

## Regional Comment

ELISABETH RHYNE

# Five countries where microfinance works

Microfinance in India is suffering a serious crisis, stemming in part from uncontrolled loan growth by microfinance institutions (MFIs) in the southern state of Andhra Pradesh. This crisis and the Indian government's response to it (see the recent Malegam Committee Report to the Reserve Bank of India) have captured the attention of top line media around the world. Their reports up-end the traditional public narrative, in which microfinance figures as an important antidote to poverty. The substitute narrative, as articulated by Mohammad Yunus of the Grameen Bank, puts blame for the crisis on commercialization and with it, the profit motive.

But Indian microfinance is hardly a template for all. There are many paths to a successful microfinance sector that serves the financial needs of low-income people well. Herewith, the view from five countries, starting with troubled India.

Indian policymakers created a perfect storm for a microfinance shipwreck. Policy toward microfinance in India could hardly have been more problematic. Possibly the biggest mistake: although large MFIs were allowed to convert from non-profits to commercial institu-

tions, they were not licensed to take deposits. Most people need savings alongside credit. The balance helps clients become better financial managers, build their own assets, and avoid falling into debt traps. The MFIs, locked out of the ability to provide a range of services, had no other channel for growth than unbridled credit expansion. On top of this, the commercial banks were given "priority sector lending targets" – essentially a demand that they thrust money into the hands of the MFIs. With all that money flowing in, the market overheated. Cap it all off with lax oversight of governance when granting licenses to MFIs: there were few checks and balances to encourage restraint and responsible practices.

Tiny Bolivia got many things right. Bolivia developed a world class microfinance sector, starting with the conversion of the microfinance NGO Prodem into BancoSol in 1992. With support from the regulators, BancoSol became one of the world's first private commercial banks dedicated to serving the poor. From then on, many microfinance institutions in Bolivia and around the world followed BancoSol's example, and several countries copied the legal framework in Bolivia that made it possible. BancoSol now offers services from microenterprise loans to savings

accounts, money transfers, home improvement loans and insurance. So do many of its competitors. And the competition between these strong institutions brought interest rates in Bolivia below 20 percent, among the lowest microfinance rates in the world.

Cambodia and Mongolia followed Bolivia's example. Aleda Bank in Cambodia and Xac Bank in Mongolia developed in much the same way as BancoSol. Starting as non-profit organizations, they converted into for-profits and eventually commercial banks. They added savings and other services, offering a solid range of products. As market leaders and innovators, they inspired other institutions to enter and spark competition. And this is very important: all these institutions are owned and governed by a carefully selected group of socially responsible shareholders who make explicit their intent to seek both social and financial returns.

Indonesia showed what a state-owned bank can do. Back in the 1980s, Indonesia's government rural bank, Bank Rakyat Indonesia, was running a subsidized credit program called BIMAS to encourage farmers to grow more rice. BIMAS performed poorly and cost the government budget so much money that policymakers decided to scrap it and start over with a

new model. That model, the BRI Unit Desa System, involved very simple branches offering savings and microenterprise credit – basic banking services – to the self-employed across the country. BRI's Unit Desa System now serves tens of millions of clients, has been profitable since it began, and has never experienced a significant crisis of overlending. It succeeded because policymakers allowed it to run on sound banking principles, without political interference.

The Philippines took an eclectic approach. Appropriately for an archipelago nation, the Philippines encouraged many kinds of institutions to blossom, including small local banks, NGOs, and specialized microfinance banks. This has encouraged local initiatives, with social entrepreneurs and social groups from many walks of life making personal contributions to create a vibrant marketplace. The government has offered them a sound but supportive regulatory path, with attention to client protection. The government's nurturing approach led the Economist Intelligence Unit to rank the Philippines second in the world in its "Global microscope on the microfinance business environment 2010" which rates countries according to their microfinance regulatory and market infrastructure.

The lessons to draw from these examples are encouraging for the future of microfinance. The countries that have created microfinance "happiness" all recognized that savings needs to accompany credit, both to be truly beneficial to clients and to prevent aggressive growth by lenders. They created specialized regulatory frameworks that were empowering to institutions wishing to serve the low end of the market. It's not that they went easy on MFIs; rather, they made sure that requirements to ensure safety and solvency were a good fit for institutions working with the tiny transactions of the poor.

