayulgen contends that the empowerment cultivated through microfinance allows the borrowing poor to make political decisions and gives them agency to act on these decisions, leading to overall outcomes of political knowledge and political participation.²¹⁶ As a result, the poor are more equipped to influence the course of their livelihoods, and more capable of making communal decisions that affect their society at large.²¹⁷ Political knowledge, or access to information, considers the level of information one has on public goods and services that are accessible to the community, the extent to which elected politicians are making good on promises of those goods and services, and the rights available to citizens that can be used to hold politicians accountable.²¹⁸

The second factor that can measure political empowerment is the level of participation. Traditionally, poor individuals and other marginalized groups have not participated in political agenda building. However, when empowered, they not only have increased awareness (due to the awareness building agendas of microlenders), but they also have gained greater appreciation of involving themselves in decision-making. While

²¹⁵ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 532.

²¹⁶ Ibid.

²¹⁷ Ibid.

²¹⁸ Ibid.

this includes voting, there are further reaching elements as well. These elements include “participation in community organizations, campaigning, contacting, petitioning, protesting, litigating and unionizing.”²¹⁹ Microfinance, then, allows for political empowerment outcomes to occur. There are two mechanisms for this causal chain. First, assuming microfinance enhances the monetary and social status of the poor, as a consequence, the poor’s empowerment increases, because their sense of self, or “self-efficacy” has improved. In addition, microfinance, through enhancing social capital within communities, improves individual access to information—including political agendas—which compels the poor to participate in the political arena.²²⁰ Under such conditions, then, microfinance allows for increased political empowerment. Field experiments conducted by Mohsin Habib and Christine Jubb support Bayulgen’s theory about the impact of political empowerment and increased self-efficacy with regards to political participation, particularly with regards to voter turnout. Habib and Jubb conducted a poll across 64 poor rural districts in Bangladesh, interviewing a volunteer based random sample, including 198 ASA members, and another voluntary random sample of 99 non-MFI members. All of the interviewing participants were female, as 99.99% of ASA’s membership is made of women. Habib and Jubb’s study finds that 98% of the ASA group voted in the last national election, compared to 81% of the non-MFI group. Moreover, the MFI group expects significantly more from the candidate they voted for, based on the response that 46% voted because of an expectation that the “candidate will bring economic prosperity”²²¹ while 63% said they voted based on their individual preferences (versus outside influence). In contrast, 47% of the non-MFI group state that their vote was influenced by pressure from local leaders, while only 13% of MFI members of the same district feel external pressure. Relatedly, there was no report of NGO affiliated pressure to vote in a particular way. These results demonstrate self-efficacy at work; however, Habib and Jubb also find MFI based influence on political

²¹⁹ Ibid.

²²⁰ Ibid., 532.

²²¹ Mohsin Habib and Christine Jubb, “Role of Microfinance in Political Empowerment of Women: Bangladesh Experience,” Ontario International Development Agency (2012): 105, 108, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2185531.

empowerment, as 25% of MFI members have an affiliation with a political party, while only 13% of the non-MFI group is involved with a political party. These figures illustrate Bayulgen's theory of how increased MFI involvement brings about heightened awareness, which compels individuals to partake in the political reform process in greater numbers, enabling the development of a civil society.

Bayulgen further suggests that increased self-efficacy correlates with socioeconomic status. For the intent of this discussion, self-efficacy is described as "the belief in one's own efforts to control desired outcomes, as opposed to luck or influence of others."²²² By enhancing the socioeconomic standing of its borrowers, microfinance raises self-esteem levels and eventually self-realization. These outcomes are further facilitated by increased standards of living (such standards were indicated earlier under outcomes of consumption smoothing). At this point, borrowers are able to focus on their environment instead of their survival. In doing so, they are better equipped to confront actors responsible for the wellbeing of their community. Effectively, these individuals now see themselves as participants in the political realm. This too, may be contributed by the fact that they now know they have either more to gain, or more to lose, if they do not participate. In this way, microfinance leads borrowers to experience notions of self-efficacy and this transfers into the political participation process.²²³

The NGO credit provider Proshika is evidence of a microfinance program that is facilitating political empowerment and notions of self-efficacy amongst its landless clientele. As one of the largest microlenders in Bangladesh, Proshika launched a program called Institute for Development Policy Analysis and Advocacy (IDPAA). This institute "campaign[s] widely on a variety of social, political and environmental issues."²²⁴ IDPAA leaders themselves work to promote the "landless group members as candidates in local elections."²²⁵ Though this institute meets resistance from local landlords who

²²² Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize" 533.

²²³ Ibid., 533.

²²⁴ Lewis, *Bangladesh*, 122.

²²⁵ Ibid., 122.

oppose changes that will affect their own land-related conflicts, its work provides evidence of the way in which credit providers such as Proshika are challenging norms.

Among its services, Proshika has a “Small Economic Enterprise Development,” program that supports entrepreneurial schemes across impoverished areas of Bangladesh. Evidence of such efforts working includes the example of a beekeeper named Shawkat Khan, who started with two hives from Proshika in 1995, and now has 850 beehives to support a 18 employee business that exports honey to various countries, not to mention having a website that takes international orders.²²⁶ Moreover, Proshika is empowering from other spectrums as well- with increased income and ties to his community, Shawkat now has more reason to involve himself at the local community level. For those like him, Proshika offers the “People’s Organization Building Program,” which teaches and encourages groups to form federations in order to build broad networks, with some members successfully entering politics at the elected federation level.²²⁷ Consequently, Proshika members are more actively engaged in their community and politics than MFI members that do not have targeted focus on political activism, such as BRAC.²²⁸ By first promoting economic training and then advocating literacy and political awareness, Proshika and similar MFI’s are effecting political and social change in Bangladesh’s rural areas.²²⁹

2. Social Capital

In addition to individual empowerment, microfinance can also inculcate shared levels of political empowerment by generating social capital. While there is a range of definitions used to describe social capital, the most widely used definition emphasizes the “features of social organization, such as trust, norms and networks that can improve the

²²⁶ Proshika, “What Proshika Does,” accessed 17 August 2016, <http://www.proshika.org/what-proshika-does.html>; Mymensingh, “An enterprising beekeeper,” *Daily Star*, last modified 28 January, 2016, <http://www.thedailystar.net/country/enterprising-beekeeper-208357>.

