Socio-Economic Results of Microfinance in Mexico and Ecuador

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Abstract

This paper introduces the economic development strategy in Latin America of training poor microentrepreneurs in small business skills, enabling them to start microenterprises, and providing microloans to grow their income-generating projects in the informal economy. The focus is on the work of a large, global NGO and its programs in the Latin American countries of Mexico and Ecuador. Four types of clientele totaling 887 microentrepreneurs are studied from field research conducted during summer 2002. The methodology for this approach is described, and several results are analyzed in demonstrating the impacts of microcredit within poor families.

Introduction

In much of the Third World, contrary to popular belief, economic conditions have been getting worse over recent decades. Today some 1.2 billion people suffer from chronic poverty, trying to subsist on less than $365 per year, which works out to only $7 a week (Daley-Harris, 2002). Glancing back at the past four decades, one sees that during 40 years the wealthiest 20 percent of the world consumed some 70 percent of all income. By the beginning of the 21st Century, that share had mushroomed further to over 80 percent. Simultaneously, the poorest 20 percent of the world's population saw decreases in their meager share, from 2.3 percent of all wealth as it dissipated to a mere 1.4 percent (Brown, 2000). Among females in the Third World, absolute poverty has grown by 50 percent in the past two decades (UNIFEM, 2001).

Unemployment is a major aspect of poverty creation, but underemployment is perhaps equally significant. It refers to the condition in which people do not hold jobs equivalent to their abilities and training. In the Philippines, for instance, it is widely known that although many people are literate and well-educated, good jobs are hard to find, resulting in underemployment well above 50 percent during recent years.

Projections for the future of the world's poor suggest that poverty may only worsen in the coming decades. For example, an International Labor Organization (ILO) study predicts that during the next quarter of a century, 1.5 billion new jobs will be needed to provide incomes for the growing global population. It assumes that if present rates continue, there will be some 3.6 billion working-age people on the face of the earth, and that possibly a third of them will be unemployed. Is it really feasible to create 40-50 million new jobs annually in the coming decades? Not if history is an indicator. Over the last three decades, the world's workforce increased by nearly a billion people needing work. But tens of millions did not obtain jobs. To make matters worse, only ten percent of future jobs will arise from the industrialized nations, meaning that 90 percent will be needed for the Least Developed Nations (LDCs)—in other words, for the Third World where population is growing, but poverty is booming.

Formal vs. Informal Economies

Traditionally, social scientists have conceptually divided a society's economic activities into the formal sector, such as labor at a factory or work as a government employee in an office, or the informal—survival on the street as a vendor or provider of services.

Informal or underground economy workers are essentially considered to be problems themselves by some experts. These are small, clandestine, unregistered individuals or family-based economic activity that do not produce taxes to the state. Typically, such people can be observed in Third World cities living in shanty towns, or functioning as street vendors. Often marginalized, they subsist by "hustling" or sweat equity, making up for the shortcomings of formal jobs such as factory employment or government positions. While the informal economy has often been viewed by traditional economists as a minor phenomenon, or a temporary reaction to natural or financial disasters, reality suggests the opposite. The Third World informal economy is growing. It is here to stay and makes up a significant percent of many LDC cultures (Sanyal, 1991; de Soto, 1989).

Microfinance

Models for Third World economic development in the past have tended to consist of large-scale, top-down approaches like the Green Revolution through which huge multinational agribusinesses attempted to overcome world hunger with John Deere tractors and Monsanto seeds. Today, there are new, small, grassroots methods like microfinance as alternatives for fighting poverty from below.

One new tool, the offering of microcredit, is beginning to yield results. Such a strategy consists of developing technical assistance centers that provide microloans as well as savings programs, often with training and consulting to create self-employment and income-generating activities. They bootstrap themselves, essentially creating their own jobs. Most of this type of work requires one's own sweat and equity, perhaps including that of one's family. It is a bottom-up method for building an income and becoming self-reliant, enjoying considerable success in certain countries as a new, innovative path to earning a living and caring for one's own. Often, training is provided, along with access to capital (microcredit) so that the small entrepreneur is able to acquire raw materials, equipment, or whatever else is needed in order to grow the business.