Moreover, all the countries encouraged microfinance to develop as a commercial business, but not one where unbridled profit-seeking was the norm. They did this by placing the driving force into the hands of owners with social commitment alongside their requirements for financial returns.

Microfinance still holds enormous promise for increasing the access to financial services to the millions of people around the world who lack them. Good policies and supportive policymakers enable that promise to be realized.

*Elisabeth Rhyme is managing director of the Center for Financial Inclusion at ACCION.*

ANDREW SHENG

# GDP versus quality of well-being in modern society

GDP, it seems, is growing. But are we really happy with our quality of life? Most people feel that life has become a rat race.

In 2008, just as the financial crisis deepened, French President Nicolas Sarkozy asked Nobel Prize-winning economist Joseph Stiglitz to organize a "Commission on the Measure of Economic Performance and Social Progress" (CMEPSP).

The report came out in late 2008, but its important conclusions and messages were perhaps overshadowed by the financial crisis. Nevertheless, as governments and companies across the world are trying hard to recover, it is more timely than ever to think beyond GDP – not just the quantity of how much we produce or consume to measure economic and social progress, but the quality.

You only have to look at the way Asia has rushed ahead at full speed to push growth and then to realize after that this may not be what the new middle class (and

indeed everyone) cares about. I was impressed when one senior Asian economist started talking about beauty and happiness as one measure of economic aspiration.

We need a new metric of human well-being that captures these dimensions: economic and job security; health; education; personal and work environment; sense of equality and respect; connectivity with family and friends; pleasant natural environment; and physical security.

There is a whole generation who seems to care more and more about Chanel handbags, iPhones, Chateau Lafite and all the icons of material wealth. Others are pursuing yoga, *qigong* or religion. There is the digital generation who prefers to communicate through Facebook, YouTube and Twitter, rather than talk face to face. Social change is happening even as the bulk of Asian society struggles to make ends meet. In many parts of Asia, we face crumbling social infrastructure, overcrowding, environmental pollution and social disquiet. Social

injustice is witnessed even in very wealthy and successful Asian cities.

What can governments and civil society do? The Stiglitz Report is a very useful reminder that we should begin by measuring what people care about, not just in terms of the quantity of production or consumption, but the quality of well-being.

The report tells us that GDP is a very narrow concept and does not measure many qualitative issues. For example, most people feel that official statistics, such as CPI (consumer price index), do not reflect their own perception of inflation, and GDP, as a concept, does not measure or undercount what households and civil society produce. They certainly do not incorporate any measure of inequalities, since the average per capita GDP can camouflage the sense of growing disparity.

As Asia goes through rapid changes in demographics, urbanization and other social transformations, it is not surprising that the metrics that we are using to mea-

sure our economic success or failure is not up to date. It is as if we are driving a car whose speedometer shows that we are accelerating at 70 miles per hour, but there is no indication that we may be going into a bad neighborhood or that the car may be falling apart. Indeed, if we focus on speed, we may neglect the direction that we are heading. Speed comes before a crash.

Globalization has created huge opportunities as well as threats. Governments need to appreciate that in the global competition for talent, people can easily walk with their feet. But they will not walk away if they love the neighborhood and the community they live in. We all want a sense of livability – clean air, good health, great culture, nice people, and no fear about physical security.

Well-being is a sense of community – that people care for each other, feel equal and have mutual respect. We should not see strangers as another mugger; a policeman as a person to be feared. We want good

governance in our society, and most of all, we want a caring community that looks after the poor, the weak and the under-privileged.

As governments struggle with how to deliver better governance, we need to begin with better measures of social well-being instead of just using GDP as an indicator. Unfortunately, the Stiglitz Report is only a beginning. It may have pointed out the weaknesses of GDP, but it has not operationalized to arrive at a better measure.

Now that Asia has reached the head table, one Asian government or statesperson should take the leadership of chairing a roundtable of statistical experts to arrive at a better measure of social well-being than just GDP.

We need Stiglitz Report 2.0, with more Asian input. Welcome back, Joe.

*Andrew Sheng teaches at Tsinghua University and is author of the book, "From Asian to Global Financial Crisis".*