²²⁷ Proshika, “What Proshika Does;” Naila Kabeer, et al, “NGO’s and the Political Empowerment of Poor People in Rural Bangladesh: Cultivating the Habits of Democracy?” *World Development* 40, no. 10 (October 2012): 343, doi.10.1016/j.worlddev.2012.05.011.

²²⁸ Kabeer et al., “NGO’s and the Political Empowerment of Poor People,” 343.

²²⁹ Lewis, *Bangladesh*, 122.

efficiency of society by facilitating coordinated actions.”²³⁰ Microcredit programs make this possible specifically because of their group lending dynamic: in Bangladesh, self-selected groups made up of 3–10 individuals within a network apply for a single line of credit.²³¹

This form of interdependency motivates each individual to ensure he or she prospers, as the premise of such networks is building and maintaining reputations within the community.²³²

Examples of spillover effects with regards to communal behavior are evident through group formations, especially for women. Karlan and Appel cite an example of an all-female group in Ghana, who had progressively borrowed a dozen loans in order to run and manage a theatre, taking turns in serving as executives of the group. This accomplishment took 8 years of planning and self-discipline, virtues evident by fact that these women did not miss a single payment. That said, the group did admit experiencing instances where members were not able to pay, or of members disappearing.²³³ Their example is a testament to how group formation and joint-lending can strengthen resolve to make a plan work. Joint lending, through its inherent framework of providing a support group, is also a sphere in which members can train and assist each other. Moreover, the informational advantage that close proximity brings enables women to benefit, particularly in Bangladesh, where formal association of males and females is not common.²³⁴

By building on themes of shared responsibility, microfinance enables each borrower a vision and identity of being one amongst a larger group. This sense of social capital is transferrable throughout the community, and a key feature of this component is that it encourages cooperation for the “mutual benefit of the members of the association

²³⁰ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 533.

²³¹ *Ibid.*, 533.

²³² *Ibid.*, 534.

²³³ Karlan and Appel, *More than Good Intentions*, 110–11.

²³⁴ Habib and Jubb, “Role of Microfinance in Political Empowerment of Women,” 103.

as well as for the society as a whole.”²³⁵ Moreover, in the context of female borrowing, joint-lending is a mechanism that treats each woman equally, thereby diminishing gender-related dynamics that may disempower females, or prevent them from partaking in the social or political process.²³⁶ In this way, a shared set of values and mutual empowerment is developed as a result of microcredit networks.

The resulting social capital also appears to facilitate economic development. This is possible because the group lending dynamic of microcredit programs makes peer monitoring of co-borrowers easier.²³⁷ Thus, by reducing the cost of imperfect information and enabling collective action solutions, social capital becomes key for managing outcomes that pertain to the community level. This includes, for example, managing forest conflicts or issues of irrigated water distribution. In an economic sense, social capital is an asset because it is a form of public good which benefits all members of the group, not only those who are financially contributing.²³⁸ In this way, we again see a positive spillover effect of microfinance towards borrowers and non-borrowers alike.

While the dynamics of political empowerment were introduced earlier, we can also consider the way in which microfinance is linked to another political aspect: democratic development. While there are well-studied correlations between social capital and democratic development, studies connecting the potential of microfinance to facilitate political activism remain largely unexplored.²³⁹ The underlying concept of social capital is that it produces a “dense civil society, which in turn, has been widely argued to be key to making democracy work.”²⁴⁰ Thus, social capital of certain forms can facilitate democratic development, through a number of mechanisms. To begin, it allows for a space in which discourse that evaluates governance is allowed. In turn, if existing group ties help to create a protective atmosphere for the discontented to voice their

²³⁵ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 534.

²³⁶ Habib and Jubb, “Role of Microfinance in Political Empowerment,” 102.

²³⁷ Hermes and Lensink “The Empirics of Microfinance,” F2.

²³⁸ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 534.

²³⁹ Ibid., 536.

²⁴⁰ Ibid.

grievances, without fear of reprisal, information can be further disseminated. This logic is supported by studies that show the increased likelihood of individuals to confront authority when they are in the company of friends.²⁴¹

Secondly, microfinance networks made of joint borrowers promote collective action in that networks function as “bloc recruitment” for social movements that oppose nondemocratic regimes.²⁴² This sense of interdependence, then, leads to increased awareness of duty, further promoting respect within groups. Thus, “through participation in trusting associations, individuals may experience changes in their values, preferences and capacity to act.”²⁴³ In return, this increased awareness could make state-backed oppression more difficult, as a robust civil society is better equipped to organizationally oppose a nondemocratic regime.²⁴⁴

In this way, arguments that link the association of social capital and political empowerment can also be applied to social capital and democracy. While Bayulgen admits that political empowerment and democracy are not the same thing, there is still an inherent association between the two. For the case of Bangladesh, in an environment of increased empowerment, the government can be more effectively held accountable, while individual demands can be better enforced. As efforts of microcredit NGOs further include enhancing education and/or literacy rates,²⁴⁵ this indirectly facilitates an increased awareness of constitutional rights.²⁴⁶ Illustrating how microfinance can support this reform is the finding that women’s involvement in public demonstrations and political campaigns increase once female members become borrowers within microcredit programs.²⁴⁷

²⁴¹ Ibid.

