

Working Paper

Employment, not Microcredit, is the Solution

Aneel Karnani
Stephen M. Ross School of Business
at the University of Michigan

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Abstract

Most studies suggest that microcredit is beneficial but only to a limited extent. The problem lies not with microcredit but rather with microenterprises. With low skills, little capital and no scale economies, these businesses have low productivity and lead to meager earnings that cannot lift their owners out of poverty. Creating opportunities for steady employment at reasonable wages is the best way to take people out of poverty. The government is responsible for providing public services that are critical for increasing the productivity and the employability of the poor.

The Nobel Peace Prize for 2006 was awarded to the Grameen Bank in Bangladesh and its founder Muhammad Yunus, a pioneer of the microcredit movement. The Nobel Committee affirmed that microcredit must play "a major part" in eliminating poverty. The central objective of the Grameen Bank has been to "reverse the age-old vicious circle of 'low income, low saving & low investment', into virtuous circle of 'low income, injection of credit, investment, more income, more savings, more investment, more income'". The United Nations, having designated 2005 as the International year of Microcredit, declares on its website, "currently microentrepreneurs use loans as small as \$100 to grow thriving business and, in turn, provide their families, leading to strong and flourishing local economies." CK Prahalad in his popular book *The Fortune at the Bottom of the Pyramid* (2004) argues that we should recognize the poor as "resilient and creative entrepreneurs," and commends commercial banks, such as ICICI in India, which are expanding into microcredit.

Given this intensity of interest and the resources devoted to it, it is reasonable to ask how much do the poor really benefit from microcredit. I argue here that microcredit does yield some non-economic benefits, but that it does not significantly alleviate poverty.

The best way to eradicate poverty is help create jobs and increase productivity.

Empowering Women

Microcredit organizations have primarily targeted women as their clients. Yunus is reported to have said "women have plans for themselves, for their children, about their home, the meals. They have a vision. A man wants to enjoy himself." Microcredit often

yields non-economic benefits such as increasing self-esteem and social cohesion, and empowering women.¹ Microcredit enables women to contribute towards the household economy, leading to economic empowerment and increasing their intra-household bargaining power. Microcredit also facilitates women to move from positions of marginalization within household decision making process and exclusion within the community, to greater centrality, inclusion and voice. The social processes of microcredit lead to strengthening the personal and social dimensions of women's empowerment. This results in increased self-esteem and self-worth for women and a greater sense of awareness of social and political issues, leading to increased mobility and reduced seclusion of women.

But there is some empirical evidence suggesting that microcredit does not always result in increased empowerment for women. Credit by itself cannot overcome patriarchal systems of control at household and community levels. Women's control over financial resources is probably a key factor in explaining these mixed results. It seems that a significant fraction of women, in spite of having *access* to credit, do not have *control* over the loans contracted or the income generated from the microenterprises.²

Macro credit

Overall, microcredit does yield non-economic benefits of empowering women. It also helps the poor smooth consumption over periods of cyclical or unexpected crisis, and thus reduces vulnerability.³ But, that is not enough; the key issue is whether microcredit helps eradicate poverty. *The Economist* magazine concluded that while “heart-warming

case studies abound, rigorous empirical analyses are rare.”⁴ A few studies have even found that micro-credit has a negative impact on poverty; poor households simply become poorer through the additional burden of debt.⁵ However, most studies suggest that microcredit is beneficial but only to a limited extent. The reality is less attractive than the promise.⁶

Why is microcredit not more effective? The problem lies not with microcredit but rather with microenterprises. The United Nations’ declaration that microentrepreneurs use loans to grow thriving businesses leading to flourishing economies is hype. A client of microcredit is an entrepreneur in the literal sense: she raises the capital, manages the business and is the residual claimant of the earnings. But, the current usage of the word ‘entrepreneur’ requires more than the literal definition. Entrepreneurship is the engine of Joseph Schumpeter’s dynamism of ‘creative destruction.’ An entrepreneur is a person of vision and creativity who converts a new idea into a successful innovation, into a new business model. Some clients of microcredit are certainly true entrepreneurs, and have created thriving businesses – these are the heart-warming anecdotes. But the vast majority of microcredit clients are caught in subsistence activities with no prospect of competitive advantage. The self-employed poor usually have no specialized skills and often practice multiple occupations.⁷ Many of these businesses operate at too small a scale. The median business operated by the poor has no paid staff; most of these businesses have very few assets as well. With low skills, little capital and no scale economies, these businesses operate in arenas with low entry barriers and too much

competition; they have low productivity and lead to meager earnings that cannot lift their owners out of poverty.