Microfinancing may be classified as small-scale loans of $30 to $100 that are accessible to the very poor, primarily in the Third World. With even a small amount of such capital, micro-enterprises may be started, or perhaps expanded. In the mid 1990s, the World Bank conducted an analysis of microfinance schemes, finding that there were in excess of nine hundred institutions in 101 nations that offer microcredit to the poor (Paxton, 1995). The organizations studied had been in existence at least three years and each had over a thousand clients. They included banks, credit unions and numerous Nongovernmental Organizations (NGOs). Today there are perhaps thousands more of newer, smaller such programs not included in the bank's original analysis. But a sample of 206 of the 900 institutions studied in 1995 enjoyed an aggregate loan portfolio of almost $7 billion, totaling over 14 million small loans to poor people for their tiny enterprises. Approximately 53 percent of loan recipients resided in rural regions around the globe. By extending microfinance capital to the poorest of the poor, millions of new jobs have been created among those languishing in extreme circumstances, thereby empowering individuals and families to gain a greater degree of control over their destinies in the move toward sustainability.

Early in 1997 the first world-wide Microcredit Summit was held in Washington, D.C. to launch an ambitious plan for empowering a hundred million of the world's poorest families through microloans and job creation. Twenty-seven heads of state and thousands of NGO representatives participated in this global organizing effort. The method advocated at the summit for obtaining credit is sometimes referred to as Grameen, or "village banking," and was pioneered by a creative economist, Muhammad Yunus, in Bangladesh (Woodworth, 1997). The typical operations of such programs are quite simple: The NGO essentially offers small or "micro" loans to each of five to ten villagers at market interest rates. They need no collateral, nor are they required to have a strong credit history. Instead, the borrowers as a group are jointly liable for paying off both the interest and principal. Social pressure and trust thus become powerful incentives for assuming one's own financial responsibility and personal accountability. The payback rates range from 94 percent to 100 percent. In 2002, the Microcredit Summit + 5 conference was held to assess progress since 1997. It was reported that there are currently some 5,225 NGOs providing microloans to over 50 million poor borrowers and their families (Microcredit Summit, 2002). With the above introduction to microfinance schemes, we now turn to the Latin American context for analyzing microfinance impacts.

Latin America Context

To understand the need for microcredit in Ecuador and Mexico, one can observe the huge contrasts between the rich and poor in those nations. In the downtown of large capital cities like Quito and/or Mexico City, high rise condos and shopping areas like Zona Rosa appear to be modern cities such as New York’s Manhattan, or even Paris. There are plenty of Mercedes Benzes, big banks, internet cafes, and lush gardens. Huge hotels are being constructed and boutiques like those of Ralph Lauren and Tiffany’s are plentiful.

But digging beneath the surface and extending outward to the city’s common neighborhoods, one is confronted with different sights and smells. *Barrios* of extreme poverty are everywhere. They are shantytowns without tap water, bathrooms, or even electricity. Poor families attempt to survive on squatter sites without permanence, raising children without educational opportunities, where millions of parents are without long-term jobs. Instead, they are caught between illiteracy, homelessness and economic collapse.

The supposed benefits of globalization and wide-open trade have had only questionable benefits for many Latin Americans. There are staggering populations without sufficient incomes to obtain basic necessities: clean water, decent housing and public services, adequate food and access to health care. Let us briefly highlight the problematic dimensions of underdevelopment in Ecuador and Mexico.

Ecuador

This country is an Andean republic in which almost half of the population is Indian. The region's history includes ancient warfare between two Inca emperors and later, the Spanish conquistadors who were gold-obsessed thugs. In 1830 Ecuador broke off from its agreements with what are now Colombia and Venezuela and became an independent nation. Since then there have been long periods of military rule, control by a few wealthy landlords, and eventually democratic elections.

But poverty and power struggles continue into the present century. In January of 2000 a group of indigenous people took control of the presidential palace and congress to protest harsh economic measures. They were critical of the rising cost-of-living expenses and demanded change. This occurred precisely during the week that the World Economic Forum was meeting in Davos, Switzerland to push the Third World toward its neoliberal agenda of economic reforms that would hasten the globalization of society.