²⁴² Ibid., 536

²⁴³ Ibid., 537.

²⁴⁴ Ibid.

²⁴⁵ Lewis, *Bangladesh*, 119.

²⁴⁶ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 538.

²⁴⁷ Ibid., 538.

Habib and Jubb found just that in their interview of 297 female ASA members and non-MFI respondents. Out of the ASA group, 68% engage in active participation with a political party, while 46% of the non-MFI group is active; this difference demonstrates MFIs do instill a sense of shared duty that invigorates the development process.²⁴⁸

As a result of microfinance then, the outcome of democratic change, or some form of consolidation, is made more likely within networks with increased social capital. To support this claim, in 2003 Muhammad Yunus wrote of how Grameen borrowers began to associate their individual interests with that of their community: “He writes, for instance, that Grameen borrowers enthusiastically embraced the idea of exercising their democratic rights in the national election of 1991 in Bangladesh.”²⁴⁹ Habib and Jubb’s findings provide insight as to why MFI borrowers are enthusiastic. Citing the top factors that concern the rural poor, 41% of ASA member respondents stated that it is social status that influences their voting preferences, while 33% of the same group claimed that power and recognition within the community is their top driving factor in shaping voting preferences. The reported figures for desires of social status/power and recognition for the non-MFI group is starkly different, at 24% and 9%, respectively. For 43% of the non-MFI group, voting is primarily swayed by pressure from local leaders, while only 17% of the ASA group expressed feeling pressure. Furthermore, ASA members seem to be less vulnerable to offers of extra money sources, as 12% responded saying that they are motivated by quick cash; in contrast, 39% of the non MFI group is swayed by cash payments. These differences in voting patterns reveal that MFI empowerment does result in the expectation of increased accountability from elected officials, shaping platform preferences—such as economic performance—that lead to conditions more conducive towards societal development.²⁵⁰

²⁴⁸ Habib and Jubb, “Role of Microfinance in Political Empowerment,” 108.

²⁴⁹ Bayulgen, “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize,” 537.

²⁵⁰ Habib and Jubb, “Role of Microfinance in Political Empowerment,” 108.

D. ASSESSMENT OF MICROFINANCE INSTITUTIONS' INFLUENCE ON SOCIAL CAPITAL AND DEVELOPMENT

Though developing democracy is not an explicit goal of microfinance, the above considerations demonstrate how democracy can be an outcome of microcredit. Furthermore, in reviewing from Chapter II, the conditions that led Bangladesh to become poor, it can be assessed that the establishment of stronger democratic institutions will aid in alleviating Bangladesh's poverty, in that the poor are better informed and therefore, force state responsiveness. By deliberately fostering collective action, microfinance increases access to information and therefore leads borrowers to be made aware of "political issues, actors, processes and channels of influence."²⁵¹ As indicated further by Yunus' assessment, microfinance goes beyond credit delivery. By creating forms of social capital, it facilitates the conditions that allow for democracy building.²⁵² Democratic progression, however, is contingent upon organizational reform, which requires more from civil action as a result of growth of civil society and the inculcation of social trust, than simply political empowerment alone. In order to overcome obstacles of government corruption and abusive land policies, Bangladesh's middle class and rural base will need to collectively organize and push for reform, thereby optimizing skills they have gained from microcredit involvement.

E. WOMEN'S EMPOWERMENT

Microcredit NGOs believe their programs are an entry point for effecting wider reaching social empowerment. Influencing this notion is the belief that, while women are more vulnerable in society, they are also positioned to benefit from development and economic growth.²⁵³ Single females head 15% of households within Bangladesh.²⁵⁴ In addition, based on adopted cultural norms, formal Bengali banks traditionally ignore women as loan candidates.²⁵⁵ For these reasons, many microfinance programs started

²⁵¹ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize," 538.

²⁵² Ibid., 538.

²⁵³ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize" 528.

²⁵⁴ Lewis, *Bangladesh*, 160.

²⁵⁵ Ibid., 150.

specifically targeting women in the 1990s, leading to females becoming the majority beneficiaries of microfinance programs.²⁵⁶

Abul Md. Bashir contends that beneficial outcomes of women's empowerment, however, are often perceived on the basis of changes in their economic behavior.²⁵⁷ There are also non-economic outcomes that take place that can facilitate societal change and development.²⁵⁸ To address this theory, Bayulgen contends that by stimulating micro-enterprise development, women are led to increased income under their control. The outcome resulting from greater jurisdiction over resources, then, is improved well-being, as well as reduced rates of mortality for children and themselves.²⁵⁹ This is possible because women are able to spend more on healthcare.²⁶⁰ In addition, women are more likely than men to use increased income towards the education of their children.²⁶¹ Under the effects of increased consumption, we know that food intake increases in households where the female head has obtained credit. These factors, then, help explain Bangladesh's improving Millennium Development Goal (MDG) track record, which has targeted "extreme poverty and hunger, securing universal primary education and reducing child mortality."²⁶²

The character of microfinance programs support ongoing development within Bangladesh. Through literary and education initiatives, social change is reinforced by "group formation, leading to wider movements for social and political change" for women.²⁶³ A reduction of fertility rates is one such example: during the 1970s, women

²⁵⁶ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize" 528, 265.