This should not be too surprising. Most people do not have the skills, vision, creativity, and persistence to be true entrepreneurs. Even in developed countries with high levels of education and infrastructure, about 90% of the labor force are employees rather than entrepreneurs. Even with greater availability of financial services in developed countries, only a small fraction have used credit for entrepreneurial purposes. Most clients of microcredit are not microentrepreneurs by choice and would gladly take a factory job at reasonable wages if possible. We should not romanticize the idea of the ‘poor as entrepreneurs’. The International Labor Organization (ILO) uses a more appropriate term: ‘own account workers.’

Jobs is the solution

Creating opportunities for steady employment at reasonable wages is the best way to take people out of poverty. The ILO states that “nothing is more fundamental to poverty reduction than employment.” In development economics there is much theoretical and empirical support for the increasing preponderance of wage labor in a developing economy. It is instructive to look at the pattern of poverty and employment over time in China, India and Africa (which together account for about three-quarters of the poor in the world), using World Bank and ILO data.⁸

	People below \$2/day Late 1980s	People below \$2/day Late 1990s
China	67.4%	50.1%
India	83.2%	78.8%
Africa	76.1%	76.1%

	Employment/Population Late 1980s	Employment/Population Late 1990s
China	51.0%	58.7%
India	29.5%	35.8%
Africa	33.4%	30.1%

In China, where the incidence of poverty has declined significantly, a large and growing fraction of the population is employed. In Africa, where the incidence of poverty has remained unchanged, a small and shrinking fraction of the population is employed. India's performance lies somewhere in between. India's efforts at poverty reduction have been hampered by its poor performance in job creation. India's jobless growth is the result of a distorted emphasis on capital intensive and skill intensive development path.⁹ Capital intensive sectors, such as heavy manufacturing, and skill intensive sectors, such as information technology, will not solve India's poverty problem. The trickle down effects of general economic growth are too little and too slow. India needs to emphasize growth in labor intensive, low-skill sectors such as light manufacturing, garments and tourism. Seven world-class Indian Institutes of Technology do not compensate for 39% illiteracy rate.

Big is better

Many people who have jobs are still stuck below the poverty line – the working poor.

Whether an employee is ‘poor’ or not depends on her wages, size of the household, and the income of other household members. It is not enough to create jobs; we also have to increase productivity such that the wages are high enough to enable the employees to rise above poverty.

	Working poor/Employment Late 1980s	Working poor/Employment Late 1990s
China	79.6%	35.2%
India	75.0%	62.0%
Africa	63.4%	65.4%

On this dimension too, India’s performance is mediocre and the situation in Africa is dismal. One cause of this poor growth in productivity in India is inadequate scale economies in its enterprises. The average firm size in India is less than one-tenth the comparable size in other emerging economies.¹⁰ The emphasis on microcredit will only make this problem worse.

Rather than lending \$200 to 500 women so that each can buy a sewing machine and set up a microenterprise manufacturing garments, it is much better to lend \$100,000 to an entrepreneur with managerial capabilities and business acumen and help her to set up a garment manufacturing business employing 500 people. Now the business can exploit economies of scale, deploy specialized assets, and use modern business processes to generate value for both its owners and employees.

Failure of public services

Poverty cannot be defined only in economic terms; it is about a much broader set of needs that permit well being. Amartya Sen, the Nobel Prize economist, eloquently argues that development can be seen as a “process of expanding the real freedoms that people enjoy.”¹¹ Social, cultural and political freedoms are desirable in and of themselves, and also enablers of individual income growth. Services such as public safety, basic education, public health and infrastructure nurture these freedoms, and increase the productivity and employability of the poor, and thus their income and well-being.

In recent years, the political ideology of the world has shifted decisively towards an increased role for markets and a correspondingly decreased role for the state. But, the role of the state has certainly not been eliminated, nor should it be. The state is responsible for basic education, public health, water, sanitation, public safety and infrastructure. The government in every developing country certainly professes to accept responsibility for these traditional functions. Yet, it has failed dismally to deliver on its promises.

As an example of the failure of public services, consider the case of India. The Indian economy is growing rapidly, the stock market is at an all time high, Indian companies are expanding abroad, and a large middle class is emerging. It is the best of times. Contrast this with another India. There is persistent income inequality and gender inequality. 79% of Indians are below the commonly used \$2/day poverty line. 39% of adults are

illiterate. 10% of boys and 25% of girls do not attend even primary school. 49% of children are underweight for their age. 9% of children die in the first five years of their lives. 31% of rural households and 9% of urban households do not have access to safe drinking water. 81% of rural households and 19% of urban households do not have a toilet. 400,000 children die of diarrhea (a waterborne disease) every year. The boom in the private sector has been accompanied by a significant failure of the state. The cost of this failure is borne disproportionately by the poor.

