PN-ABF 538
67051

ARIES

Assistance to Resource Institutions for Enterprise Support

Improving Rural Financial Markets: Appropriate Design of Savings Projects

by

Catherine A. Rielly

Prepared by the
Harvard Institute for International Development
for the
Office of Rural and Institutional Development
Bureau for Science and Technology
and
Office of Private and Voluntary Cooperation
Bureau for Food for Peace and Voluntary Assistance
U.S. Agency for International Development
Washington, D.C. 20523
Contract Number DAN-1090-C-00-5124-00
February 1988

Acknowledgements

I would like to give special thanks to Dr. Charles Mann for the thoughtful advice, insightful suggestions, and constant support and encouragement he gave me throughout the writing and revising of the paper. Chip Mann's technical prowess at operating IBM and McIntosh micro-computers greatly facilitated the paper's production.

I would also like to thank Dr. Merilee Grindle for the excellent recommendations of sources during my research, her guidance on the paper's organization, and her useful comments at every stage of this paper's writing. Anne Hornsby, who edited the paper, also deserves thanks for her helpful suggestions.

Finally, I wish to thank Rajesh Pradhan for his important contribution to the paper's production and his patience and good humor throughout.

Table of Contents

INTRODUCTION

Misconceptions about savings mobilization and badly designed rural credit-projects have stunted the potential growth of rural savings-deposits. In the past, programs for developing rural financial markets have focused more on providing credit -- often at cheap rates -- than on stimulating rural savings-deposits. Recently, savings mobilization has been increasingly recognized for the important role it plays in the development of rural financial markets, and in promoting broader development goals in the Third World.

The workings of savings and credit projects are an important concern of the ARIES project, since many resource institutions serve small-scale enterprises in rural areas through the provision of credit. This working paper is intended to stimulate discussion on the key issues in the design of rural credit and savings programs and offers guidelines for planners. The discussion illuminates four criteria for successful joint savings and credit projects: 1) access and distribution to intended clients; 2) savings mobilization; 3) loan recovery; and 4) economic efficiency. Beliefs and practices that determine the degree of dependence upon donors, appropriate interest-rate structures, the packaging of savings services, and institutional choice affect the capacity for programs to meet these four criteria.

The first chapter of this paper demonstrates how the "too-poor-to-save" belief constrains rural saving, and indicates how credit projects in the past have blocked savings mobilization through inappropriately low interest rates and dependence on external financing. Secondly, it clarifies the previously disguised direct and indirect benefits of generating rural savings; and most importantly, it poses the critical questions that project designers should ask in developing successful savings mobilization projects.

The second chapter assesses the extent to which different types of institutions can meet the criteria for successful savings projects detailed in Chapter 1.The discussion uses the notion of comparative advantage to point out which organizations tend to achieve or fail to meet certain features of good savings projects and why.

The third chapter maps the policy considerations that project planners should address in project design. Government policies both directly and indirectly influence an intermediary organization's ability to achieve the criteria necessary for good savings projects. The recommendations in these three chapters can serve as a guide for project planners in structuring incentives for savings generation, making the organizational choices for savings projects, and in making project choices in the face of policy constraints.

CHAPTER 1

PAST OBSTACLES TO RURAL DEPOSIT MOBILIZATION AND RECOMMENDATIONS FOR BETTER-DESIGNED SAVINGS PROJECTS

Savings-Retarding Features of Past Projects

Savings play an important role in developing rural financial markets and furthering broader development goals. In addition to unleashing rural savings potential, additional benefits may accrue from integrating savings mobilization into the design of credit projects: higher loan recovery rates; reduced dependence upon donors; expanded demand for loans; heightened financial "literacy;" and financially healthier institutions and group organizations. Further, greater exposure to formal financial institutions could generate entrepreneurial spirit, and could be a useful educational device for instilling sound principles of money management (Mauri 1983).

Two factors imbedded in the past structure of rural credit projects have obscured clear thinking about the potential value of savings generation to credit projects: artificially low interest rates on loans and overdependence on outside donor funding. Recent criticism of these savings-retarding features has shed light on the potential role of savings generation in rural finance and broader development goals (Von Pischke 1983; Meyer 1985; Vogel 1982). The key challenge, then, for intermediary institutions is to design and promote more appropriate projects that stimulate and strengthen savings mobilization.

"Too-Poor-to-Save" Myth

The myth that the poor in developing countries do not save, or are indifferent to rewards to savings has led some lenders to conclude that they cannot mobilize savings cost-effectively (Meyer 1985; Von Pischke 1983). Until recently, conventional theory in development economics assumed that the marginal propensity to save was low for households whose income lay below a certain level. As a result, little attention was given to how interest-rate policies and the overall use of financial markets to stimulate consumption affect decisions by such households to save. Such attitudes can lead to self-fulfilling prophecies: rural people are thought to have negligible voluntary savings capacity. Thus little or no opportunity or incentive to save is provided in rural areas. Consequently, the majority of policy-makers in developing countries in the past have imposed involuntary savings techniques such as taxation, inflation, price ceilings, and distorted exchange rates (Kane 1984).

In the 1970's, however, revisionists refuted the belief that the poor do not save, arguing that even the poorest save a little, since the existence of intervals between the realization of income and the act of expenditure is normal and universal (Von Pischke 1983; Adams and Gordon 1983). A World Bank study points out that the poor's propensity to save may be underestimated. In all cases where the loan is used to buy equipment and machinery, the amount of income generated and used to pay back interest and principal on the loan is not counted as "saved," when in fact it is part of the value-added by the borrowing enterprise (World Bank 1985).

In fact, poor rural households do indeed have the capacity for voluntary savings; but rural financial markets --as they have been structured in the past -- have discouraged savings (Blayney and Otero 1985; Meyer 1985; Von Pischke 1978; Von Pischke 1983). Not only do the poor, like everyone else, save, but the savings threshold is generally much lower in developing countries than in industrialized countries and lower in the countryside than in the cities (Mauri 1983). When methods of production involve long gestation periods between the start of the production process and sale of finished goods, saving is essential.

The strength and complex development of informal rotating savings and credit associations throughout the developing world confirms that the poor do save (DeLancey 1978; March and Taqqu 1982). A recent study of development projects shows that informal sector savings principally finance the small-scale enterprise sector, while banks and credit unions contribute very little. In the case of Haiti and Sierra Leone, personal savings accounted for 72 percent and 60 percent, respectively, of initial capital in small-scale enterprises (Overholt et.al 1984).

For example, in the central African nation of Cameroon, a small-scale entrepreneur borrowed $35,000 in cash to open his business from his tontine, an informal credit system rooted in African tradition. 47 percent of Cameroonians participated in informal credit and savings associations, the highest of five French-speaking African countries surveyed by Marcomer Gallup International (Brooke 1987). Cameroon had the continent's highest average economic growth rate in the first half of the 1980's, 7 percent. While bankers in Cameroon complain of loan delinquency rates as high as 50 percent, tontine payments are taken very seriously and participants rarely default. Tontines work because their loans are backed by social pressure, a system familiar to Africans. On the other hand, banks perform poorly because their loans are backed by paper guarantees made to strangers, a concept alien to Africans. According to Theodoret-Marie Fansi, the director of an economic consulting firm in Cameroon, banks are "colonial structures that don't match the mentality of the people" (Brooke 1987). The banking interest rate on deposits and taxation structures make saving in formal institutions less attractive than saving informally. Banks pay 7 percent annual interest on savings, while interest-bearing tontines pay much higher interest, up to 30 percent a year, depending upon the demand for capital. And interest earned on bank savings is subject to a 10 percent tax, while tontine earnings go unrecorded.