²⁵⁷ Abdul Bashir, "Empowerment of Microcredit Participants and Its Spillover Effects: Evidence from the Grameen Bank of Bangladesh," *The Journal of Developing Areas* 40, no. 2 (Spring 2007):173, <http://www.jstor.org/stable/4193037>.

²⁵⁸ Ibid., 174.

²⁵⁹ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize" 531.

²⁶⁰ Khandker, "Microfinance and Poverty," 266.

²⁶¹ Linda Mayoux, "Microfinance and the Empowerment of Women: A Review of the Key Issues," 12, accessed March 10, 2016, http://www.ilo.org/wcmsp5/groups/public/@ed_emp/documents/publication/wcms_117993.pdf.

²⁶² Lewis, *Bangladesh*, 165.

²⁶³ Mayoux, "Microfinance and the Empowerment of Women," 9.

bore an average of seven children; by 2000, however, Bangladesh had a broader spectrum of microfinance resources geared towards educating women, facilitating the average number of children per woman to drop to three. In the bigger picture, this shift allows women more time to work, paving the way for economic and social change. Similarly, the illiteracy rate for women also fell during the same timeframe, dropping from 88 to 70%.²⁶⁴ Reflecting the success of MFIs in supporting Bangladesh's overall MDG's is the fact that 100% of second generation borrowers of Grameen are literate, while the literacy rate for Bangladesh as a whole is 64%. In addition, Grameen claims that 60% of its borrowers cross over and out of the poverty line, reflecting how overall MFI initiatives improve economic standing amongst poor women in Bangladesh.²⁶⁵

Relatedly, enhanced economic standing within their household and community is another form of empowerment women benefit from. This is supported by the notion that greater access to savings and credit provides more sway in the decision-making that deals with savings and credit. When this is possible, women are better able to optimize the welfare of their household and themselves. At the same time, men can also benefit, as leakage of the additional income (which is in the hands of the female) is prevented. Furthermore, investment in women's occupation allows for the spillover effects that were addressed earlier, including improved health (through greater access to medical care and information on birth control), access to education, increased literacy and political awareness, resulting in reduced the vulnerability of women.²⁶⁶ Supporting this theory is the fact that the number of female microcredit borrowers within Bangladesh is growing. Turning to Khandker and Pitt's study once again, panel data between years 1991/92 and 1998/99 shows that, while the average rate of male borrowers declined by 28.5%, the average for female borrowing increased by 94% during the same timeframe.²⁶⁷

²⁶⁴ Armendariz and Murdoch, *The Economics of Microfinance*, 212–213.

²⁶⁵ "The Grameen Creative Lab," accessed August 20, 2016, <http://www.grameencreativelab.com/live-examples/grameen-bank-the-mother-of-grameen-social-business.html>.

²⁶⁶ Mayoux, "Microfinance and the Empowerment of Women," 8.

²⁶⁷ Khandker, "Microfinance and Poverty," 273.

F. ASSESSMENT OF MICROFINANCE INSTITUTIONS AFFECTING WOMEN'S EMPOWERMENT

The rise of women's participation in microcredit programs suggests their expectation that access to credit will improve their livelihood. This also reflects the self-efficacy aspect of Bayulgen's hypothesis: women are taking their employment into their own hands. Furthermore, while the Bengali state is sponsoring reading programs that are driving literacy rates up, the parallel programs being offered by MFIs are tailored to refine literacy skills, particularly by targeting rural communities that may not be at the reach of the state and teaching them specific skills relevant to their needs. To this end, rural women are learning to read and conduct business in ways that include understanding and signing legal documents.²⁶⁸ This form of specialized empowerment is bringing women to the forefront of the civil domain. Thus, while independent impact studies have been few in number, existing evidence finds that women in rural Bangladesh benefit substantially from microloans.²⁶⁹

G. INNOVATIVE FEATURES THAT ALLOW MICROLOANS TO BE SUCCESSFUL

1. Targeting Female Borrowers

Microfinance institutions are served well to target women, as females make up 70% of the world's poor. Among the reasons that substantiate targeting women for microloans is the fact that 60% of women surveyed in Bangladesh have complete or partial control over household investments, meaning they are well-positioned to augment their financial standing.²⁷⁰ Furthermore, access to microcredit will help balance the daily wage bias that women face; this bias is particularly evident for poor women, who

²⁶⁸ Kazi Abdur Rouf, "Grameen Bank Women Borrowers Non-Formal Adult Learning Transformation in Bangladesh," *Global Journal of Management and Business Research* 14, no.1, Version 1.0 (2014): 9, https://globaljournals.org/GJMBR_Volume14/3-Grameen-Bank-Women-Borrowers-Non.pdf.

²⁶⁹ Mayoux, Linda. 1998. "Women's Empowerment and Micro-finance Programmes: Strategies for Increasing Impact," *Development in Practice* 8 no. 2 (1998): 236, <http://www.jstor.org/stable/4029310>.

²⁷⁰ Armendariz and Murdoch, *The Economics of Microfinance*, 218.

“typically work for longer hours, and when they are paid at all, will be so at lower wages.”²⁷¹

Grameen’s track record towards its female borrowers provides a lens through which the success of gender targeting can be measured. When Grameen initially started in 1983, most of its borrowers were men, while females made up 44% of its clientele. However, by 1986, females made up 75% of its customer base, with numbers increasing into the 1990s, while the current Grameen female membership base is now over 95%.²⁷² This increase reflects microcredit’s flexibility in adapting to poor women who are in a position to consider engaging in entrepreneurial activities. Supporting this notion is Muhammad Yunus’ assessment that women selling handmade crafts are compelled to sell their wares at a loss because they use input providers. On a large scale, this form of income deprivation is a contributing factor to poverty.²⁷³ The intent of microloans, then, is particularly suited to combat such forms of income deprivation for women.