At that time, indigenous Ecuadorians were suffering on roughly $40 a month income. Approximately 39 percent of rural native peoples try to survive while being chronically undernourished (Coffey, 2001). One of the country's biggest exports is bananas. Grown on huge plantations, the industry is largely controlled by transnational corporations like Dole, Del

Monte and Chiquita. But the Indian laborers work for low wages while being victimized by dangerous pesticides to eliminate blight. Such chemicals are associated with workers' eyesight problems, dizziness, headaches, and eventually infertility (Visscher, 2003).

Thus, poverty-stricken rebels in 2000 pushed their government for change in protest against joblessness, underemployment, dangerous jobs where they did exist, and the effects of being marginalized socially and economically. As the uprising grew to over 15,000 in Quito alone, the police and army used tear gas and guns against human blockades and Indians possessing only sticks as weapons. Some died, hundreds were injured, and eventually a 21-point agreement was reached that included the natives removing road blocks and the government dropping gasoline prices.

But such temporary political accords do not cover up the need for a revitalized informal economy in which poor Ecuadorians may gain access to small pools of capital and lift themselves by their own bootstraps.

Mexico

In the case of Mexico, the start of NAFTA (North American Free Trade Agreement) in 1994 was supposed to be the cure. Yet in spite of the rise of *maquiladoras* (foreign-owned factories) all along the Mexican side of its borders with the United States, the hoped for miracle has not yet occurred.

Instead, the flow of poor Mexicans moving illegally into the U.S. for jobs and a hoped for better life has risen. The 1995 collapse of the peso generated a "*tequila* effect" throughout Latin America. Modest growth rates, the *El Nino* phenomenon, and gradual downsizing of malquiladoras as investors went on to cheaper labor costs in Asia, all combined to hammer the people of Mexico.

These factors were associated with the Zapatista uprising by rural *campesinos* in the state of Chiapas, an indigenous rebellion that has made the country's problems even worse. Motivated additionally by Mexico's foreign debt crisis, the citizens eventually overthrew the PRI, Mexico's 71 years-in-power dynasty, and a new political party came to power under the presidency of Vicente Fox.

But the Mexican economy is still in deep difficulty. Hundreds of thousands of street children roam the alleyways of the nation's capital. Crime, drugs, prostitution and other forms of family and/or street violence characterize much of life in the so-called "misery belt" surrounding places like Mexico City, Monterrey, and even big resorts like Cancun.

Public debt repayments in 2000 totaled nearly $14 billion (U.S.), while another $4.1 billion was spent bailing out major banks. Between 1995-2000 the minimum wage's buying power declined by 40 percent. Only 14 million adults have regular employment in the formal economy, while 26 million others try to hold on to temporary or informal jobs that lack economic and social security (Salgado, 2000).

Economic inequality is a major problem in Mexico as judged by observers who declare it to be "among the 15 countries with the worst concentration of income in the world" (Gallardo and Osorio, 1998). There is not only great inequity between rich and poor, but also between Northern Mexico and the South, and urban versus rural. For instance, wealth in the North grew over the last decade by 5.9 percent while in the South it dropped to 0.4 percent (Derbez, 2001). In over 300 cities of the country there are some 25 million people without decent housing, water, sewage, electricity and access to healthcare (National Council, 1998). Even worse, in rural households where families dwell in extreme poverty, 59 percent lack drinking water, while 49 percent of women have no prenatal care (Under Secretary, 2000).

Thus, as President Fox took over Mexico's leadership, he began to emphasize microfinance as a new strategy for empowering poor families. At the Microcredit Summit in 2002 he declared:

> We must demonstrate a real commitment to achieving and reaching this goal [of microcredit]. Microcredit and microfinance are elements of reconstruction of the social fabric. Not only in terms of productivity, but also in solidarity…. As governments, we must promote and empower these efforts (Fox, 2002).

