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Investing in the Poor – Jobs, Education and Technology

Microfinance has come a long way since the 1970s, when Grameen Bank first offered small loans to the poor. It is now at the cutting edge of evidence-based aid. Chakriya Bowman and Patrick Kilby say that today we know it is the investment in people, not simply the provision of loans, that really makes the difference to the poor.

Nobel Laureate Mohammad Younus and his Grameen Bank were pioneers in the provision of small loans to poor people, and started an industry that now sees finance companies like Citibank and ANZ providing financial services to customers previously thought unbankable. Savings and loans programs are just the visible tip in a vast array of ways that relatively small amounts of money are made available to the poor in developing countries.

The insurance role of savings and loans is the most valuable aspect of microbanking to the poor, not the ability to finance entrepreneurs and business activity

Microfinance offers a full range of financial services to the poor, including savings, loans, insurance (including life, weather, livestock and natural disasters), money transfer services (including remittances) and pension schemes. Here we examine new directions in microfinance, and focus on innovations that improve the delivery and use of financial services to the poor.

Micro-credit, the provision of small loans to the poor, works on the premise that the poor lack access to capital, and that this is what keeps them in poverty. Some proponents have gone so far as to claim that access to credit is a human right – albeit one denied to most of the population over the course of history.

But things have changed since the poor were regarded as producers in need of capital. We now know that the insurance and consumption-smoothing role of savings and loans is the most valuable component of these services, not their ability to finance entrepreneurial activity. Micro-insurance is growing strongly and is providing products as diverse as monsoon insurance for Indian farmers, snow leopard insurance for Nepalese herders and remittance insurance for the families of migrant workers in Mexico.

This policy brief looks at three emerging issues in microfinance: two innovations - financial training for the poor, and new technologies in service provision; and a continuing puzzle - the failure of micro-credit to create employment.

POLICY RECOMMENDATIONS

1. JOBS FIRST

Microfinance plays an important role in the lives of the poor, but the provision of credit to fund home-based business is no substitute for wage-earning opportunities. Ultimately, most people prefer wage employment. Microfinance is a complement to, not a substitute for, policies that encourage larger-scale employment generation.

2. EDUCATION SECOND

Human capital is as important as financial capital. Training in business skills and financial literacy must accompany the provision of microfinance services. The poor can be taught skills that will improve their financial management and business skills, to the benefit of both themselves and their microfinance provider. Programs such as ANZ's partnership with UNDP show the way forward in the Pacific.

To complement this, programs like the Australia Pacific Technical College, which equips Pacific students for the global job market, should be encouraged for their potential to increase the flow of remittances.

3. ENCOURAGE A REMITTANCE CULTURE

Remittances are also an important source of finance for the poor, and policies that increase remittances should be encouraged. The Australian aid program needs to recognize the importance of remittances to developing countries and incorporate them into poverty reduction strategies.

4. ENCOURAGE COMPETITION IN TECHNOLOGY AND BANKING SECTORS

Microfinance has thrived in markets where governments have regulated, but not constrained, the banking sector (e.g. micro-insurance in India) and telecommunications sector (e.g. mobile phone banking in the Philippines). Competition in Pacific telecommunications is likely to lead to a mobile microfinance revolution like that seen in India, Africa and Asia.

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Of real concern to the modern microfinance community is the mythology that behind every poor person is a budding entrepreneur. While there is no doubt that micro-credit can bring welfare benefits to the poor, the ability of the poor to turn subsistence living into a true enterprise – to "go to scale" - is much more doubtful. Even Alex Counts, director of the Grameen Foundation, admits that only 10 percent of the bank's 7 million clients are "true entrepreneurs" who "started borrowing $100 and are now borrowing $10,000 to $20,000", and says that most are simply making ends meet. The failure of micro-credit to move from the household to the enterprise has been one of the confounding features of microfinance.

In Australia, less than 20% of workers are self-employed or run their own businesses, and it is unrealistic to expect developing country workers to have different employment preferences to those in the West. Most now recognize that home-based enterprises are an option poor people take simply because they have no alternatives. Turning economic activity into jobs remains fundamental to development, particularly in countries experiencing slow economic growth coupled with high birth rates and particularly in our region, where countries like Papua New Guinea and East Timor are experiencing civil unrest caused in part by unemployed youth.

Micro-enterprise is not a panacea for a growing youth bulge, and few experts would proffer it as such. As Elizabeth Littlefield, CEO of microfinance experts the Consultative Group to Assist the Poor, said recently, "Are all of these… young people going to want to be micro-entrepreneurs? Are they going to want to sell bananas and tomatoes on a little handkerchief on the side of the street like their mothers did? Or are they going to want jobs? I think they may want jobs."

The fact remains that large-scale economic development, such as that seen in India, China, Singapore and Japan, is driven by large-scale industry, be it manufacturing or services. That is not to say that microfinance doesn't have a role – it plays an important part in development – but its role should not be overstated, nor should it be used to downplay the necessity of business enabling reform. Instead, microfinance should be used to complement initiatives that promote a business-enabling environment and help to facilitate foreign and domestic business investment.

Part of the scalability puzzle may be access to education. New work by Dean Karlan, of Yale University, shows that financial literacy training significantly improves the performance of micro-entrepreneurs. He finds that small amounts of compulsory small business training significantly improve business performance and the ability of customers to repay their loans. This last item is particularly important, since many of the social problems around microfinance schemes are caused by lenders unable to make repayments. Dean's work shows that education, not just access to capital, is fundamental to people's ability to participate in business activity. While in the past we thought that the provision of loans made people wealthier, Dean has shown that education most helps the poor improve the quality of their lives. Education should be at the heart of microfinance.

ANZ has led the way in the Pacific with its innovative "Banking the Unbanked" rural banking program. By partnering with UNDP, who provide financial literacy training to customers for bank accounts and services, ANZ has provided education and access to finance for over 60,000 Fijians and is now working with tens of thousands in the Solomon Islands. Financial literacy training helps ANZ manage its risk, while also helping the poor to make best use of the services they receive.

Technology is also helping the poor access financial services in new and innovative ways. It has been particularly effective in bringing banking infrastructure to rural and remote locations. Automated teller machines and point-of-sale savings and credit access allow the poor to more easily access banking services, and initiatives like ANZ Pacific's mobile banks help them to reach isolated customers. Technological innovation is greatest in those developing countries fortunate enough to have functioning telecommunications markets with adequate competition. Mobile telephones have revolutionised banking in India, Africa and Asia, where small transactions can be made very cheaply using mobile phones instead of debit cards.

Microfinance is not the only way the poor finance their investment and savings activities. Remittances are increasingly important in many countries, and the Pacific has seen strong increases in remittance levels over the last five years. IMF figures show that Fiji's remittances have grown almost 130 percent in this time, and now comprise 6.6% of GDP. Tonga, one of the most remittance dependent economies in the world, has remittances comprising almost 40% of GDP.

If remittances could be sent cheaply by mobile phone in the Pacific, as is done in the Philippines, millions of dollars would reach the poor that are currently being lost in transaction fees. With better education, micro-entrepreneurs could move beyond subsistence living. But most importantly, the Pacific needs jobs – and that remains the biggest challenge for donors and governments alike.