In addition, the impact of microloans may be greater when women are targeted because, compared to men, their decisions “tend to be biased in favor of the provision of public goods helpful for families and communities,” in addition to favoring health and educational related costs for their children.²⁷⁴ In turn, these choices will help contribute to the long-term development goals of Bangladesh. See Figure 3.

²⁷¹ Ibid., 212.

²⁷² Ibid.

²⁷³ Chowdhury et al., “*The Impact of Micro-credit on Poverty: Evidence from Bangladesh*,” 300.

²⁷⁴ Armendariz and Murdoch, *The Economics of Microfinance*, 212.

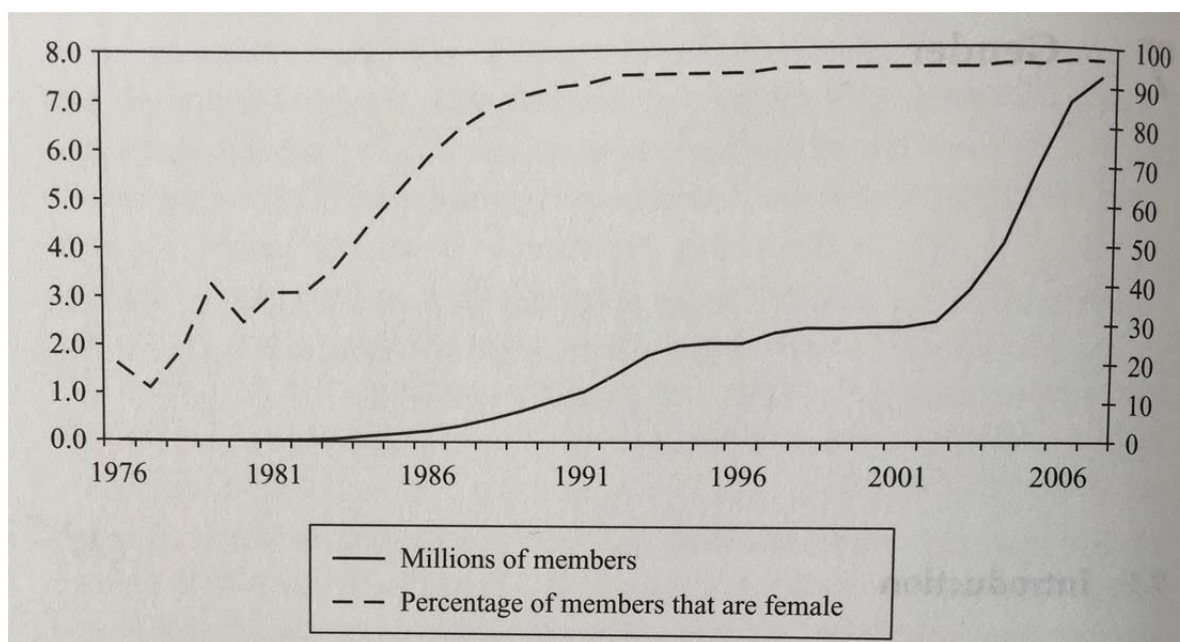


Figure 3. Female Membership of Grameen Bank.²⁷⁵

2. Joint Lending

A hallmark innovation of microfinance is group lending, a feature credited to the success of Grameen Bank. Group or joint lending is a “mechanism that essentially allows the poor borrowers to acts as guarantors for each other.”²⁷⁶ This feature gives loan providers the flexibility to expand access to loans as their funding pots increase. Compared to the standard commercial bank contracts, which require collateral from an individual, Grameen’s classical group lending mechanism is a contract that leverages communal relationships. For example, a group contract can involve up to five borrowers, with loans being awarded to the first two, then to the next two, and finally the fifth member. The success of loan repayment denotes the continuation of the loan disbursement to the preceding group; however, if one member fails to pay off their debt, the members of the group are refused future loan disbursements. Another feature of joint loans is that repayments are made in public, which encourage participants to repay. This leads to the peer-to-peer monitoring aspect, which ensures neighbors can monitor their

²⁷⁵ Ibid.

²⁷⁶ Ibid.

fellow borrowers, allowing members to make the most of “local information, peer support, and, if needed, peer pressure... The program thus combines the scale advantages of a standard bank with mechanisms long used in traditional modes of informal finance.”²⁷⁷

H. ASSESSMENT ON THE EFFECTS OF TARGETING FEMALES IN POVERTY ALLEVIATION

Targeting female borrowers is a strategic shift toward combating poverty because not only are women among the world’s poorest, but—in the case of Bangladesh—they are positioned to make the most of village based opportunities. Furthermore, compared to men, females have shown to be more responsive to the joint liability feature of microcredit programs, as joint lending enables women to mobilize in a way that is superior to acting as an individual, as groups provide a support base that otherwise is unavailable in the segregated formal sector of Bangladesh. The end result of making consistent group payments, then, means that women enjoy progressively increased access to loans, which helps augment their investment potential.

I. CONCLUSION

This analysis laid the key ways in which microfinance reduces poverty within Bangladesh. The intent of microfinance centers around addressing Bangladesh’s poverty level and the need of the poor in helping to escape the poverty trap. Tracking the direct impact of poverty changes has provided a lens through which the success of microfinance can be measured. Current statistical data, which has sampled a diverse range of random village communities within Bangladesh, demonstrates that microcredit programs geared towards the poor can alleviate poverty levels at the household level.