Methodology: Assessment of Four Different Clients

Our research reports on field data collected in the summer of 2002. A large, global NGO we shall call "LatinoFinance" sent U.S. college student research interns out to assess the impacts of microfinance on poor families. The idea of our LatinoFinance poverty assessment project was to find out if microentrepreneurs, upon entering the microfinance institution and participating in microloans, would become less and less poor until they turned self-reliant enough to leave the institution. The assumption was made that if microfinance had helped microentrepreneurs leave poverty, New Clients would be the poorest, followed by Current Clients, and finally by Ex-Clients who left after becoming more self-reliant. The category of Non-Clients would be used as benchmark to see if LatinoFinance was helping the poorest of the poor, and to compare those who have participated in LatinoFinance with those who have not.

Poverty Gages

The assessment effort used economic and social factors to determine poverty. Economic factors are by far the most commonly used in today's society to determine the level of penury. Traditionally, the first and foremost ranking of poverty is defined by how much a person earns daily--the Daily Per-Capita Income (DPCI). The United Nations has declared that those in "absolute" poverty are people who have a DPCI of less than $1 (USD) a day. The "universal" poverty line is classified as those who have a DPCI of $1 – $2 (USD) a day. Our assessment took into account all of the clients' income including remittances from abroad, savings, and expenditures. After extensive field-testing, it was found that female respondents tended to be more accurate in estimating household expenses than their household income. This is because they are more involved in daily expenditures for food, education, healthcare, and so on. These expenses are normally paid with income the respondent has earned herself, or which a male income-earner has given to her to spend on the needs of the family. Therefore, in order to better represent their income, LatinoFinance found it more useful to define and measure the DPCI of a poor household by its Daily Per-Capita Expenditure (DPCE). This is how much a person spends each day, and like the DPCI, absolute poverty would be determined by those persons who have a DPCE of less than $1 a day. The universal poverty line would be determined by those who have a DPCE of $1 – $2 a day.

Selection of Communities and Clients

After arriving in a country, the field interns obtained a list of all village bank groups groups by region which were over a year old and had completed at least three loan cycles. In LatinoFinance, a loan cycle is defined as a payback period of four months. The prerequisite of over a year of time was necessary to ensure the sampling of "Current" Clients. With this list of microentrepreneurship groups, the field researcher then calculated how many of eligible groups belonged to each region. If there were more than three regions, the interns restricted their visits to only three regions, the one in closest proximity to the central LatinoFinance headquarters, as well as the next two largest regions. Each intern developed a minimum visitation target of 12 groups. After picking the regions, the interns calculated the distribution of their visitation capacity in accordance with the percentages of eligible groups (those that had one or more years in existence) in the region. For example, if there were 100 eligible banks—60 in region A, 30 in region B, and 10 in region C—this would translate into visiting 7 groups in region A, 4 in region B, and one in region C. The groups in each region were then selected based on availability as to which groups actually had regularly scheduled meetings on the days the interns were visiting the regions.

After the individual groups were picked, the field interns accompanied LatinoFinance's field credit officer to the groups' meetings. There, they began interviewing 10-11 clients, of which 2 or 3 had to be New Clients. If there were more than the required quota of clients, the intern randomly selected the new and current clients.

After the interviews with the New and Current Clients were completed, the interns conducted a participatory mapping exercise with the microentrepreneurs, identifying the location of all persons interviewed. This was done to map out the group's boundaries for Non-Client interviews. Near the end of the mapping exercise, the interns asked about Ex-Clients who had left the bank, preferably over a year before, and indicated their houses on the map. A Current Client usually was asked to accompany the intern to act as a host to the Ex-Client's residence for interviewing.

When the Ex-Client interviews were completed, the interns began interviewing Non-Clients using their map as a reference to the group's geographical area. The intern located and interviewed Ex-Clients who lived within the geographical boundaries of the group, preferably near the residences of the Current Clients of that same group. The total number of clients interviewed was 887 in our study.

