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Microfinance and Famine: The Irish Loan Funds during the Great Famine

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Summary. — What happens to microfinance organizations when faced with massive external shocks such as famines? Using a unique and extensive data set, we analyze the impact of the Great Irish Famine of the 1840s on the Irish loan funds. The funds were a large and important microfinance institution operating throughout Ireland. We find that the pre-famine capital ratio of each fund was a strong predictor of survival of the fund through the famine. Among available local demographic variables, the most significant is the rate of female literacy, which was strongly correlated with the probability of fund survival.

Key words — microfinance, Ireland, famine, capital structure

1. INTRODUCTION

What happens to microfinance organizations when faced with massive external shocks such as famines and wars? Sustainability is one of the central problems in modern microfinance, not least because many microfinance institutions are located in countries that are susceptible to huge swings in economic climate. Despite this, few studies have documented the outcomes of famine and other very large external shocks on the sustainability of microfinance organizations. This study examines the effect of a devastating famine on one historical institution—the Irish loan funds—to see what we can learn about how a microfinance organization can be successful and sustainable even through the worst episodes of famine. We find, using an extensive and unique data set, that pre-famine efficiency and capital ratios were important for institutional survival; more surprisingly, local female literacy is strongly correlated with fund survival, even accounting for other demographic and famine-related variables.

Johnson and Rogaly (1997), Buckley (1997), Conning (1999), Morduch (1999, section 4) and others have argued that sustainability is a key problem in microfinance. There has, however, been very little analysis of microfinance during times of severe macroeconomic fluctuations. One exception is Patten, Rosengard, and Johnston's (2001) fascinating study of the BRI bank in Indonesia during the period of the East Asian crisis. They show that its microbanking units performed better than other parts of the bank, possibly owing to the design of the lending structure.

A related major issue arising in microfinance is the tradeoff between "outreach" (which

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means lending to the very poor) and sustainability (see, e.g., Conning, 1999; Paxton, 2002). The managers of the Irish funds had to face exactly this problem at its most acute during the Famine. Should they continue to lend to laborers who were unlikely to be able to repay? Should they impose extra fines on borrowers who were late in repaying? Should they seek to enforce repayment from impoverished borrowers or their co-signatories through the courts, resulting in evictions? Loan funds that strictly enforced loan requirements during the Famine may have been more likely to survive, but those funds may also have been less beneficial, or even harmful, to the starving poor during the crisis. We do not, in these circumstances, make any judgment about whether outreach or sustainability is the more important goal; we can only show what seems to have been important for sustainability.

Sustainability is often taken to indicate reliance on commercial deposits, which a microfinance institution can attract if it demonstrates financial success. But, while depositor funding may leverage donor funding to achieve a greater scale of operation, it may also erode sustainability, since deposits may be withdrawn during times of crisis—either to fund the depositor's own activities or as a reaction to crisis-induced risk at the institution. Thus while commercial deposits are the hallmark of sustainability, too heavy a dependence on them, as we see in this paper, can lessen the sustainability of the institution. It may be possible that the optimal capital structure may vary with the economic environment; the structure that maximizes expansion may reduce robustness to negative external shocks.

Although Ireland is now a wealthy country, in the 1800s it was an impoverished hinterland to Europe, plagued by frequent famines. Despite local poverty, the (then) British government kept good records, and the activities and finances of the Irish loan funds are therefore extensively documented. [1] The funds' history can be traced from the early 1700s until the 1960s. In the period just before the "Great Famine" in the late 1840s, over 300 independent loan funds were making small loans to the Irish poor. Approximately 20% of households were borrowers from the loan funds annually, making this one of the most successful microfinance institutions anywhere. The average loan size was approximately equal to the per capita income of the poorer two-thirds of the population. The Famine, caused by repeated failure of the staple potato crop, had a devastating impact on the people of Ireland, and on the loan funds. Excess mortality from the famine has been estimated at around 12%, and emigration at another 12%, leading to a sudden decline of approximately one-quarter of the population. Not surprisingly, many of the loan funds closed; somewhat more surprisingly, about 43% managed to stay open. [2] We focus in this paper on discovering what fund and demographic characteristics led to fund survival.

Lessons drawn from the Irish experience are relevant to microfinance institutions in various parts of the world. Microfinance institutions in Bangladesh faced a crisis in 1998 when massive flooding inundated the country, wiping out the capital of many borrowers, and necessitating substantial loans to the affected institutions (Pearl & Philips, 2001). In Africa, the HIV/AIDS crisis is causing tremendous problems for microcredit institutions: for example, the Zambuko Trust in Zimbabwe estimated in 2000 that 20% of its clients had died of AIDS-related infections in the previous two years (Versluysen, 2000, p. 7). Other microfinance institutions operate in the midst of conflict and various disasters. The particular contribution of our study is to analyze data on independent loan funds facing a common crisis to see how differences in each contributed to the probability of survival.

We provide a brief review of the problems related to sustainability of microfinance organizations in Section 2, and then discuss the Irish loan funds and the famine in Sections 3 and 4 respectively. In Section 5, we outline the effect of the famine on the loan funds, and in Section 6 present data and an econometric analysis of what factors were important for fund survival.

2. MICROFINANCE, SUSTAINABILITY, AND CRISIS

Access to capital is for the poor a critical obstacle to escaping poverty, and this is particularly true in developing countries. Such demand for capital is not met by traditional banks, whose cost structure and culture typically prevent them from dealing with the poor. In response, microfinance organizations have arisen indigenously in some places, or been set up by nongovernmental organizations (NGOs) elsewhere, and had remarkable success in both making small loans to very poor people *and*