These and other instances of successful saving generation in the informal sector indicate that the previous concern -- that the poor do not save -- is no longer relevant and suggest a new one: the structure of the formal financial sector does not accommodate the needs of the less well-off, as the preceding description of banking in Cameroon illustrates. This was the case in Costa Rica where low income households with savings preferred to save in "formal institutions," but claimed ignorance of procedures and terminology (Blayney and Gonzalez 1984, cited in Blayney and Otero 1985).

Instead of saving in formal institutions, the rural poor in developing countries often save in kind -- such as by investing in a cow -- when they acquire even small amounts of extra capital. It seems that the poor are not a financial "basket case," and they should not be treated as one. Instead projects must be designed to address their particular needs, and consequently tap their proven savings potential.

Subsidized Interest Rates

Capital erosion resulting from low interest rates on borrowing undermines the ability of credit organizations to offer market rates of return to induce savings (Mayer 1985; Adams 1983). The failure of credit projects to cover their costs blocks the rural poor's access to savings with formal financial institutions. In the case of Fondacion Nicaraguense de Desarrollo (FUNDE) in Nicaragua, low interest rates on borrowing may have contributed to the practice of offering low, and even negative, returns on savings, with zero interest rate and 30 per cent annual inflation. (A number of other factors contributed to FUNDE's discouraging savings, including the risk of sudden withdrawals, the danger of ending credit unions' dependence on FUNDE, and its access to a steady inflow of funds from outside donors -- a much easier means of obtaining funds than through savings mobilization.)

Esse .tially, cheap credit policies lead to cheap savings policies that lack incentives to attract potential rural depositors. In the long run, formal financial institutions can serve more people by mobilizing deposits than by dispensing cheap credit. Thus, those credit projects subsidizing interest rates may do more harm than good, by wasting potential for savings generation.

These artificially low interest rates create an excess demand for funds, which leads banks to ration scarce funds by giving priority to their large scale clients. Subsidized interest rates intended to redistribute wealth to certain less well-off segments of the population -- such as women or other borrowers without political influence -- often do not reach the targeted group (Adams 1983; Lycette 1984).

Organizational Pressure for Low Interest Rates. Even when national policy does not mandate low interest rates, certain types of intermediary organizations, such as NGO-sponsored coops or credit unions, have been reluctant to charge high interest rates for reasons of philosophy, self-interest, financial ignorance, or dependence on outside funding. For example, coops may face strong pressure to charge interest rates that are more "just" than the exploitative middleman. This has invested coop interest rates with strong social symbolism, making it difficult to charge prices that cover costs. Another problem exacerbating the pressure to keep interest rates low is the resistance of coops to pegging interest rates to inflation. Coop members in Bolivia would have considered indexing interest payments to inflation "evil" (Tendler 1983).

Two other factors influence donor tendencies to charge low interest rates. First of all, managers of credit unions and other intermediary organizations may lack knowledge, training, and expertise in finance, and thus may not fully understand the economic consequences of their low interest rate policy. Further, non-governmental organizations that continue to rely on the steady inflow of donor funds may not feel pressure to charge interest rates that cover their costs.

Overdependence on Donors

Both recipient and donor organizations are guilty of stifling savings potential by institutionalizing the practice of running on imported fuel: perpetuating dependence on massive inflows of donor funds. The result is that cooperatives and credit unions continue to live the "uncertain life of the beggar," dependent upon outside donors for their existence (Adams 1983).

FUNDE in Nicaragua is a case in point. Potential inflow of savings deposits at credit unions threatened to shake up their dependent relationship with FUNDE -- the bond that guaranteed FUNDE's existence. FUNDE also discouraged savings out of further self-interest. Risk of sudden withdrawals could disrupt FUNDE's lending plans and jeopardize repayment to the organization, itself (Tendler et al 1985).

Another case, the Dominican Development Foundation (DDF) suffered from financial difficulties when it became dependent upon outside sources of funding that had become increasingly difficult to sustain on a continuing basis. Foundations would give DDF one or two grants, but were not interested in indefinitely supporting the agency. DDF ran into trouble when the granting organization wanted it to stand on its own.

DDF experienced both increasing loan repayment problems among its client groups and erosion of its portfolio purchasing power as a result of inflation. Without a continual inflow of grants and subsidies, DDF's charges -- one third of operating costs -- were insufficient to maintain the real value of its portfolio. As a result, when donors cut off funding, the organization was unable to remain financially viable, on its own (Adams, Antonio, and Romero 1981).

Even when the very existence of an institution is not threatened by dependence on outside sources of funding, financial dependence can render the organization subject to pressure from donors. UNO, the Northeast Union of Assistance to Small Businesses, a credit organization in Recife, Brazil, provides an example of such a case. UNO opted for a highly-subsidized interest rate and a low commission that guaranteed perpetual dependence upon the goodwill of public-sector benefactors. With the scaling up of the organization, the government pressured it to reorient its approach toward impact-maximizing, a policy geared toward reaching as many people as possible rather than cost minimization (Tendler 1983).

Reduced donor dependence will create greater incentives for generating internal savings. And in turn, increased savings mobilization will allow organizations to sever their financial umbilical cord to donor agencies, and become more self-sufficient. Further, organizations that do not depend on a steady inflow of outside funds may tend to focus more attention on keeping costs down. In addition, the discipline of savings mobilization would help end the practice of donors using lending to distribute patronage by continuously funding organizations that are politically expedient (Vogel 1982).

Lax Loan Collection Policies. Overdependence upon donors can take the pressure off project planners to keep their costs down by minimizing their losses from delinquent loan payments. Constant inflow of loans from donor agencies can serve as a disincentive to organizations to take the necessary but time-consuming steps to pursue every late or missed loan. The USAID-financed Partnership for Productivity project in Liberia (PFP-L) has followed a rigorous, thorough, and relentless loan collection policy, and, as a result, its revolving loan program has had a very high repayment rate. Since many loan programs attempted in Liberia in the past had become gift programs, PFP-L decided to pursue every loan, no matter how delinquent. When personal persuasion failed to bring accounts up to date, PFP-L would take the client into court (Management Systems International 1987). Replication of PFP-L's strict loan collection policy should increase the likelihood of prompt repayment.

Neither subsidized interest rates nor donor dependence can be institutionalized on a sustainable basis. Low interest rates and dependence upon donors tend to inhibit loan recovery, muzzle rural savings potential, and raise administrative costs.

Appropriate Design of Savings-Generating Projects

How can project planners convince poor clients to entrust their savings to intermediary financial institutions? First of all, the way financial services are packaged is important as the choice of the type of financial services, perhaps even more so. The nature of most appropriate packages of financial services varies, depending upon the needs of different project target groups. For example, a group may have seasonal cash-flow problems. In this case, group credit issued at different times may be appropriate for farmers who have cash surpluses and deficits at different times, depending upon their cropping patterns. Thus the overarching principle that should guide planners in shaping savings mobilization schemes is to be as innovative as necessary to adapt the savings mobilization project to the needs of the community.