Results of Economic Findings

After analyzing the data, we found that there was a relationship between the poverty level of those who participated in microloans for a year or more, and those who had just begun. In addition, there was a relationship between the economic status of those who participated in microloans, and those who had never participated in such loans, and also between those who had discontinued participating in microfinance. Those who participated in microloans in Mexico earned more money per day, and were less poor, than those who did not, while those in Ecuador actually digressed in economic status while participating. The following charts contain the findings taken from LatinoFinance's New, Current, Non- and Ex-Clients from Mexico and Ecuador.

LatinoFinance's New Clients Upon Entering Program

Description	Mexico		Ecuador		Total	
Total New Clients interviewed	55		83		138	
Household DPCE of less than $1/day	17	31%	14	17%	31	22%
Household of DPCE of $1-1.99/ day	20	36%	42	51%	62	45%
Household of DPCE of $2-2.99/day	12	22%	21	25%	33	24%
Household of DPCE of $3-3.99/day	6	11%	5	6%	11	8%
Household of DPCE of $4-4.99/day	0	0%	0	0%	0	0%
Household of DPCE of $5 or more per day	0	0%	1	1%	1	1%
Median DPCE for all New Clients	$1.39		$1.64		$1.54	

LatinoFinance's Current Clients

Description	Mexico		Ecuador		Total	
Total Current Clients interviewed	165		169		334	
Household DPCE of less than $1/day	40	24%	37	22%	77	23%
Household of DPCE of $1-1.99/ day	75	45%	77	46%	152	46%
Household of DPCE of $2-2.99/day	29	18%	33	20%	62	19%
Household of DPCE of $3-3.99/day	14	8%	12	7%	26	8%
Household of DPCE of $4-4.99/day	4	2%	3	2%	7	2%
Household of DPCE of $5 or more per day	3	2%	7	4%	10	3%
Median DPCE for all Current Clients	$1.48		$1.53		$1.51	

LatinoFinance's Ex-Clients

Description	Mexico		Ecuador		Total	
Total Ex-Clients interviewed	51		25		76	
Household DPCE of less than $1/day	14	27%	9	36%	23	30%
Household of DPCE of $1-1.99/ day	15	29%	7	28%	22	29%
Household of DPCE of $2-2.99/day	14	27%	2	8%	16	21%
Household of DPCE of $3-3.99/day	4	8%	7	28%	11	14%
Household of DPCE of $4-4.99/day	1	2%	0	0%	1	1%
Household of DPCE of $5 or more per day	3	6%	0	0%	3	4%
Median DPCE for all Ex-Clients	$1.88		$1.40		$1.72	

LatinoFinance's Non-Clients

Description	Mexico		Ecuador		Total	
Total Non-Clients interviewed	157		182		339	
Household DPCE of less than $1/day	40	25%	36	94%	76	22%
Household of DPCE of $1-1.99/ day	53	34%	75	5%	128	38%
Household of DPCE of $2-2.99/day	32	20%	42	1%	74	22%
Household of DPCE of $3-3.99/day	19	12%	8	0%	27	8%
Household of DPCE of $4-4.99/day	7	4%	6	0%	13	4%
Household of DPCE of $5 or more per day	6	4%	15	0%	21	6%
Median DPCE for all Non-Clients	$1.71		$1.67		$1.69	

As shown in the above charts, microentrepreneurs in Mexico who had just entered the microfinance program had an average income of $1.39 a day. Of these clients, 31 percent lived in absolute poverty of less than $1 a day, 36 percent lived in poverty of $1-1.99 a day, leaving about 33 percent living on more than $2 a day. Two dollars a day is above the World Bank's so-called range of poverty. Comparing these figures to Current Clients in Mexico showed that on average Current Clients lived on $1.48 a day, with 24 percent living on less than $1 a day; some 45 percent were living on between $1-1.99 per day, leaving the remaining 30 percent of Current Clients' incomes earning $2 or more a day. Thus, Current Clients who had participated in microfinance loans for at least a year in Mexico were less poor than New Clients who had just entered the MFI.