This chapter analyzed empirical data of microfinance programs to find that they are successful in increasing income for borrowing households as well as households who are in proximity to borrowers. In addition, the deposit and savings mechanisms that are required by particular microcredit programs help promote healthy saving habits, while

²⁷⁷ Ibid., 12–14.

leading to consumption smoothing. Meanwhile, this chapter suggests numerous spillover effects of small credit programs, including the inculcation of social capital and the building of civil society, which further compel a relationship to be drawn between social capital and democracy. In addition, this analysis investigated social development outcomes vis-à-vis women's empowerment, and finds that women are benefiting from: direct guidance from MFIs, increased well-being, greater opportunities made available through higher income, and general empowerment that comes from being involved in a group. Mechanisms that allow microcredit programs to be fruitful were also considered, including targeting female clients and joint-lending. These innovative features of microfinance programs have facilitated the effectiveness of loan programs, aiding in Muhammad Yunus' ultimate goal of alleviating poverty through microfinance.

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VI. RESEARCH CONCLUSION

This thesis posited the question as to whether microfinance alleviates poverty, and if so, what mechanisms contribute to its success. Chapter I presented the reasons as to why Bangladesh can benefit from microfinance-led reform: the nation's human capital is its largest asset, its large agricultural workforce is in a position to benefit from the structure of microfinance programs, and microcredit organizations have tools and services that are flexible enough to reach and help the poor. Based on evidence presented in Chapter V, this chapter evaluates which of the hypotheses offered in Chapter I appears most accurate, as well as outline which of the MFI operation mechanisms are most effective.

A. HYPOTHESIS ASSESSMENT

The empirical data mentioned in Chapter V negates the notion that Bangladesh is ensconced in a poverty trap, showing ways in which aid has proven beneficial. The argument that microfinance only benefits current small business owners has been disproved, and the argument that those with little assets can improve their livelihood was demonstrated. The caveat to this, however, is that training and individual guidance helps ensure better results for the poor in augmenting their incomes. This then correlates with the assertion that only the core poor benefit- this is also not true, as studies show beneficial impact on non-borrowers as well. A third argument, that of targeting female borrowers will overall reduce poverty, has proved elastic, as success of a program's impact has as much to do with how women treat their debt and income as much as whether they make more successful entrepreneurs than men. Still, the argument can hold that by targeting females, if quality of life is a way to measure poverty alleviation – then the non-economic outcomes that arise out of MFI participation do alleviate symptoms of poverty amongst women and their children.

B. HOW MICROFINANCE INSTITUTIONS ADDRESS BANGLADESH'S HISTORICAL LEGACIES

Chapter IV covered historical and political milestones in Bangladesh's history in order to outline how political and economic legacies shaped Bangladesh's poverty. This understanding, then, helps shape the ways in which microcredit programs operate. To begin, by focusing on the development gaps that plagued rural Bangladesh, MFIs can address some of the structural causes that have led to the nation's current poverty level. The role of MFIs in addressing this gap has included disbursing fertilizer, seeds and equipment that allow for more effective cropping;²⁷⁸ however, these development initiatives—when applied at larger scale—further require extending irrigation and cropping techniques. Thus, in addition to helping provide the right tools, MFIs also train and educate poor farmers, while offering credit programs so that they may be able to expand their operations. This then leads to the role of MFIs in serving as middlemen for joint-ventures that capitalize on open market economies, such as Grameen Danone Foods Ltd. This partnership not only created 1,600 jobs among the poor, but also continues to aid in economic growth. For instance, Grameen Danone purchases milk from micro-farmers; once local employees have made yogurt, local women sell the food to receive a 10% sales provision. Meanwhile, the yogurt is enriched to help individuals receive additional nutrients, which is intended to address malnutrition issues amongst the nation's poor.²⁷⁹

Chapter IV also illustrated how much of the gap that exists in Bangladesh's shrunken export domain is the result of exploitation during colonial rule and during its existence as East Pakistan. More recently, however, the burgeoning garment industry in Bangladesh has provided an opportunity for export expansion, and is serving Bangladesh well in that over one million women from the rural population have gained employment.²⁸⁰ MFIs such as Grameen have further created opportunities for the poor by forming coalitions such as Grameen UNIQLO—a Japanese label that has partnered with

²⁷⁸ Banerjee and Duflo, *Poor Economics*, 193.

²⁷⁹ Grameen Creative Lab, "Grameen Danone Foods Ltd."

²⁸⁰ Lewis, *Bangladesh*, 150.

Grameen to produce South Asian and western garments that are made and sold in Bangladesh. Taking a cue from this joint venture, MFIs now need to attract additional foreign investors willing to expand other sectors—including formal industries that require technical production. Meanwhile, looking at the “paper tigers” rise of South East Asia, MFIs can offer specialized incentives for market entry of entrepreneurs. For example, as India is turning to its service industry as a way to promote its own growth- MFIs in Bangladesh can take this opportunity and enter into India’s vast market, exporting to India’s 1billion plus market. MFIs already offer training programs and have donor capital, thus, the leap towards teaching these skills is an accessible one.

In addition, Chapter IV demonstrated how the attention of Bangladesh’s rural community has historically focused on land distribution issues instead of the provision of public goods. In addition, incentives that encouraged farmers to productively invest and till land were few, as land property laws were not in their favor. As seen in Chapter V, MFIs are reshaping the outcomes of these legacies by offering training programs that encourage the formation of unions and federations, creating momentum to encourage rural participation in politics. This momentum is leading to greater accountability in the deliverance of public goods, thereby fostering politics that cater to the poor.