No matter what the specific needs of their clientele are, project designers building a working loan program of a PVO or special projects within already existing financial institutions must ask two questions:

1) What rate of return should the intermediary offer on savings?
2) What incentives should the project offer to build client confidence and stimulate the institutionalization of working balances?

The following discussion explores the general issues to consider in integrating responses to these questions into project design. Chapter 3 looks more specifically at appropriate responses to these questions in different institutional settings.

Setting the "Right" Price for Services: A Challenge for Project Planners

Distortions in financial markets in many developing countries have become entrenched for sound political reasons, and it is unlikely they will entirely disappear from policy environments in the near future. As a result, the selection of appropriate interest rates to charge on credit and to offer on savings in distortion-ridden environments is one of the toughest and most important choices for project planners.

While neoclassical economic theory postulates that market interest rates on credit and savings are optimal, before this free market solution can be prescribed for developing countries, planners must examine the relationship between expected rates of return on financial savings and household savings and consumption decisions. Raising rates of return on deposits will not magically make all impediments to savings disappear. "Getting the (borrowing and lending) prices right" alone will not guarantee increased rural savings. In most cases when small savers have not had access to financial services and indigenous credit groups do not fill all their needs, they are likely to respond favorably to an innovative savings project, which fills the gap between their current opportunities for savings and their needs. It is likely that this will prove to be true, even if the interest rates are sufficiently low to satisfy the intermediary. In certain other situations, it might be unwise to appear to be discriminating against small savers by offering them different sorts of accounts or lower interest rates than large depositors (Von Pischke 1983).

In practice, more savings projects have worked when interest rates on deposits are high, and failed when they are low, than vice versa. In the case of USAID's BANCOOP Project in Peru, low interest rates and ceilings on savings rates offering no incentives to save and led to an excess demand for loans. Credit unions in the project's two target areas suffered from severe shortages of loanable funds, as members' demand for low-interest loans far exceeded their capital contributions and small time and savings deposits. BANCOOP's solution was to offer high interest on time and savings deposits, resulting in the mobilization of funds far exceeding the US $150,000 goal. Deposits on time and savings deposits far surpassed demand deposits, which did not yield high rates of return.

The BANCOOP example indicates that hope of mobilizing low-cost resources through demand deposits -- with high clerical costs paying low rates of interest -- is illusory (Vogel 1983). Savings institutions should try to offer financial instruments such as time and savings deposits, which cover their costs.

Acquainting themselves with past and present interest rate structures and with the population's responsiveness to interest-rate changes is essential for planners to make appropriate assessments of what interest-rate strategies for credit and savings will and will not work for their specific clients. Based upon the rocky track record of subsidized interest rates on credit -- and the corresponding low rates of return on savings -- project designers should be wary of matching these low rates (See Adams 1983; Chuta and Leidholm 1979: 66-72; Von Pischke 1978; Von Pischke et al 1983). Low rates may attract individuals or groups outside of the targeted population to try to usurp funds (Lycette 1984).

Ideally, interest rates should come reasonably close to market rates, to insure financial institutions enough capital to pay appropriately high rates of return on savings accounts. But in the cases when subsidized credit is available to potential clients, it is unlikely that projects offering credit at market rates will attract borrowers. The key challenge, then, to project and program designers is to charge an interest rate on loans that is low enough to attract customers, but high enough both to defray costs and instill in the borrower both a sense of the value of the loan and the accompanying obligation to repay it.

The National Christian Council of Kenya (NCCK) successfully achieved this balance by adjusting credit prices upward over time as clients came to appreciate the coop's benefits and became more trustworthy. Mindful of the low income status of its clientele, NCCK resisted USAID's pressure to charge commercial interest rates, but instead charged 3.5 percent, and increased it to 5 percent, and then 8.5 percent on longer-term loans and for second-time borrowers (Ashe 1985). The interest rate was adjusted upward as it became obvious that poor clients could absorb, utilize, and repay their loans successfully. If the borrowers were able to maintain their rise in income, interest rates were raised again to slow decapitalization of the revolving loan fund and to give a greater number of clients access to this fund. The organization also found that by extending amortization periods in order to lower monthly repayment costs, higher interest rates became more acceptable (Ashe 1985).

Choosing the appropriate interest rate package for credit projects could assume one or a mixture of the following forms:

(1) *Setting Interest Rates between Market and Subsidized Prices*. One option would be to attract borrowers through publicity emphasizing features of the project such as accessibility, safety, and liquidity, and the flexibility to charge higher than subsidized, but lower than market interest rates. The effectiveness of this approach depends heavily on the relative attractiveness of the overall project, as compared to other credit sources.

(2) *Charging User Costs Plus Subsidized Interest Rates*. Another option would be for credit and savings projects to charge user costs in addition to subsidized interest rates, serving to raise the effective interest rate and the costs to the borrower. Such an

approach would help cover administrative costs, and give borrowers a more realistic sense of borrowing costs.

(3) *Imposing Forced Savings Requirements Plus Subsidized Interest Rates.* Similarly, mandatory savings deposits would raise the effective interest rate, build the project's capital base, and, ideally, instill a greater commitment on the part of the borrower to repay the loan. While the purely financial benefits of offering market rates are clear, it may be more practical for the project to charge lower interest rates and compensate for them with other conditions on borrowing, such as those suggested in (2) and (3).

With knowledge of the specific needs and the borrowing and savings patterns of their target population, project planners should decide where on the continuum between market and subsidized rates they should set their prices.

Triad for Success in Savings Mobilization: Safety, Convenience, and Liquidity

Financial and other institutions extending credit to inexperienced clients must create incentives to move savings from traditionally secure non-interest bearing forms --livestock, land, jewelry, or stocks of commodities -- into formal intermediaries that are viewed as much riskier (Gonzalez-Vega 1982). A first rule should precede any further discussion of how to design an effective savings mobilization package: savings projects should be voluntary, as opposed to coercive. After this minimum standard has been attained, other incentives tend to enhance project effectiveness. Three other critical features in the packaging of savings mobilization are: (1) insuring safety of deposits; (2) convenient access (in terms of location and time of day); (3) and ease of withdrawal. These three elements may even surpass interest rates in their influence on the response of rural dwellers to saving projects, as suggested in the Chapter Three discussion of the relative ability of different organizations to provide these attractive features.

First, project planners should put considerable effort into creating saver confidence through providing helpful staff, furnishing neat and comfortable surroundings, and fostering efficiency and competence (Spall 1981). Intermediary organizational staff should receive special training in working with the target community, especially when first expanding the scope of activities to include savings. The Grameen Bank's method of training staff in the field is an appropriate model for training staff to understand fully the specific conditions of the rural community--and the needs arising from these conditions. Project staff should patiently explain the procedures for making saving deposits and make it easy for newcomers to "learn the ropes" of managing in the world of formal finance. When skeptical customers first approach the intermediary, the savings deposit procedure should be portrayed as "user-friendly." (See Chapter Three for an explanation of which organizational forms tend to provide more convenient service to rural depositors.)

A nationwide insurance program can help assure savers that their deposits will be safe (Adams 1983). But designers should be wary of too much government involvement, which may undermine client confidence through fear of tax assessments and loss of confidentiality (Von Pischke 1983). To minimize the risk to the intermediary institution -- and the community served as well -- of sudden cash withdrawals, projects could offer deposit accounts for a fixed period, when savings insurance is not readily available (Tendler et al 1985).