When comparing Non-Clients to New Clients and Current Clients in Mexico, it was found that on average, the poorer of the poor participated in microfinance. Non-Clients from Mexico earned $ 1.69 a day with 22 percent earning less than $1 a day, 38 percent between $1-1.99 day, and 40 percent above $2 a day. According to World Bank data, 60 percent of those randomly interviewed in Mexico are considered poor. While this data does not help answer the question whether microentrepreneurship, coupled with microloans, helps improve economically the way of life of impoverished people, it does show that microfinance attracts the poorer of the poor, and as shown above, helps them become less poor through participation.

When LatinoFinance's Ex-Clients were compared to Current Clients, and New Clients in Mexico, a few interesting items were observed. Ex-Clients from Mexico on average made $1.88 a day with 27 percent earning less than $1 a day; some 29 percent percent earned between $1-1.99, leaving 43 percent making above $2 a day. Compared to Current Clients (using the DPCE), Ex-Clients were much better financially, thus showing that microfinance in Mexico is working to help the poorer of the poor become less poor. When Ex-clients ($1.88/day) are compared to Non-clients ($1.71/day), it is shown that they are financially better off than the average person not participating in microfinance. All this data seems logical because as microenterpreneurs participate in the MFI, they become more financially self-reliant to at last be able to leave the institution and stand on their feet alone.

For some peculiar reason, Ecuador did not give the same results as those taken from Mexico. This could be due to a variety of reasons which we discuss. Ecuador's New Clients on average earned about $1.64 a day, with 17 percent earning less than $1 a day, 51 percent earning $1-1.99 a day, and 32 percent earning more than $2 a day. Current Clients in Ecuador earned on average less than New Clients at $1.53 a day with 22 percent earning less than $1 a day, 46 percent $1-1.99 a day and 33 percent earning over $2 a day. Non-clients in Ecuador earned on average $1.67 a day, three cents a day more than New Clients. Why are New Clients in LatinoFinance's Ecuadorian operations earning more than Current Clients? An apparent way to explain why Current Clients are poorer compared to New Clients is in the group selection. In microfinance groups, the group members decide who will join the group. It appears from the statistics that group members are now picking clients who are not among the poorer of the poor, but rather, those who are near Ecuador's average income earner. The reason group members would prefer members who are not among the poorest of the poor is because they may be higher risk, and those who are poor—but not the poorest—are less risky.

But, the analysis only becomes more complicated when we look at Ecuador's Ex-client numbers. The Ex-Clients in Ecuador on average earned $1.40 a day, with 36 percent earning less than $1 a day, 28 percent between $1-1.99, and 36 percent over $2 a day. Why are LatinoFinance's Ex-clients in Ecuador earning much less than the other three groups? Shouldn't the Ex-clients be earning more than Current and New Clients? Since the interest rates on the microloans in Ecuador are almost equal to Mexico's, and the rules regulating LatinoFinance's microfinance operation in Ecuador are virtually identical to Mexico's, it seems likely that the problem lies not in the MFI but again at the local group level where selection is made by the members of the group. Not only can group members decide by vote who to matriculate into the groups, but they can also by vote decide who leaves the microfinance loan system. If members feel that one or more of their members in the group are not keeping up with their commitments, then they can vote them out after one or two loans and they will be back where they started, or, in this case—being pulled from the benefits of the microfinance loans when they had just begun—worse off.

Whatever the scenario may be, it seems that the group selection process in Ecuador needs to be evaluated to see if LatinoFinance is living up to its objective to assist the poorest of the poor. These numbers show that in Ecuador, LatinoFinance may have deviated from its course objections by recently attracting financially less risky microentrepreneurs to participate in microloans. Clearly, the anomaly of Ecuador suggests the need for more research to shed light on our current findings.

Conclusion

As we can see from the field data taken from Mexico, microfinance has promise for helping the poor improve their lives by increasing their purchasing power and giving them more income. It is an effective way to assist the poor to become financially self-reliant and take more control of their lives. On the other hand, as we have seen from Ecuador, since funds are always limited, care must be taken to ensure that microfinance institutions encourage group members—who democratically accept and reject membership of others—to select the poorer of the poor. In this way, limited funds can be used to lift the very poorest. For now, however, this relatively simple and inexpensive field study suggests that small loans to Latin American microentrepreneurs at least shows some evidence of positive impacts that improves their quality of life.

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