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# Alleviating poverty through microfinance: Village banking outcomes in Central America

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## Abstract

Our research reports on Brigham Young University (BYU) field studies carried out in Central America to assess the impacts of village banking on indigenous families. We first introduce the growing movement of microfinance institutions (MFIs), organizations that provide small loans as start-up capital for the unemployed poor in Central America. We briefly describe the native nongovernmental organizations (NGOs) that allocate their financial resources. Our methods are described and the survey instrument we created is analyzed, as well as the process of data collection. Finally, we report our findings and interpret their conclusions and implications, as well as suggest further studies on poverty alleviation.

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## 1. Introduction

There is a growing debate as to the best strategy for alleviating global poverty. A major thrust in recent years is the rise of radically innovative approaches from the grassroots. One tool is known as village banking, which refers to tiny loans to the Third World poor. This has grown from a small program in the 1970s in Bangladesh to a worldwide movement. Such microloans are usually provided through nonprofit, humanitarian organizations such as [Freedom From Hunger \(2004\)](#) and [CARE \(2004\)](#). These new mechanisms are often referred to as nongovernmental organizations (NGOs) whose focus is on empowering poor families. According to the recent Microcredit Summit ([Daley-Harris, 2003](#)), this effort has mushroomed to over 3,600 microlending organizations, mostly in Africa, Asia, and Latin America. Collectively, these microfinance institutions (MFIs) have given out over 18 billion dollars in loans ([Lapenu & Zeller, 2000](#)) to more than 67 million individuals, 79% of whom are women.

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Yet this strategy is not without its critics. Initially, large multilateral organizations such as the World Bank, the World Trade Organization (WTO), and the African Development Bank all rejected this movement as of little consequence—too little money, given to poor families who are unemployable, and who are not credit worthy. Instead, these institutions favored large-scale, top-down methods in which huge loans were given to governments and large corporations. It was assumed they would enjoy economies of scale, invest capital in creating employment in the private sector, and that poverty would gradually be reduced. Yet [Joseph \(2000\)](#) and others have argued that changes in the international political economy, Third World dissatisfaction with such multilateral institutions, and growing power among developing states have combined to break up “stasis” and push for change.

In short, the top-down approach has not delivered intended results. Hence, in recent years, the World Bank, for example, has come to be impressed by the feasibility of village banking and has provided over a billion dollars to NGOs. Likewise, the U.S. Agency for International Development (USAID), the United Nations, and others have begun channeling microloan funds through small NGOs because of their impressive results. Initially, many national governments seemed to support NGOs and the voluntary services carried out by concerned citizens. In fact, considerable funding from governmental sources supported NGO activities such as the 1992 Earth Summit in Rio de Janeiro, the Social Development Summit in Johannesburg in 2002, and the work of specific groups such as Catholic Relief Services, AFRICARE, and so on. Government leaders tended to appreciate civil involvement and saw NGOs as more flexible and rapidly mobilized to address human problems. These NGO strategies were seen as fostering democratic values and the building of civil society in the process.

But currently, there is criticism about the work of NGOs. Fears that NGO labors are extremely diverse and often quite critical of the establishment have led to major questions. Much of the concern about this derives from the American Enterprise Institute (AEI), a Washington, DC think-tank. Policy experts at [AEI \(2004\)](#) have begun to challenge the NGO movement and its processes. They question whether these nonprofits should be getting so much funding, and worry more about their power and societal influence. Certain NGOs such as Human Rights Watch and the American Friends Service Committee are seen as leftists, or at least too liberal, and too critical of big business.

AEI is increasingly voicing criticism of all NGOs as dangerous, too populist, and too participative ([AEI, 2004](#)). The institute has now linked up with the arch-conservative Federalist Society to establish a new monitoring institution called “NGO Watch” as a means of fighting the growing influence of international NGOs. Its sponsors are tracking thousands of NGOs around the globe, holding conferences to criticize their work, attempting to warn corporations and governments that these grassroots movements are dangerous. By arguing that NGOs now need to be regulated and/or controlled seems to be a curious proposal coming from avowed free market advocates.

However, regardless of the criticisms or advocacy of NGO efforts in fighting poverty, for now at least, the trend continues for fueling village banks to provide credit among the poor of the Third World. This paper reports on the authors’ field research in Central America regarding the impacts of village banking in reducing poverty.

Increasingly, major donors are asking NGOs to evaluate the effectiveness of poverty lending. Does it work? How does it impact various family challenges? Does it improve people’s quality

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