Second, convenient access to savings facilities is a critical feature of successful mobilization of rural savings. The intermediary institution should try to bring the savings branches to the people, although it is very costly in the initial stages, before a substantial volume of business has been built up (World Bank 1981). If distances are long and customers are scattered, mobile units may be a valuable public medium for providing convenient service. Offices should operate at times and places that are convenient to customers, such as when the market is open, and during market days (Von Pischke 1982).

Third, ease and speed of withdrawal of deposits are essential to attract customers. Since rural people often save for emergencies, funds should be readily available to them. Liquid accounts should be a well-publicized savings option, but organizations should offer a range of less liquid, but more lucrative accounts, as well. Financial institutions should provide various types of financial savings instruments paying a range of different rates of return, varying inversely with liquidity. Additional incentives in the form of prizes of sought-after consumer goods, lottery schemes, or linking savings to house purchase or improvements are also possible (World Bank 1981).

Finally, project designers should be careful not to cut cultural and ethnic corners in creating their credit and savings package. For example, in some Muslim societies where charging interest rates is forbidden, project designers should consider other means of charging customers for services provided.

Conclusions

To generate savings growth, incentives must be offered that are tailored to fit the specific needs of the target community. This chapter has explored three questions that planners should answer which can influence the outcome of savings programs:

1) How can projects be less dependent upon donors?
2) What interest rate structure is appropriate?
3) How should credit and savings services be packaged?

Planners' responses to these questions shape the outcome of savings programs. This discussion of critical questions planners should pose has revealed four features that characterize successful savings and credit projects: savings mobilization, loan recovery, access and distribution to intended clients, and economic efficiency -- defined as keeping administrative costs down.

The preceding analysis suggests that reducing donor dependence improves the program's chances of achieving all four of these criteria. Choice of an appropriate interest-rate structure provides another opportunity for planners to help generate savings, reduce defaulting, keep administrative costs down, and offer access to the target population. The above discussion has also revealed that tailoring an incentive package to the needs of the target community should improve the project: a package that includes safety, convenience, and liquidity should enhance the project's chances of accomplishing all four project objectives.

The next chapter examines the fourth question planners should ask in order to develop better savings and credit programs: what institutional form is most suitable for the credit and savings project? Responses to this question influence the project's ability to mobilize savings, recover loans, reduce donor dependence, and give access to its target population -- and hence influence its potential for success.

CHAPTER 2

COMPARATIVE ADVANTAGES OF DIFFERENT INSTITUTIONS OFFERING SAVINGS AND CREDIT PROJECTS

Institutional viability can be measured by a combination of the four performance criteria for successful savings and credit projects that were discussed in the previous two chapters: (1) distribution to intended clients; (2) savings mobilization; (3) loan recovery; (4) economic efficiency (low administrative costs). An institution that provides easy access and benefits to its chosen target group, mobilizes as large a share of resources as it lends, has high recovery rates on loans, and is efficient is more likely to achieve long-term growth and stability. This chapter attempts to assess the fitness of institutional forms for best accomplishing these criteria for effective credit and savings projects. Distribution of services to clients is divided into two categories; access and scope. Access describes an organization's ability to reach its target population, often the rural poor who would otherwise not have access to formal credit and savings services. Scope refers to the number of individuals or groups served and to the different geographical areas that an organization serves.

An institution is not superior to others intrinsically. Rather, the key features of the institution -- its rationale, authority structure, and functions -- must match the project's context: the social structure (including the nature of elites and their interests); the homogeneity or heterogeneity of the target population; and the community's receptiveness to change or adherence to tradition (Cleaves, 1980).

The extent to which an institution reinforces the propensities of the population and responds to clients' needs influences its ability to meet the four criteria for good savings projects. However, these goals may conflict. For example, institutions offering easy access to clients may not be equally capable of keeping transaction costs low. This relative ability of institutions offering credit and saving services to perform certain functions better than other institutions -- institutional "comparative advantage" -- will be explored below.

Comparative advantage will not be used to rank institutions according to which can most efficiently produce the credit/savings "commodity." Rather, credit and savings services will be divided into the five functions mentioned above: access, scope, credit recovery, savings, and economic efficiency. Institutional comparative advantage will be assessed for each of them. Table 1 diagramatically illustrates the comparative advantages of these different "institutional types." This chart, based upon the author's survey of the literature, ranks each type either low, medium, or high, according to its comparative advantage in each of the five functions discussed above. This method of comparison illuminates the advantages and disadvantages of different organizational types, rather than categorically labeling them either successes or failures. For example, a non-government sponsored coop may have a comparative advantage in access relative to other types, but not efficiency; the opposite may hold for a commercial bank.

An important caveat must be noted here: while certain institutions may tend to have comparative advantages and disadvantages, they do not remain in a static state: institutions that may be weak at providing a certain service in the beginning stages of a project's development may improve over time (Tendler 1983). In other words, the notion of "dynamic comparative advantage" applies here.

Before looking at the specific savings and credit institutions, let us briefly scan the horizon of institutional choice for savings mobilization. Typologies of the institutional players in rural development abound (Blayney and Otero 1985; Carroll 1986; Esman and Uphoff 1984; Johnston and Clark 1982; Leonard and Marshall 1982; Moris 1984). Rural development organizations can be classified a number of different ways. Frequently dichotomies are used such as public versus private, government vs. non-government, market-oriented vs. non-market-oriented, multi-function vs. single function and those serving groups vs. those serving individuals. In reality, neat categories with a clear-cut distinction between public and private do not exist. There are many hybrid organizations owned by both public and private interests that combine for-profit goals with community or social development goals--such as parastatals, development banks, government banks, or joint ventures (Blayney and Otero, 1985).

These typologies may be multi-tiered, ranging from local organizations at the lowest tier (in terms of geographical scope) to international organizations at the apex, with any number of hierarchical intermediary tiers in between. The purposes of these linkages between tiers are both assistance and control, to enable one organization to determine some aspect of another's performance (Leonard and Marshall 1982). For example, intermediary credit cooperatives monitor the financial management and loan practices of the primary cooperatives to which they lend. The array of linkages between these organizational levels -- and the relationship between them -- has a major impact on the outcome of the project.

This chapter will examine only the subset of these institutions that is most commonly used in credit and savings projects:

(1) government coops and other local government institutions
(2) non-government coops (sponsored by non-government organizations (NGOs)
(3) NGO-sponsored "solidarity groups"
(4) banks (commercial, development, and cooperative)

This choice of forms offers a significant range of alternatives for the project designer. In each of these institutional forms, one must make an effort to look at their revealed function -- with the benefit of hindsight -- rather than their intended function. Planners in the past have not always followed this advice; for example, project designers have continued to advocate coops modelled on the English-Scandinavian Rochdale pattern, long after actual performance had demonstrated its inappropriateness for most developing countries (Hunter 1971, cited in Johnston & Clark, 1982; Lele 1982).

Coops and Group Projects

The next section looks at the comparative advantages of coops in general, before assessing the particular strengths and weakness of government and NGO-sponsored coops. While coops often offer credit and savings opportunities to individuals, NGOs also sponsor credit programs to groups of rural people, who ordinarily would not have access to individual credit. The discussion below evaluates the advantages and obstacles to these group credit projects, referred to here as the "solidarity group" model.