Chapter V further provided empirical data by Khandkar and Pitt; and Chowdhury and Wright, showing that at the microlevel, poverty levels are changing in Bangladesh. Households that borrow are more likely to experience an increase in income, while non-borrowing community members who live within the same community also benefit. This may be explained by the fact that as incomes rise, consumption also rises, and this spending takes place across the community, allowing more households to eat greater calories and receive better healthcare. Moreover, subjective and objective poverty rates also continue to decline the longer microborrowers stay within a program, while instances of political empowerment and self-efficacy are greater for program participants than their fellow non-borrowers.

These economic and non-economic social spillover effects of microfinance are not unique to Bangladesh. With regards to targeting women borrowers, research conducted by Banerjee and Duflo finds that in Cote d’Ivoire, households in which women

make more money from their plots than their husbands also eat more, reflecting similar patterns found in Bangladesh, in that while male borrowers spend increased income elsewhere, women are more likely to invest in goods and services that will benefit their household.²⁸¹

Moreover, the versatility of joint-lending in its ability to empower women is also evident in international applications. A study conducted by Poverty Action Lab finds that in Mongolia, while two-thirds of women who engage in group-lending or individual lending invest their first loan into assets such as livestock or machinery (the remainder is used for household expenses), the women holding joint-notes are 9% more likely to end up owning a business enterprise than women who borrow as individuals. In addition, of those joint-borrowers, those who are less educated are 31% more likely to create a business of their own.²⁸² Thus, the positive outcomes felt by households and women go beyond initial MFI investments.²⁸³

C. MICROFINANCE INSTITUTIONS AND POVERTY ALLEVIATION IN THE DEVELOPING WORLD: MECHANISMS THAT WORK BEST

Chapter I makes the case that microfinance models used in Bangladesh are versatile enough to be applied at the international level, and with this in mind, there is good news to share.

Duflo studied a rural village of West Bengal in India, finding similar income generating results that Khandkar and Pitt find in Bangladesh. Duflo evaluated a microfinance organization called Bandhan, tracking financial outcomes after some livestock, a small stipend, and training to the poor are given. To receive this aid, Bhandan requires members to contribute to a mandatory savings plan. Duflo finds promising outcomes, as 18 months after the initial investment, recipients had an increased income of

²⁸¹ Banerjee and Duflo, *Poor Economics*, 126.

²⁸² Orazio Attanasio, et al., “Group Lending versus Individual Lending in Mongolia,” J-PAL, accessed August 22, 2016, <https://www.povertyactionlab.org/evaluation/group-lending-versus-individual-lending-mongolia>.

²⁸³ Monica Sharma, “Beyond Capital Gains, The Multiplier Effect of Youth Savings,” Consultative Group to Assist the Poor (July 2012), <http://www.cgap.org/blog/beyond-capital-gains-multiplier-effect-youth-savings>.

20%, while their food consumption also rose at a rate of 15%. In addition, Duflo again witnessed a multiplier effect, in that “the increase in non-farm small enterprise income exceeded the gain in livestock income, despite the fact that beneficiaries almost all received livestock.”²⁸⁴ These results demonstrate that with tailored training, aid can improve the livelihoods of its recipients.

For instance, savings and insurance programs amongst the poor have become a tool that can promote additional long-term gains in Africa. To support this claim, the organization New America relates of intervention programs in Uganda having greater “asset effects” on children, as the youth have a longer-time span to invest and form good spending habits than if they start saving as adults. Moreover, the second-generation children of microcredit borrowers learn of willpower and planning from the lessons and skills their parents are learning, thereby having greater confidence and aspiration in their adult years.²⁸⁵ Within the macro level, this shift in behavior means that good practices become engrained into widespread practice.

In turn, the structure of savings and repayments of microloans lends to conditioning behavior. For the youth in developing regions, this is a particularly important lesson, as such programs “harness the critical development phases of youth,” while also shifting mindsets with regards to forms of risky behavior, such as that related to unsafe sex.²⁸⁶ Yet, this intervention has security implications as well, as MFI programs that target the youth are taking part in preventative measures that help address emotional setbacks²⁸⁷ or despair that draw individuals into terror and gang networks. In effect, innovative savings schemes enhance the prospect of asset accumulation for children and adults, addressing hazards that the poor face on a daily basis.²⁸⁸

The benefits offered by MFIs go beyond the scope of income generation and savings. Chapter III addressed Proshika’s offerings of various development programs;

²⁸⁴ Sharma, “Beyond Capital Gains.”

²⁸⁵ Ibid.

²⁸⁶ Ibid.

²⁸⁷ Ibid.

²⁸⁸ Banerjee and Duflo, *Poor Economics*, 136.

however, Proshika also offers its borrowers an insurance program that is linked to climate risk, which (as demonstrated in Chapter II) is a variable that significantly defines Bangladesh's overall solubility. Recognizing the need to protect the rural population, Proshika offers an insurance program covering climate related catastrophe to over 2,000 impoverished villages. Learning from Bangladesh's experience, India is now amidst developing its own "smart schemes" and "smart cities," as Prime Minister Narendra Modi is initiating "disaster management" programs that call for infrastructure and planning that will protect India from the effects of climate change.²⁸⁹ These insurance programs will protect India's large farming community from monsoons and floods, natural occurrences that have led India's agricultural wages to be "twenty-one times more variable than in the United States."²⁹⁰

In addition, joint lending is a tool that capitalizes on the makeup of agrarian populations in developing regions. Chapter III's assessment of the way social networks impact joint-lending loans is underpinned by the fact that joint-lending works because it relies on geographical proximity, yet, joint borrowing also works because of the desire of individuals living in close-knit communities to maintain their reputation.²⁹¹

The horizontal networks that form out of the joint-lending process not only establishes greater social solidarity, but the premise is that it is a less obtrusive form of information gathering than having an "outsider" keep an eye on the group.²⁹² This framework means that the joint-lending mechanism is adaptable across various cultures, like in the case of the women running the Roxy theatre in Ghana.

