Financing of Development and Micro-credit

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Introduction

Sustainable development requires sustainable funding. Sustainability in funding is achievable when lenders and borrowers are mutually dependent and know each other well. This principle is missing from many large-scale lending programmes of banks and multi-lateral development banks.

The recent currency crisis in Asia can be attributed to the lack of this market interdependency: the so-called short-term 'flash-capital' was abruptly withdrawn by far-way foreign partfolio investors who did so not because of the performance of particular investment companies, but because of a generally negative sentiment in the market about some South East Asian Tiger economies.

Certainly a degree of large-scale central funding is still required, specifically to fund those sectors of the economy and society that do not have access to capital markets easily (such as remote mountain communities).

In terms of sustainability most development is to be expected from the efforts to set up micro-finance schemes in which small ('micro') loans are given to, e.g., individuals, households, thrift societies, small enterprises, and NGOs, usually without demanding collateral except for a group guarantee.

In the last decade, micro-finance has proven to be a very effective instrument to raise the incomes of local grass roots' communities, while high repayment rates have created financially sustainable lending programmes. Success stories of Micro Finance Institutions (MFIs), such as those of the *Grameen* Bank in Bangladesh and the *Banco-sol* in Bolivia, are now followed throughout the develop-

ing world. Central Asia is also experimenting in this field; e.g., through the Mercy Corps which supports programmes in Kazakhstan, Kyrghyzstan, and Tadzhikstan; a joint Chinese-Canadian initiative in Xinjiang;, the Peak Enterprise Programme of the Mountain Institute in Tibet; and Micro-Start of the UNDP in Afghanistan, Mongolia, and Kyrghyzstan. ADB has invested in micro-credit institutions in Nepal and China.

Clearly, with any credit scheme, the loan recovery rate is a critical factor. Often there are problems with loan repayments. This determines the viability and sustainability of a scheme.

Factors to be considered when establishing credit programmes include the following.

- A legal structure is needed to regulate MFIs, including NGOs, credit unions, and public trust funds.
- Cost of operations — Sustainable credit systems not only need to cover costs of operations (overheads) but also non-recovered loans and inflation.
- Organizational structure — Should the credit be provided to individuals or through private farmers' associations?
- Governmental role — Should the government be involved and compete with private enterprises?
- Social values and lack of economic understanding can undermine a credit system. Credit recipients of donor grant programmes are sometimes confused about the difference between credit and grants.

A big obstacle to credit supply in countries under a socialist regime is that land is a communal or state property. The farmers only have users' rights to the land and no title deeds. Thus, the land cannot serve as collateral for a credit supplier, which makes the acquisition of credit very difficult.

Therefore, in the countries belonging to the CIS it is of utmost importance that laws on privatisation of land are passed by their governments. This will support agriculture, as it will not only allow the farmers to get credit, but they will also be more eager to invest in their own land.

As soon as the farmers (and other entrepreneurs) possess title deeds on their estates, banks should have no problem in starting credit schemes.

It is also recommended that central governments, such as the Chinese, free the fixed interest rates now monopolised by state banks. Without flexible interest rates there is no incentive for micro-credit programmes and those that do start are prevented from becoming financially sustainable organizations. Higher interest rates do not mean exploiting the poor, but rather it is a way to achieve efficiency and to stimulate capital flows to farmers and small-scale enterprises in the rural sector.

Major Issues and Experiences

Micro-Finance in China: A Xinjiang Case Study

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The Canadian Cooperation Association is the executing agency for the Canadian International Development Agency (CIDA) for the Xinjiang project. This project was designed in October 1996 and attempted to take the best aspects from a variety of micro-finance projects and integrate them into a project that was both financially and operationally sustainable. The project has now been successfully tested for about a year and a half.

Banking for the poor is a concept that has been around for a very long time and which has been operationalised un-

der a variety of names such as village banks, credit cooperatives, revolving loan funds, pre-credit units, and, more recently, micro-finance. One of the better known is the *Grameen* Bank in Bangladesh, created by M. Yunnus, which is engaged in commercial lending to poorer groups.

The Xinjang project, which focussed on providing women with access to credit, training, and other inputs for improving their economic opportunities, operates at a level between that of a village bank and a credit union. The priorities are to ensure sustainability through independence and beneficiary control of activities, a grass roots' approach, and permanent access to credit. The last point is important because most projects think only of the short run. In order to ensure sustainability of the activities, mechanisms had to be envisaged that ensure the project continues long after external support has gone.