Comparative Advantages of Coops in General

Coops cannot be treated as generic organizations that tend to succeed or fail for identical reasons. The performance of coops differs, depending on their size, scope, function, rationale and sponsorship. However, there are a few fundamental characteristics that apply to many, but not all, coops.

The following section examines two characteristics that have recurred in past cooperative projects: strong ideological support and bureaucratic organization.

A remarkable optimism based on two ideological beliefs has sustained cooperative development during the past century, despite the fact that coops are often portrayed as acting against the interests of rural people. One is that cooperation is not only positive and progressive, but also a natural human propensity. This is not wholly consistent with the second general premise: that the ideal combination of efficiency and equity can be achieved only by application of modern, i.e. bureaucratic, organization. It is still commonly assumed that simple rural people have a latent capacity and enthusiasm for cooperation, but lack the formal organization to render this more efficient (Robertson 1984).

Ideological Support for Coops. Faith in the cooperative propensity continues to inspire development planners, against the evidence of protracted experience. Noting that cooperatives in Lesotho have enjoyed minimal support, the government's "Blueprint for Action" in agriculture (1981) insists that "in spite of this lack of progress, the Government remains convinced that the Coop movement provided the best framework for rural self-help activities in Lesotho. It is committed to the promotion of voluntarily-supported coops which are firmly based on the traditions of village management of resources and collective exploitation of them. It believes that coops offer a practical means of giving power to the people" (Kingdom of Lesotho 1981, as cited in Robertson, 1984).

Bureacratic Tendencies of Coops. The persistent failure of state-sponsored coops may indicate that this ideal form, bureaucratized "natural cooperation," as described above, is highly problematic. The change in organizational form brought by bureaucratic formalism -- regulations, managerial hierarchies, committee decision-making paperwork, and so on -- may not actually transform the "natural" cooperative propensity into an efficient and equitable organization (Robertson 1984). But so strong is this notion of the development of "modern" coops that proponents of cooperativism commonly see the establishment of an institutionalized bureaucratic framework as, in itself, a manifestation of success (Robertson 1984). In fact, bureaucratic devices may be alien to the peasant cooperator.

For example, the "institutionalized suspicion" implicit in formal auditing would be highly offensive to a community where trust is highly personalized. Cultural barriers to effective auditing -- an important task in controlling the efficiency and honesty of financial projects -- may lower the financial performance of savings projects, whether or not they are sponsored by cooperatives. The following look at experiments with public and private coops suggests how they might avoid the possible problems common to bureaucratized and ideologically-charged coops.

Past Experience with Government Coops

A brief look at past experience with government sponsored agricultural coops will frame the analysis of the comparative advantage of this type of organization in the four areas of savings development. Numerous studies have concluded that government-sponsored credit cooperatives have lacked the confidence of lenders and incentive structures to serve rural people but have instead incorporated independent economic activities into a framework of government control, provided jobs, and extracted benefits for government employees (Bennett 1983 ; Hart 1982; Lele 1982; Robertson 1984; Shipton 1986).

Distributional Patterns of Government Coops. In Africa, state-sponsored credit coops and other coops providing agricultural inputs have been considered less as efforts aimed at economic improvement of agriculture than as embryonic institutions of government control (Hart 1982). The state has been portrayed as "usurer," offering credit that draws ever more peasants into a nexus of indebtedness. Hart aptly captures the recent feelings of rural Africans about government coops:

> These initiatives [to organize farmers] are normally called cooperatives," but West Africans know what they are: a source of employment for government workers, a nexus of indebtedness to rival the Lebanese storekeeper, a means of transferring part of their labor to the state, a monopoly distributor who sells dear and buys cheap, a political payoff to the government's supporters, and a general agent of the state in the local community of farmers (Hart 1982).

This quotation reveals that coops, often described in Western terms as participatory and egalitarian, are often, in fact, highly discriminatory. Egalitarianism in credit coops has often proved to be a facade, an early promise of mutual aid, that soon reveals a differential capacity for individual gain. Outsiders' expectations that cooperatives be democratic and participatory are unrealistic and inappropriate in many traditionally hierarchical rural environments or under certain kinds of state structures. Use of traditional forms of mutual exchange may only exacerbate traditional patterns of obligations in a manner that results in greater inequity and exploitation by the elite (Hyden in Widstrand 1970, cited in Lele 1982). The role of wealthier farmers participating in "Better Living Societies" in the Punjab has been described as "restrained and altruistic," confining their participation to investment, good counsel and friendly patronage (Campbell in Robertson, 1978). In reality, big farmers are seldom so altruistic. In Uganda, for example, it was discovered that they led and used the credit facilities of village coops, but sold strategically on the open market, undermining society finances (Campbell in Robertson 1978).

In other African countries, formation of credit groups involving tribal chiefs has often resulted in channeling of the credit to various members of the chiefs' clans, and relatively little to small farmers (Lele 1982). In societies where socio-economic differentiation has been acute, as in parts of Ethiopia prior to political change in 1974, or in parts of Latin America, government coops may be viewed as a threat to the socio-economic structure (Borda 1969 and Apthorpe 1970, as cited in Lele 1982). Government or non-governmental group credit may be unfeasible in such instances, unless a drastic redistribution of power takes place.

Another problem is access of certain groups of individuals to official government cooperative status. A national Community Development Office-sponsored women's savings group in the Central African nation of Cameroon did not have the funds to obtain a permanent meeting place, a requirement for becoming a government pre-cooperative and then cooperative, and receive the financial benefits which accompany this status. Organizations composed of low-income groups, such as this group of African rural women, may be deprived of financial benefits which accompany government-sponsored cooperative status (Rielly 1987).

Past experience with government coops which serve a different function than providing financial services illuminates traits of this particular organizational type. For example, the Kaira Cooperative Union (Amul), a dairy coop in India, has proven to be a dramatic exception to the portrayal of government coops as nonparticipatory and undemocratic (Paul 1982). Village members use democratic processes to form milk producers' unions and manage them via elected committees. Amul's strong political support at the local level contributed greatly to its use of democratic practices. Local leadership mobilized farmers at the district level to take advantage of the potential benefits of starting a dairy coop. This unusually democratic cooperative system has directly improved the welfare of 1.3 million small farmers in 12,000 villages, who have been able to augment their incomes 50 to 100 per cent, as a result of the Amul program (Paul 1982).

This experience suggests that political support for the rural beneficiaries of government coops tends to enhance its potential to operate democratically, and to benefit the small farmer. Garnering this support, however, may not be easy. While government coops often do benefit from an organizational structure that allows them to penetrate rural areas, down to the village level, they do not always have strong political support at that level.

Another common feature of government coops that Amul escaped was heavy bureaucratization and its associated problems. The unusual voice and flexibility that the Government of India gave the National Dairy Development Board, (the organization in charge of the coop program), minimized the usual problems of government coops, such as delays in decision-making, slow feedback, and a separation of design and implementation. NDDB, unlike some other government agencies running coop programs, had a strong stake in the implementation of the dairy cooperative program. Its continued involvement in implementation enabled it to appreciate the field problems, correct any design errors brought to light through feedback, and adapt the program and its components to the emerging environment.

At first, the NDDB was subject to the same conventional budgetary norms, audit and control procedures, and constraints as any government agency; but it found them so irksome that it established a sister public corporation that allowed it financial autonomy. The NDDB further loosened its dependence on the government by raising its own revenues through fee-for-services charges. User charges also made NDDB more careful about the relevance and quality of services, as measured by client response. This experience suggests that government coops which are not financially dependent on government revenues may be less subject to heavy government controls, and may provide more appropriate services to their clients. Government coops that have the opportunity to exercise some degree of financial autonomy may escape excessive government regulation by doing so.

