

The microcredit

*Author: Michel LELART
Research Director of CNRS
Economics Department of Orleans*



INTRODUCTION

Microcredit now seems familiar and it is easy to understand why. A microcredit summit was held in Washington in 1997 by an international NGO in charge of the fight against hunger and poverty (RESULTS). Other "summits" followed. The UN has decided to declare 2005 the year of microcredit. The following year the French President Chirac organized in Paris an International Conference on microcredit in which Muhamad Yunus took part. Now everyone knows this Bangladeshi professor of economics who, considering the conditions under which his village women borrowed money every morning, decided to lend them some money, so that they no longer needed to turn to loan sharks and finally enjoyed their work. This happened in 1972. A few years later, a bank is created: the Grameen Bank now has 7 million of customers in Bangladesh and is present in sixty countries. The history of microcredit seems uncomplicated. The reality is more complex, to the point that it is not easy to define the concept in a precise way, as it is no straightforward to know if it actually creates wealth or, on the contrary, if it encourages debt.

WHAT IS MICROCREDIT ?

Microcredit is a loan of a low or very low amount granted to people with a very modest income and who don't have almost any guarantees to offer, with the exception of the creation of small groups where everyone agrees to be supportive. This definition does not define the amount to be considered for "microcredit". The World Bank retains a limit corresponding to 30% of GNP per capita of the concerned country, which should make \$ 150 in Madagascar, \$ 400 in Cameroon and \$1300 in Tunisia. Specialized institutions such as ADIE in France grant these credits, or cooperatives, especially in Africa, like Crédit Mutuel and Desjardins. When these institutions were created, they lent to their members very small amounts. Moreover, the credits can be granted also by banks of small enterprises or by support programs sustained by NGOs ... The diversity of these institutions lies within the fact that it is not always easy to take stock of these operations. Micro-credit is not an usual loan, it is most often accompanied by others elements. In fact, while he retains some money, the borrower benefits from tips that will help him use the borrowed money in the best way: how to keep accounts, calculate a cost, comply with a regulation, and choose a particular approach or a project among others ...this microcredit comes normally with other services, mainly financial services. The savings are complementary to the credit since they are the same savings that allow you to borrow less; it is the assurance that reduces risk and provides some security; in the end, it is the transfer of money, which has become so important for people who do not have bank accounts. The set of all these services characterizes the microfinance. This concept is often confused with the microfinance. We will continue to talk of micro-credit, but we could say much the same of microfinance.

DOES MICROCREDIT CREATE WEALTH ?

Microcredit should generate wealth when the borrower exploit it to develop an "income-generating" business or even to start a new business. It is usually an agent of the informal sector who hopes in this way to make more money and improve his standard of living and the well-being of his family. And sometimes he succeeds. Who has not heard about some success stories highlighted by the press? They tell the story of a woman or a boy who, having borrowed the equivalent of 100 or 200 euros, managed to open, on the sidewalk of her/his home, a small neighbourhood restaurant or to create a tiny sewing shop. The years

passed, the restaurant and the shop grew. In reality, the picture is not always so positive: we talk about stories that are successful, but we do not speak of others. We know how many credits the institutions granted, but we don't know how these credits were used. Moreover, we know that it would not be easy to isolate what is really investment, to understand how to assess the impact of this investment and how to measure the increase in income which it has generated. We deal with informal situations, where any measure is imprecise by nature.

The surveys conducted showed quite different results. These small loans often result in an increased production and thus revenue, but the results vary from one institution to another and from one company to another. They depend greatly, for example, on borrower's skills or on assistance effectiveness. It must be said however, that these loans are always based on a short term, so they are more suited to commerce or crafts, or even to agricultural production. In addition, many other conditions must be met, at the micro level but also at macroeconomic level, in order to make this investment profitable. Despite the large number of impact studies, as they are called, an accurate assessment of the economic efficiency of micro-credit still remains to be conducted.

DOES MICROCREDIT PROMOTE THE DEBT?

Any credit must be repaid when it is mature with the expected interest, as a result the debt does not accumulate. It is the same when it comes to micro-credit, especially since the amounts are low, the interest rate is sometimes subsidized and it is not very significant. Moreover, money from microcredit is "hot" money, which debtors repay on time, unlike the "cold" money. Finally, it was often found that poor people repaid more than the rich did because, without guarantee to offer, they want to honour their word. This is why many institutions have no unpaid loans or, if they have, they are not excessive.

In reality, it is not always like this. The rates are generally high because the management of appropriations is more expensive when the sums loaned are modest: how much does the management of 100 credits of 300 euro and that of a single credit of 30,000 euro cost? In addition, institutions are rarely subsidized, so they can balance their accounts, and reach and then retain their financial independence, only by increasing the rate of their loans. Although these rates are still lower than those charged by usurers, they can become excessive. It then causes problems in repaying the credits, which can be renewed. Debt accumulates and borrower position may quickly deteriorate, especially if he repays one institution, borrowing from another institution ... These debts have recently taken new proportions, considering that some institutions favour the financial profitability at the expense of the services for the poorest people. It is called the commercialization of microfinance which affected especially some Indian institutions (SKS in Andhra Pradesh) and Mexican institutions (Compartamos). This was caused by a strong increase of their customers, along with abusive behaviours of their loan officers. The result was, at once, a huge increase in their operations (70% per year for SKS!) and the growing indebtedness of an increasing number of clients who found themselves unable to repay their debts, to the point to commit suicide. Ultimately, micro-credit promotes sometimes indebtedness and it does not always create wealth. These two effects are complementary: it is because the borrowed money is not well spent or because the borrower poorly invests it, so that he cannot pay interests, or especially repay them. This may be his fault, incompetence or bad faith, or it may be the institution that forgets its mission and seeks firstly its profit. You can find everything in microfinance. And this is the reason why some focus on the excesses of microfinance, while others defend its contribution to poverty reduction and, beyond, to development. The current controversy between JM Servet and I. Guérin one hand, and A. Banerjee and Duflo E. on other hand is indicative of the variety of analysis. Some borrowers will flourish, others will be ruined; some institutions will expand, others will go bankrupt. The reality of microfinance - and therefore of microcredit - is certainly not impossible to define, but this does not mean that it is easy to grasp.

REFERENCES

BANERJEE A et DUFLO E., *Repenser la pauvreté*, Seuil, 2012.

BOYE S., HADJENBERG J. et POURSAT C., *Le guide de la microfinance : micro-crédit et épargne pour le développement*, Editions d'Organisation, 2^{ème} édition, 2009.

DUFLO E., *La politique de l'autonomie*, volume 2 : Lutter contre la pauvreté, Seuil, 2010.

GUERIN I., *La microfinance et ses dérives – Emanciper, discipliner ou exploiter ?*, Démopolis, 2015.

SERVET J.M., *La vraie révolution du micro-crédit*, O. Jacob, 2015.

Techniques Financières et Développement, La crise de la microfinance – Tour d'horizon, n°106, mars 2012.

The opinions and recommendations included in this Thematic Brief are those of the author(s) and do not necessarily reflect those of the European Commission.