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Many borrow, more save, and all insure: implications for food and micro-finance policy

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Abstract

Among policy makers, researchers and micro-finance practitioners alike, there is much discussion on the role of micro-finance for alleviation of poverty. This paper focuses on the linkages between access to credit, savings and insurance services and household food security. What is the role of micro-finance in the overall mix of policy instruments? What types of financial services are demanded by the poor, and which are offered by micro-finance institutions (MFIs)? Hence, which are the gaps in financial products? We present a conceptual framework that addresses these questions, and provide a synthesis of the empirical results of a multi-country research program in ten African and Asian countries. We conclude that insurance can be considered as the missing third of micro-finance during the 1990s, and that the MFI's outreach to the poor can be improved by offering savings, credit and insurance products that enhance the poor's ability to bear risks. Applied research on the poor's preferences as well as bold experimentation with new financial products appear to be particularly promising in making progress towards that goal. Since insurance services are difficult to be offered except for easily observable idiosyncratic risks, precautionary savings services can be a valuable insurance substitute in particular for the poorest. © 2000 Elsevier Science Ltd. All rights reserved.

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Introduction

At first glance, many might be tempted to say that the poor in developing countries, earning incomes of less than a dollar per day, are neither creditworthy nor are they able to save; nor can they pay for insurance against the risks they face.

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That these common assumptions are wholly unfounded has by now been demonstrated time and again by empirical research on informal financial markets and risk-coping behavior of households. During the past fifteen years or so, these myths should also have been laid to rest by the recognition of an increasing number of successful institutional innovations that provide savings, credit and insurance services to poor people in developing countries which were previously thought of being unbankable and uninsurable.

Yet, much of financial policy right until the end of the 1980s and even today has been based on these faulty premises, leading to well-meant, but inefficient and costly policies for the development of financial institutions with negligible outreach to and impact for the poor. Past policy neglected to provide savings and insurance services, and much, if not all of the emphasis was put on "giving and forgiving" loans. Most, if not all so-called credit projects quickly degenerated into transitory income transfer programs with doubtful coverage of the poor, but with never-ending need for injecting public resources to keep state-driven, top-down banks and cooperatives from collapsing[1]. In recognition of these past failures, and in conjunction with the structural adjustment policies implemented during the last twenty years, donor and government support for development banks and parastatal agricultural credit institutions substantially dwindled. Today, many (but not all) developing countries lack a single functioning rural financial institution operating on a widespread, if not national scale that reaches substantial numbers of savers and borrowers. Credit for smallholder and tenant agriculture appears to have been especially hard hit. On the other hand, new member-based institutional innovations have emerged with the support of government and donor organizations, such as solidarity credit groups, village banks, and member-managed savings and credit cooperatives.

Faulty perceptions about the clientele and its demand serve as excuses for inaction or lead to policy recipes promoting ill-adapted services, market structures and institutions. The truth is that the poor are creditworthy, can save, and pay for insurance: They have done it all along, as the myriad of informal savings, credit and insurance arrangements between friends, relatives and other networks daily demonstrate. But it is also the truth that the financial institutions and related knowledge and technology as well as an enabling policy environment were not in place in the past (and still are not in many countries or areas within countries). Because this all did neither exist nor was acceptable to think about at central, commercial and parastatal banks alike, the poor were deemed to be unbankable. To put it positively, one thing that we can learn from "micro-finance revolution", as Jonathan Murdoch terms it (see Murdoch, 1997) is that institutional — not only technological — innovations and related changes in the legal and regulatory policy framework can extend the feasibility frontier of sustainably reaching the poor with financial services. While increasing numbers of people living around or somewhat below the poverty line are reached by innovations in financial institutions, the outreach to the poorest is low. However,

[1] For a comprehensive critique of past credit policy, see for example Adams (1988), and Adams and Von Pischke (1984).

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