The NDDB's highly motivated staff, strongly committed to the organization, is another characteristic distinguishing it from many government coops. What enabled NDDB to assemble such an unusual staff was its commitment to avoiding the customary practice of hiring experienced government officials who bring with them the operating cultures of their old departments. These "deputationists" do not have any stake in the new organization, since they retain permanent jobs elsewhere. Amul's employees possessed a sense of mission and desire to work together to fight vested interest -- the urban bureacratic elites, who have historically been the enemies of rural farmers. Staff members were further motivated by the prospect of career advancement for good performance, an opportunity not always open to employees of other government coops. No matter what type of organization, staff members tend to respond better to the needs of clients when they have a firm stake in the program's success. Government programs, in particular, which have tended to perform weakly in this area, should focus special attention on staff motivation.

Amul enjoyed the political support of local leaders, broke away from strict financial controls and bureaucratic problems often present in government coops, and instilled its staff with a deep commitment to the project's success. Amul's performance in these three areas demonstrates that government coops can overcome the problems that often vitiate their success. When possible, planners of government coop programs should integrate the lessons of Amul into their project design.

While government coops may not tend to have a comparative advantage in access, their financial resources and organizational structure -- often reaching down to the village level -- may give them an advantage in scope; i.e. the capacity to reach a large number of individuals in a wide geographical area. The NDDB serves as an example of a government coop which tapped into its elaborate organizational network to stimulate farmers to start their own coops at the grassroots level.

Conclusions. While case studies documenting government-sponsored savings projects are sparse, these characteristics of government-sponsored coops offer guidelines for assessing their comparative advantage in savings projects. From the preceding analysis, it would seem unlikely that government-sponsored savings coops would be readily accessible to rural dwellers; or rather, peasants might not make themselves accessible to the coops (at least in Sub-Saharan Africa). On the other hand, government coops may reach a larger number of individuals as private coops, which lack the elaborate organization structure to reach a spread of geographical areas. As Chapter 1 concludes, this confidence in the institution and the security of their deposits are prerequisites for successful savings projects.

Unfortunately, the bureaucratic procedures intrinsic to government coops may even further alienate suspicious peasants. Not only would they hesitate to accept credit, with the fear that they might be subject to high interest rates or driven into debt permananently, but they would be especially reluctant to entrust their savings to the government organization.

In the area of debt repayment, government coops have a rocky track record. Many African governments sponsoring agricultural credit programs in the past two decades e.g. Senegal, have periodically forgiven all debts during periods of economic crisis. As a result, farmers still view government credit as "free." If government coops hope to recover loans, they must warn members about default penalties in advance, and enforce them.

From the past record of government-sponsored agricultural coops, one could speculate that government organizations would not have a comparative advantage in the categories of access, repayment capacity, or deposit mobilization. Given the government's emphasis on professional standards of "modernity" and efficiency, do government cooperatives have a comparative advantage in our fourth criterion, efficiency? The answer is no, if one responds on the basis of their past performance. (The case of the Amul Dairy Coop in India is a noteworthy exception.) Officials everywhere tell tales of coop members and managers who have manipulated cooperative rules to their advantage, by corruption, embezzlement, or nepotism. These practices are clearly at odds with efficient financial management. The free money phenomenon described above decapitalizes the organization, further lowering efficiency.

The level of formal education required to deal with the complicated bureaucratic procedures lessens chances for efficient management and limits the number of individuals who could actively participate in administrative and management tasks; they are essentially left in the hands of government employees. The government staff would tend to be less motivated to achieve standards of efficiency than coop members, who have a personal stake in the future of the organization. All these factors combined do not add up to a highly-efficient organization.

To sum up, government coops in general do not show great promise for successful savings-generation projects, although they could offer the advantage of reaching a large number of people, by tapping into their extensive organizational structure. The Amul dairy coop effectively uses its organizational structure to reach a large number of rural people at the grassroots level. As indicated above in the discussion of the Amul coop, if government coops had the support of political leaders, limited their bureaucratic procedures, and recruited dedicated staff, they might be more effective in meeting each of the four criteria.

Perhaps government coops would be more effective if they emulated the style of delivering services used by private coops--such as issuing group credit or offering access to those previously denied.

Past Experience with Private Coops

The following discussion of private cooperative models, in contrast to the above treatment of government-sponsored models, illustrates the great variety within the organizational subset "cooperatives." While much institutional credit offered through government agricultural coops has been issued on an individual basis, privately sponsored coops have experimented with extending credit to groups, in order to open access to those people to whom it was previously denied. When social and cultural conditions are amenable (as defined by the conditions listed below), group credit may have the advantage of using social pressure to ensure repayment. Group responsibility for screening applications and ensuring repayment are often considered a better alternative than individual criteria of creditworthiness, as the Walamo Agricultural Development Unit in Ethiopia has indicated (Lele 1975). Requirements for downpayments, and proof of an individual's land ownership or tenancy used to insure repayment, are often impossible for small farmers and tenants to meet (Lele 1982). If government coops issued group credit, they could imitate the success of private coops in providing access to those previously denied.

Commitment to the coop taking out credit collectively is a prerequisite to a project's success. Individual resistance to forming groups turned the credit project sponsored by the National Christian Council of Kenya (NCCK) into a major struggle. Two factors crucial to the success of group credit projects were missing here: trust in fellow group members and superiority of the group credit option over other means of obtaining credit. The NCCK made the mistake of offering larger loans to individuals than they could receive through the group (PISCES II 1985). One may learn from this example that project planners should insure that enough financial investment is made to generate enough income for ample loans to each group member.

Access of Private Coops to Members. Coops sponsored by non-government organizations have a comparative advantage in access: their raison d'etre is often to open up credit and savings channels to those individuals previously denied, by virtue of their marginalized status in society (Spall 1981). The target population to which the organization intends to channel the credit is often explicitly written into the project's design. In Government coops, beneficiaries are more likely to be delineated by geographical locale rather than socio-economic status. NGO coops are often regarded as more accessible than government programs to members, especially when well-organized groups already exist in rural area (PISCES II 1985). On the other hand, private coops may not have the organizational or financial capacity to reach as broad a scope of clients in dispersed geographical areas, as government coops are better equipped to do.

A key question in the vast literature on coops is whether the Western notions of participation and democracy have been realized in rural coops and whether they are even appropriate for hierarchical rural societies. The question of to which segments of the population coops offer credit is important in institutional selection for project design. Several studies have indicated that coops in inegalitarian rural peasant communities are bound to be inegalitarian themselves (Lele 1982; Carroll 1982). Carroll describes this tendency of coops to serve the better-off portions of the population as "kulak-type" rural development (Carroll 1982). Emphasis on grassroots participation through coops can defeat equity objectives by vesting power in the hands of the rural political elite. Rural coops which are often organized around the supply of agricultural services to producers often automatically exclude the landless poor (Tendler 1983).