The horizontal network that microcredit works off of has the added advantage of empowering communities as a whole. Grameen found that integration within a community allows its organization to ask clients to commit to life changing behaviors,

²⁸⁹ Nita Bhalla and Jatindra Dash, "India is building 100 'smart cities' across the country," Reuters, March 3, 2015, <http://www.businessinsider.com/r-indias-smart-cities-would-be-stupid-without-disaster-strategy-2015-3>.

²⁹⁰ Banerjee and Duflo, *Poor Economics*, 136.

²⁹¹ Bayulgen, "Muhammad Yunus, Grameen Bank and the Nobel Peace Prize," 534.

²⁹² Karland and Appel, *More than Good Intentions*, 107.

ranging from education of their children to subsistence farming.²⁹³ Yet, programs like Grameen and Proshika also teach about political rights, thereby indoctrinating political reform by shaping development initiatives. For instance, activists working with the NGO National Democratic Institute (NDI) publicly campaign against vote buying in villages across Uganda. Though results for NDI's impact are pending, Banerjee and Duflo contend that Uganda's similar newspaper campaign has had compelling results. In this way, NGOs and MFIs are decentralizing democracy, in that beneficiaries are made responsible "for making sure that schools, clinics, and local roads work well... handing anti-poverty policy...to the poor."²⁹⁴ Thus, by holding public meetings and making use of face-to-face contact, instances of vote buying decrease, while voter turnout increases.²⁹⁵ Moreover, "the very act of working together on a collective project may help communities rebuild their social ties after a major civil conflict,"²⁹⁶ as is reflected in Habib and Jubb's empirical data, which demonstrates a greater sense of civil society exists amongst MFI borrowers than non-borrowers of the same community. The combination of savings, joint lending, close proximity and group empowerment are factors that condition individuals to seek out ways to improve their own social standing. This habituation—extended over a long period of time—is helping shift social and cultural norms that will reduce symptoms of poverty, specifically by shaping how the poor interact in the political domain.

Despite these distinctions, the obvious and possibly most important qualifier for microcredit programs is that they offer an opportunity to the poor when no other option is available. Moreover, MFIs cater to the needs of their environment, with representatives learning from borrowers about what works. The challenges that microfinance banks face, however, is how to ensure borrowers are successful. This leads to questioning the possibility of greater outcomes if borrowers are provided specific training- as entrepreneurship is not natural to all people. In an effort to validate if training makes an

²⁹³ Ibid., 120.

²⁹⁴ Banerjee and Duflo, *Poor Economics*, 146–47.

²⁹⁵ Alan Gerber et al., "Voting and Habit Formation in the United States," J-PAL, accessed August 22, 2016, <https://www.povertyactionlab.org/evaluation/voting-and-habit-formation-united-states>.

²⁹⁶ Banerjee and Duflo, *Poor Economics*, 148.

impact on income generation, Karlan and Appel provide promising data. In Peru, they conducted a controlled experiment comparing business revenues of locals who received brief training from Foundation for International Community Assistance Peru, including bookkeeping and market information with locals who did not receive any such training. They find that business revenues of those that received training were higher, particularly during bad seasonal months, as the clients learned how to guard their business operations from fluctuations more effectively.²⁹⁷ A positive relationship between training and increased business success is further substantiated when Karlan and Appel find similar results in Mexico and The Dominican Republic.²⁹⁸ Their data provides insight that individual training can better equip borrowers with information to succeed as entrepreneurs. The essence of microcredit, then, is that it adapts to the poor. MFI branches that exist in environments where groups are culturally connected allow this to happen—a condition proven to make civil society more salient.²⁹⁹ Under the framework of behavioral economics, microcredit emphasizes social and group dynamics, lending to the efficacy of microcredit programs. For these reasons, the types of microcredit schemes applied in Bangladesh seem, anecdotally, to also be successful in alleviating poverty in other developing nations that have similar social and cultural structures.

D. CONCLUSION

The direct effects of microcredit have shown to reduce poverty. Simultaneously, the spillover effects of microcredit have proven to shape social and political outcomes that are positively affecting symptoms of destitution.

Areas of study for future research may provide insight on ways in which microfinance institutions can continue to alleviate poverty. Currently, the primary goal of NGOs is not profit- but what if this were to change? For example, if the intent for banks and institutions is to make profit while serving the poor, will this then further incentivize the stakes to reduce poverty or will it leave out the real poor where chances on making

²⁹⁷ Karlan and Appel, *More than Good Intentions*, 94–96.

²⁹⁸ *Ibid.*, 97.

²⁹⁹ *Ibid.*, 123.

profit are unclear? Are there different mechanisms that for-profit organizations can offer that hinder or improve rates of poverty reduction? As the commercialization of the microcredit market is a new junction, commercial developments on poverty alleviation remain to be seen.

Meanwhile, Bangladesh has made significant gains post-Independence in 1971. While Millennium Development Goals are being met through both private and public initiative, the innovative micro-movement is furthering the nation in its development goals and efforts to reduce poverty levels. With regards to international policy, the experience of Bangladesh serves as an example for other developing nations replicating Grameen's microcredit model.

In addition, with international trade and technology transfer underpinning the globalizing current, MFIs are in a position to take advantage of growing trade opportunities. Substantial widespread results, however, will come to bear only if poor individuals receive the education, training and access to information needed to make the most of these opportunities. The good news is that microcredit organizations are offering just that- and the private sector is catching on.

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