The rich often purchase these services from private enterprises. The middle class are the main beneficiaries of the public service expenditures. The poor have no or little access to these services, or get very low quality public services, or pay very high prices for private services. For example, the rich go to world-class private hospitals and clinics. The middle class has access to reasonable public health facilities. While public health centers do exist to serve rural and poor areas, these centers are grossly underfunded and understaffed. Even worse, the staff are underqualified, and often absent. Children of the rich go to exclusive private schools. The middle class uses a mix of private and public schools. Children of the poor often do not go to school or go to low quality public schools. In one survey, a quarter of the teachers were absent and another quarter were present but not teaching. Absentee rates for teachers and health workers are higher in poorer regions. The rich have ample access to clean water: they purchase bottled drinking water, drill private tube wells and use booster pumps. The middle class settles for piped water even if only for a few hours a day. The poor have no or little access to clean public water supply. The rich hire private guards. The middle class live in

reasonably well policed neighborhoods. The poor have little protection from thugs and criminals.

The burden of failure of public services is borne disproportionately by women, which exacerbates gender inequality. Lack of access to toilets poses a bigger problem for women because of anatomy, modesty and susceptibility to attack. Women often lose much time to hauling buckets of water over long distances. Women are more likely than men to need medical care; they are expected to care for sick family members, especially children. Girls attend school less often, especially in poor families.

Markets are not the solution

There is a growing 'neoliberal' movement which looks to the private sector for the solution to the failure of public services. There is much debate about whether the direct production of these services should be privatized. But, few would argue that the state can totally avoid its responsibilities. For example, if water supply is privatized, the government needs to regulate the rates or ensure that the poor have enough purchasing power to buy water. In the case of a 'public good' such as sanitation and public health, the market cannot solve the problem. Even late Milton Friedman advocated school voucher system, and not for the state to withdraw totally from the field of education. The state must be responsible for services when there is a natural monopoly (piped water), when it is a public good (public health), and for the sake of equity (education). When the state fails, the market might be a partial complement, but it cannot be a total substitute.

The business guru CK Prahalad has said “if people have no sewage and drinking water, should we also deny them televisions and cell phones?”¹² Writing about the slums of Mumbai, he argues that the poor accept that access to running water is not a “realistic option” and therefore spend their income on things that they can get now that improve the quality of their lives.¹³ This opens up a market, and he urges private companies to make significant profits by selling to the ‘bottom of the pyramid’ (BOP).

The real issue which the BOP proposition glosses over is: why do the poor accept that access to running water is not a realistic option? Even if they do, why should we all accept this bleak view? Instead, we should emphasize the failure of government and attempt to correct it. Giving a ‘voice’ to the poor is a central aspect of the development process. That is what the civil society, for example Oxfam, is attempting to do.¹⁴ In many developing countries, an autocratic government has denied a voice to the poor. Even in developing countries with a representative democracy, the political process has been hijacked by various vested interests. The business community, bureaucrats, politicians and the media are full of self congratulations on the booming private sector – for example, on the increased penetration of cell phones. However, the representative image of a developing country is not a cell phone, but rather defecating in public. For example, in Mumbai, the business capital of India, about 50% of the people defecate outside. There is no magic solution, but the starting point is passion and anger at the failure of the state to provide these basic services.

Appealing to private companies to help the poor on the grounds of corporate social responsibility has not been an effective strategy. But, we can demand that private companies at a minimum should not drown out the voice of the poor. For example, sustaining a social movement to empower women is more difficult in the pervasive presence of sexist advertisements, such as those for Fair & Lovely, the whitening cream marketed by Unilever. Self-regulation by the private sector might be the solution.

The civil society, with good intentions, often tries to supply the services the state has failed to provide. The problem is that the civil society has neither the resources nor the economies of scale to provide these services to any significant degree. Instead, the civil society should attempt to strengthen the state, support the voice of the poor, and be a catalyst in the political process.

Conclusion

Microcredit has received much attention and has grown rapidly in recent years. Women, who account for the bulk of the clients of microcredit, have benefited in terms of increased self-esteem and empowerment. But, microcredit has not had a significant impact on alleviating poverty. The women run businesses with low skills, little capital and no scale economies, and as a result do not earn enough to rise out of poverty.

Creating employment and increasing productivity is the best solution to poverty. We should emphasize the role of the government in providing basic public services, which have a direct and significant impact on productivity.

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