Planners working for non-governmental organizations must take special care to avoid replicating the mistakes of some government organizations that have in the past produced inegalitarian coops. In some instances, coops sponsored by NGOs have successfully reached those who would not otherwise have had access to credit. "La Libertad de Mujeres," a women's savings and loan coop in the Bolivian Andes, successfully provided credit and mobilized savings among poor women on an equitable basis. This coop, sponsored by a private Ecumenical Development Foundation, appeared to succeed in several of the areas where government-sponsored programs failed: participation and equitable distribution, spotless repayment record, efficient administration, honesty, and absence of fraud (Wasserstrom 1984).

Frequent elections insured that new members were recruited into positions of leadership. While the extent to which good financial management contributed to the program's success will be discussed below in the credit and savings sections, the fact that the organization was autonomous from the government allowed it more flexibility in meeting its clients' needs (Wasserstrom 1984).Also, the women, who had no other means of obtaining credit, were committed personally to the coop's success.

But coops sponsored by NGOs can fail to accomplish distributional objectives as well. For example, in a comparative study of IAF-financed agricultural coops in Bolivia, it was found that the different socio-economic structures of two areas determined their different distributional patterns. CCAM in Santa Cruz was less egalitarian than El Ceibo, because its community exhibited strong socio-economic differentiation on the basis of crop, in contrast to El Ceibo where no such differentiation existed (Tendler 1983).

In the former case, most rice farmers who accumulated a little capital wanted to shift from rice to the more lucrative crop, sugar cane, and to do this they needed credit to hire labor. Thus credit was highly coveted, and, as a result, was distributed disproportionately to the most economically and socially powerful of the group's members. In the case of El Ceibo, where farmers had little concern for shifting into a higher-value, more capital-intensive crop, credit was not the primary demand of coop members; they were more eager to reduce their transport costs and increase their selling price for their crops (Tendler 1983). This comparison suggests that coops that offer divisible goods, such as credit, have inherently lower spill-over distributional benefits than coops that offer public goods, such as marketing channels. This could be one explanation for why coops providing credit fall short of the models of egalitarianism as they are sometimes portrayed.

In conditions of acute socio-economic differentiation (even greater than the situation just described), redistribution of socio-political power often must be the first step for the group approach to be successful. In most instances, NGOs have little influence of this scope over political change. If such a restructuring of power is impossible, the group approach to allocating agricultural services (including finance) may not be feasible for any type of organization.

Consideration must be given to how economic status within the group changes over time, as some farmers respond more effectively to the inputs or training coops offer. Over time, if the group's composition changes drastically,the coop approach may no longer be appropriate. Certain members may then be eligible for credit from commercial channels. Project planners should be flexible enough in their project's design to allow for the changing needs and capabilities of their beneficiaries over time.

While NGO coops do have a comparative advantage in offering initial access to members of the population previously denied, they do not necessarily have a comparative advantage in equitable distribution of benefits to their members. Patterns of credit distribution vary among NGO-sponsored coops, depending heavily on the socio-economic structure of the project's environment.

NGO-Sponsored Coops: Credit Repayment

The viability of credit and savings projects depends on good management of credit disbursement, especially a management structure that insures against default, and takes quick punitive steps in the cases where default occurs. Groups have been lauded for their greater potential for insuring that their members repay their loans than individual borrowers. But their success depends on the existence of clear incentives for repaying loans and equally clear penalties for not repaying them. Groups that borrow money as an organization should put pressure on each other to repay their loans to insure that each members' access to loans will continue. If no sanctions are taken against defaulters, or if the borrower has no hope of obtaining a second loan from the organization, the borrowers have little incentive to repay.

One of the important lessons of failed government-sponsored agricultural credit programs is that borrowers must take their repayment commitments seriously. Like "free" government credit, "free" donor capital to coops can lead to their downfall. When the Inter-American Foundation sponsoring the Bolivian coop CCAM was not tough about repayment, the coop took advantage of the agency's seemingly casual attitude and failed to enforce loan repayment rules. Only when the IAF-financed credit fund was so decapitalized that there was no other alternative but to seek a commercial bank loan did the coop impose strong repayment discipline on its members.

The help of outside pressures "beyond coop managers' control" can help them to carry out unpopular disciplinary measures with severity. Coops often lack the professional distance of banks that would allow them to take coldly punitive measures against "their own people." OXFAM points out that borrowers from voluntary agencies have sometimes treated loans as a "soft option," knowing that the agency will not go to extreme lengths to recover debts, partly for practical and partly for ethical reasons. OXFAM goes so far as to ask whether it is possible for voluntary organizations to act as both development agency and "mini-banker" (Pratt and Boyden 1985). The fact that coop leaders are often the largest borrowers creates another obstacle to automatic punishment of defaulters.

The experience of an IAF-funded coop in Bolivia, COINCA, provides an example of the usefulness of strict donor policy on coop management. An unfavorable audit from the IAF caused a crisis that provoked the coop to make drastic improvements in its management. Fearing that the IAF would not grant their organization any more loans, COINCA was forced to stop lending to borrowers who were delinquent on past loans.

By laying out strict reprisals against defaulters, donors could help coops to create a demanding environment for loan repayment; otherwise, coop leaders might be stymied by their close ties to members. To sum up, NGO coops' comparative advantage in credit repayment depends on whether they and their funders are committed to enforce rigidly penalties against borrowers.

Savings Mobilization through Private Coops

As Chapter 1 underlines, security, accessibility, liquidity, and profitability are all requirements for good savings projects. The extent to which cooperatives can insure these characteristics will determine their success rate in mobilizing and maintaining savings deposits. Security, or trust in the organizations and its members, is essential to a project's success. Three women's savings groups where member confidence ran high were highly successful at savings mobilization: the Libertad de Mujeres in Bolivia (Wasserstrom 1985); the Tototo Home Industries in Kenya (Mutua 1986); and the Njimbot 1 Community Development Women's group in Cameroon (Rielly 1987). Starting with 30 women in 1975, Libertad attracted 600 members by 1979, and generated $64,105 in savings (Wasserstrom 1985). In addition to feelings of confidence and solidarity, realistic interest rates of 1 percent a month contributed to the organization's success. The organization further raised its rate .5 percent more, as its staff needs grew. In the Njimbot 1 Community Development Women's group in Cameroon, serious commitment to the organization and solidarity among members -- all Anglophone women living in a Francophone province -- insured timely payments to their savings fund.

NGO coops have an advantage over other savings-generating institutions in their accessibility to clients. They are often geared toward certain select segments of the population, and are designed with the specific needs of this group in mind. As a result, these types of coops are much more appealing to poor rural savers than other institutions such as banks. This is an area where government coops could improve their services. NGO coops could have a major advantage over other organizational types in savings mobilization, when they offer security and high economic return, as well, to their clients. The last condition, a high interest rate on savings, is usually tied strongly to the interest rate charged on borrowing, as discussed above.

Management and Administrative Problems of Private Coops

Group coops are commonly criticized for their lack of sound financial management and weak administration (Tendler 1983; Lele 1982). Rightly so, for one of the greatest costs to credit and saving coops is loan delinquency. As recommended in the first chapter, coops must make repayment regulations clear, instill in members a firm commitment to obey them, and stringently impose penalties if they do not.

Reduced dependence upon outside donor funds is a healthy accompaniment to increased coop-generated funds. As Chapter 1 explored in detail, reliance on financing from outside sources has impeded the financial viability of credit and savings associations. Unfortunately, in Latin America the capacity for independence of these private cooperative organizations is not always tested. In their initial stages, they are funded by outside donors, and if they work, their success is crowned with their "adoption" by the local public sector -- at least in terms of financial support (Tendler 1983). Project designers should try to prevent such a cycle of financial support -- when they have the power to do so.