An important component of sustainability was the mobilisation of savings and a certain loan to saving ratio was maintained that was altered from one cycle to another. Two kinds of savings' accounts were maintained with funds split between the two. The regular savings' account permitted members to deposit and withdraw funds while the share accounts had funds locked in for certain periods before one could withdraw, even if one did not participate in the programme. A 20 per cent interest rate was charged on all loans. The concept of a village centre development fund to be supported from a part of the interest payments was also introduced for investment in a community type devleopment project.

Initially, credit was provided for a period of six months to all because a longer time period implied greater risks for the loans. The model adapted different components from both the *Grameen* Bank and P-28 of UNDP and established solidarity groups formed by a membership of seven to 10 persons. Each individual was responsible not only for his/her loan but also for the loan of the other individuals in the group.

The repayment rates since the project started have been one hundred per cent. In the first cycle the loan savings ratio was 10 to one and this became eight to one in the second cycle, six to one in the third cycle, and four to one in the fourth cycle. The maximum amount was limited to 2,000 RNB, and the future of the project will need to address how to increase the size of loans. A minimum monthly payment cycle is also enforced. Some of the interest incomes are also forwarded to the county government.

One of the important challenges so far has been to motivate people considered backward to come forward and participate in these activities, learning how to run their own business organization, to keep records, and make decisions. The project has also organized training and study tours to other groups.

Initially it was difficult to choose the right target group, and experience underscores the importance of a proper baseline survey so that the most needy households are selected. Working with women members in certain types of communities must be approached carefully. At present, all the participants are women with the average age being from 45-50 and ranging from 18 to 75. There are no restrictions on adult participation.

The formation of solidarity groups is left to the members who send representatives to the management committee. There is also a county project office and its staff members are paid by the county. The field offices are being supported by the project but will also be supported by the county soon. The role of the field officer is very important because he/she is both the motivator and the technical

person that helps six to 10 groups at any time.

The training programmes have attempted to develop confidence among the people. As far as possible technical knowhow has been sourced at the grass roots and tailor-made for specific needs. It is sensitive to culture and gender and interactive delivery methods have been used. It has also tried to be responsive to evaluation and feedback. The areas of training have focussed on micro-enterprise business management, financial management, literacy, numerical skills, health care, gender, and cooperative development with the full participation of husbands and professional development for staff. Support has been provided to the county project office so that it can be effective in planning, monitoring, and evaluating in the future. A computerised financial information system has been put in place that provides membership information and project performance data that can be readily recovered.

During 1997/1998 there were over a thousand members in 28 groups in 14 villages. The loans disbursed were above US$145,000 and savings were US$34,500. Marketing funds were also obtained from Beijing for one-third of the group, although a small interest is being paid on the amount received. In future, the plans are to expand membership groups and loans, generate more savings, and start a women in development centre with a priority on medical services and a cooperative health plan. So far the project has been very encouraging and, as it expands, new challenges are expected with an increasing role for the local people in solving their own problems.

Micro-Credit for the Poor of China

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The micro-credit pilot project started in 1994 and was implemented by a unit of the Chinese Academy of Social Sciences. It was an action research project attempting to replicate the *Grameen* Model approach for poverty alleviation in China. This was in response to the conditions prevailing: poor households lacked access to credit, most poverty-related loans had very low repayment rates, and it was generally believed that poverty alleviation activities could not be carried out with loans from financial organizations.

The main objectives were to provide loans to poor farmers, demonstrate that loans could be repaid, and cover 1,500-2,000 poor households in the next two to five years. The project received funds through a technical grant from the Ford Foundation, the Australian International Development Agency, and from Canada.

The operational system consisted of a head office and country office with a great deal of independence given to the county office. The local government provided full support. The target was to reach poor households and poor women specifically. There were three sizes of loans of *RMB 1,000, 1,500 and 2,000. The interest rate was eight per cent and repayment after three weeks' grace was in weekly installments. Solidarity groups consisted of five members in each group. Four to five groups got together to establish one centre where weekly meetings were held to discuss weekly repay-

* Currently there are 8.26 RMB to the US dollar.

ments and other issues in the group. Savings were also considered part of the group funds and weekly savings expected from each individual were of RMB one each.

So far four branches have been established in the three Provinces of Heibei, Hunan, and Shanghai with 5,668 borrowers.

The total loan was US$ 1.5 million while the outstanding loan was US$550,000. The repayment rate was 98 per cent.

Regarding the impact on poor households, the average profit rate was 144 per cent, while for farming and animal husbandry it was 107 per cent, and almost 94 per cent for small businesses. Three of the branches have achieved operational sustainability in terms of being able to support all their costs from the interest payments. The other impact has been the extension of this model for poverty alleviation by the two hundred other county governments in 10 different provinces. By the end of 1997, about RMB 100 million was being provided under this scheme.

The Asian Development Bank's Commitment to Sustainable Development in Central Asia

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Sustainable development is an important issue for every country in the world, be they established industrial, new industrialising, or predominantly agrarian countries. All share the same global resources of air, water, and land, so unsustainable development in one country often effects other countries. This is particularly evident when such activities generate transnational pollution such as atmospheric smoke and airborne particulates, or water-borne pollution in our oceans and seas.

For the newly industrialised countries, it is particularly important to keep sustainable development in the forefront of development planning. All too often, in striving for rapid economic growth, the Bank's Developing Member Countries (DMCs) have industrialised using inefficient and unsustainable technologies rather than planning for sustainable development. The result has been costly not only in terms of a degraded physical environment, which must be later cleaned up, but also in terms of the declining health standards and quality of life caused by pollution.

The United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro, Brazil, in June 1992, provided guideposts to humanity leading to equitable and sustainable development in the 21st century. Sustainable Development was defined in 1987 by the World Commission on Environment and Development as a process in which the exploitation of resources, the direction of investment, and the orientation of technological development and institutional change meet the needs of the present generation without compromising the ability of future generations to meet their own needs.

The Bank, recognising its important role in promoting sustainable development, was represented by its President at this historic event. The broad goals of UNCED were laid out in the 40-chapter plan known as Agenda 21, or the action programme for implementing the principles enunciated in the Rio Declaration, or 'Earth Charter', which resulted from UNCED. After a review of the Bank's environmental and social development programmes and activities in comparison to the recommendations in Agenda 21, the Bank adopted measures to ensure sustainable growth in the region. As a first step, the Bank outlined a strategic

framework for environmental action, taking due account of the Bank's Medium-Term Strategic Framework and the UNCED recommendations relevant to its operations. This was formulated in the volume, *'Incorporating the UNCED Agenda, in the Bank's Strategic Planning Process'*, issued by the President's Office in December 1993.

In keeping with its mandate, as well as to prevent overlapping with the work of other international development agencies, the Bank has concentrated on financing specific aspects of sustainable development as outlined by the Agenda 21 action plan. Among others, Bank activities have included poverty reduction; protection and promotion of human health; integration of environment and development in decision-making; promotion of sustainable agriculture and rural development; protection of the atmosphere; conservation of biodiversity; transfer of environmentally sound technology; cooperation and capacity building; combatting deforestation; and protection of the quality and supply of fresh water resources. Not covered by the Bank have been Agenda 21 items such as the safe and environmentally sound management of radioactive waste.

The Asian Development Bank provides several types of financing for sustainable development projects. These include both loans for investment projects and grant funded projects. The poorest Developing Member Countries (DMCs) have access to Asian Development Fund (ADF) financing. The ADF provides long-term investment project financing at concessional rates; typically with a nominal one per cent per annum interest rate. For other DMCs, investment project financing is provided from the Bank's Ordinary Capital Resources (OCR). OCR loans are provided at the Bank's market interest rates, which are still considerably below those that would have to be paid for borrowing money from private commercial banks.

The Bank provides a variety of Technical Assistance (TA) projects which are financed by grants. Generally small, these may be to prepare for a later loan-financed project, or they may be to provide advisory assistance for institutional capacity building. Regional Technical Assistance (RETA) is provided also by the Bank to foster cooperation among several DMCs facing a common issue such as air pollution, a shared resource such as a watershed, or cross-cutting concerns such as poverty alleviation.

In addressing sustainable development in the new Central Asian DMCs, the Bank is focussing on: mitigation of the high cost of transition, capacity building in environmental management, energy and agricultural policy reform, and restructuring of water resources in the context of irrigation and agricultural projects.

To promote sustainable development, the Bank has actively supported regional/subregional cooperation among its DMCs. To accomplish this, Bank-financed Regional Technical Assistance (RETA) projects have been provided to help resolve cross-border and regional / subregional issues. Over the years, a number of RETA projects addressing sustainable development have included Central Asian countries.

The individual country projects and Regional Technical Assistance projects are just a sample selection, highlighting some of the ways in which the Bank has promoted sustainable development. Through individual country projects and technical assistance programmes, the Bank continues to assist its DMCs in achieving economic growth through socially and environmentally sound development. Multiple country cooperative efforts have been designed to complement and enhance individual country programmes and specific projects aimed at sustainable growth and development of the Asian Development Bank's Developing Member Countries.

HPI's Model for Helping the Poor in China

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Heifer Project International (HPI) is an ecumenical, non-government and non-profit organization of worldwide prestige. HPI raises funds and livestock in the United States and implements projects aimed at ending hunger and poverty in underdeveloped areas of the world. Since 1944, HPI has implemented projects in more than 110 countries, helping people create better lives for their families and their communities. HPI provides food-producing farm animals and training to needy families in rural areas. In return, each family will pass on the animal offspring and knowledge to others in need. What they pass on is called a gift, like a living loan. The whole process is called 'Passing on the Gift'.

Because of 'Passing on the Gift', HPI's unique model of helping poor and hungry people, HPI has implemented a great number of effective and efficient projects through the living loan cycle. Since 1985, HPI has been implementing the China Programme through the HPI/China Office. For 14 years, HPI/China has developed HPI's model for helping the poor in China. In the HPI/China Programme, 'Passing on the Gift' means not only passing on animals, technology, and experience but also passing on real loans.

Today, HPI/China intends to monetise 'Passing on the Gift', in order to achieve its financial sustainability in the long run. Because of HPI's model, the China programme enables limited-resource farm families to improve the quality of their lives and equips them to assist others. The programme provides opportunities for families to produce, as well as share, food and income from their own resources, and remarkable results have been achieved.

Promoting Sustainable Development: the Role of The Global Environment Facility

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Constraints for sustainable development emerge from not one but several factors. World population growth is but one of them. Another one is the rapid increase in consumption of fossil fuel – a key factor that impacts the environment and is rising fast not only in industrial countries but also in developing economies.

Likewise, consumption of other resources is also increasing and is foreseen to have severe impacts on development. The worlds' resources that provide food and income to local populations are becoming scarce. In addition, the world is becoming less secure as natural systems are destroyed, species become extinct, and atmospheric pollution keeps rising.

Let us now look at the role of GEF in meeting these challenges. The GEF is a financial mechanism with a very focussed mandate that provides grants to enhance sustainable development.

GEF focusses on four specific areas: (i) Climate Change, (ii) Biodiversity, (iii) International Waters, and (iv) Ozone Layer Depletion. It also supports activities concerned with land degradation. GEF's key role is catalytic. It multiplies the impacts of its grants by raising additional investments from other sources.

By focal areas, 67 per cent of the GEF's funds of over 141 million dollars were for Climate Change projects, followed by 25 per cent in the biodiversity focal area.

Water and Environmental Management in the Aral Sea basin perhaps pose the biggest challenges for the Central Asian Republics of the former Soviet Union in the International Water Focal Area. Yet,

programmes in the Ozone Layer Depletion Focal Area in Central Asia are almost insignificant and limited to the formulation of Country Programmes for the Montreal Protocol.

A key lesson learned from GEF's limited experiences is that sustainable development cannot be attained without environmental security. Environmental security requires the maintenance of an intricate equilibrium between fulfilling human demands and the preservation of natural resources.

At this point, let us revisit the odds and evens for sustainable development. From a global context, the odds against environmental security and sustainable development appear to be overwhelming when you consider the harsh realities of our world.

Recently scientists and practitioners of environmental security, too, have given not ecological but economic justifications for promoting sustainable development. In contrast to the classic economists, the question they ask is: can we afford **NOT TO,** when the services provided by mother nature amount to twice the World's GNP and at least US $ 3 trillion per annum?

Thus the key question is what is missing? I do not know the answers to these questions, except to say that one of my fellow countrymen from the Himalayan Kingdom of Nepal, once remarked that Sustainable Development Management is no science, but like politics it is an art – an art of the possible.

Let me close by a statement from a distinguished Japanese – an architect of sustainable development, who once remarked *"How people use or abuse environment are expressions of the country's socioeconomic, political and cultural paradigms. Alarmist calls alone by ecologists or environmentalists or NGOs with a crisis mentality will not bring about changes unless the root causes are mitigated."*

Conclusions

The presentations and the discussions that followed raised the following points.

- The poor often lack access to credit and the innovations made in providing credit to poor people are performing well and need to be strongly supported. These primarily consist of small loans with group guarantees only, taken for short periods of time at prevailing market rates of interest. They are called by different names and are now commonly known as micro-credit.
- The support of the local government is very important at all stages of the activity. As poverty reduction is an important goal of the government, this programme helps to address the needs of poorer groups. It is essential to have reliable information so that poor households can be selected.
- Even the larger regional banks have started to play a major role in this area. However, they also have equally significant roles to play in developing other sectors and areas.
- There is a major role for the Global Environmental Facility in helping countries of the region deal with some of their environmental problems.
- In the Central Asian Countries, previously under the former Soviet Union, lack of private ownership of land is an important constraint to providing loans to farmers. This difficulty could be overcome to some extent by following the micro-credit approach.