Privately-run coops have trouble attracting well-trained competent professionals to run their coops because they cannot afford to pay them salaries competitive with the for-profit sector. The result is that staff often lack adequate bookkeeping, accounting, and general financial management skills and accounting is often simply ignored (Tendler 1983).

The COINCA coop in Bolivia loaned money from an IAF-financed rotating credit fund for three years without recording any of the transactions. Not only did coop managers lack financial management training, but they had little arithmetic training, which was necessary to make interest calculations for each repayment installment.

Coops may lack the commercial profit-oriented mentality, and thus must make a greater effort to instill the importance of financial viability in the minds of their members and managers. Participants must be trained in simple bookkeeping and cash management, and sponsoring agencies should carefully audit coops' books and flag potential -- or actual financial problems.

While coops in the past have not made efficiency a high priority, they may avoid these tendencies by focusing on strengthening their capacity in this area. They can build strength in the area of financial management, by making a concerted effort to improve the financial acumen of their managers and members. Where possible, coops should invest profits in salary bonuses for their employees or offer non-monetary awards for good performance such as career advancement. In the Amul Dairy Cooperative in India discussed above, career opportunities contributed to staff members' willingness to work hard to make the organization run well. Project planners using coops to deliver financial services should devote special attention to devising the best means to insure their smooth financial management.

Group Credit: The Solidarity Group Model

Private organizations have also administered group credit and savings schemes on a much smaller scale to groups of six to ten members. ACCION International adopted the group approach to credit and savings projects and coined the term "solidarity group" for its borrowing units. Solidarity group projects have been established throughout Latin America and more recently in Africa and Asia as well. Even those group projects which are not formally known as solidarity groups are discussed under the solidarity group heading.

The idea behind the solidarity group is that small businessmen and women -- who often would not have other access to credit -- join with others to form a credit group to qualify for loans. The members of the group are collectively responsible for the loan of each group member, and thus resolve the problem of providing collateral which individual borrowers face. The underlying rationale behind these guarantees is that peer pressure within the group will be strong enough to insure timely payments (Farbman 1981).

A number of Asian countries as well have established innovative savings and credit schemes for the rural poor based on the formation of small groups (United Nations Task Force on Rural Development 1984). Such group-based innovative savings and credit programs in India, Bangladesh, the Philippines, Sri Lanka, Nepal, Thailand, and Pakistan enhance access of the rural poor to institutional credit, overcome collateral requirements, and contribute to the creation of production employment and income-earning activities in rural areas. Regularity of savings among these Asian group-based programs is an important factor in developing the rural poor's asset base and building on their resources and initiatives. In most cases, the savings are both contractual and compulsory in the and initiatives. In most cases, the savings are both contractual and compulsory in the sense that every group member is expected to make a weekly deposit, however small. Group responsibility and group pressure are extremely valuable in developing the necessary discipline for regular deposits.

A major factor assuring that the groups build mutual trust--a prerequisite for project effectiveness--and that administrative costs are kept low is that the groups are formed by the borrowers themselves with little staff intervention (Farbman 1981). Administrators of the PRIDECO/FEDECCREDITO project in El Salvador and the Working Women's Forum in Madras, India found that it was more efficient and effective to allow people to select themselves into groups rather than to have the project staff choose their group (Farbman 1981; PISCES II 1985). When FEDECCREDITO's project staff tried to form groups they found the one-to-one selection process was time-consuming and ineffective (Farbman 1981). And when clients, themselves, take the bulk of the responsibility for promotion and payback of credit, project costs can be lowered, as illustrated by the cases of PRIDECO/FEDECCREDITO, the Madras Working Women's Forum, and the Women's World Bank in Cali, Columbia illustrate (Ashe PISCES II, 1985; Ashe 1986).

Women's World Bank promoters invest little time in each solidarity group. Consequently, groups are expected to take major responsibility for carrying out the program: forming groups, informing others about the group, and making payments. The majority of the project's participants, 71 percent, felt their standard of living had improved, as a result of improvement in their businesses, facilitated by the Women's World Bank credit (Ashe 1986).

The Asian experience discussed above showed that the success of solidarity groups depended on a homogeneous membership excluding the non-poor, and on the rural poor's confidence, solidarity, and their own motivation. To have a genuine viability, these groups must be perceived by group members as their own instrument for receiving credit on an individual or collective basis (UN Task Force on Rural Development 1984). The members must know each other well and trust each other in order for the system of mutual credit guarantees to work effectively.

When solidarity groups of tricicleros (men who pedal cargo tricycles selling goods) in the Dominican Republic (sponsored by the Dominican Development Foundation's Program for the Development of Micro-Enterprises, PRODEME), formed too quickly in their desire to get loans, late payments became a problem (Ashe, 1985). This case, where group members who did not know each other very well failed to pay back their loans on time, confirms the fact that building group trust is critical to the project's success.

Credit Repayment. As the discussion of private coops pointed out, stiff default penalties heavily influence credit- repayment rates. This holds true for solidarity groups as well. As was also true for the coops discussed earlier, fear of losing assets or further loans from the donor agency is what solidarity groups need to convince them to tighten their policy on default penalties. In the case of PRODEME, repayment rates among solidarity groups of tricicleros were low because the sponsoring agency, the Dominican Development Foundation, would not repossess the borrowers' physical assets, tricycles, or take other measures when serious late payment problems emerged (PISCES II 1985).

One of FEDDECREDITO'S loan programs to market vendors had a remarkable repayment rate of 99 percent. Another FEDDECREDITO program which extends credit to credit unions has had a much less spectacular success rate (Gomez 1988). Solidarity group members participating in the successful project believed that the short payback periods and very frequent repayments helped them to pay back their loans regularly and promptly.

Given that many of these tiny businesses receive immediate payment for their goods and services, they often pay the group leader daily (Farbman 1981). FEDECCREDITO project planners took into account the fact that many participants had never had access to credit before, and thus needed to be introduced to it slowly. In this situation, a large loan, lax payback schedule, and long grace period might do more harm than good (Farbman 1981).

The Asian group-based savings and credit programs for the rural poor constitute sound banking operations. In terms of solvency and repayment records, they are generally higher than in other rural financial programs (UN Task Force on Rural Development 1984). The importance placed on attendance at regular meetings -- generally on a weekly basis -- contributes to the group's low default rate. At these mandatory meetings, members become more aware of the groups' needs -- including savings and credit requirements -- and problems, such as defaults.

Cooperation between PVOs and Commercial Banks. Banker Henry Jacquelin made a convincing argument that PVOs do not deliver financial services as efficiently as bankers. (Jacquelin, 1988). PVO staffs usually are not adequately trained in financial management to perform the services of bankers well. On the other hand, PVOs do have a comparative advantage in reaching their target populations, a task which is often cumbersome and costly for banks, especially when their customers are very small borrowers. Banks may be willing, and eager, to loan to small borrowers, but are unwilling to shoulder the burden of the high costs per loan of reaching these often widely dispersed clients.

Cooperative projects between banks and PVOs combine the strengths of these two different types of organizations. Division of the different tasks involved in offering financial services between banks, which would do the "banking," and PVOs, which would handle client contact, matches both the needs of the project recipients and the training of the organizations' staffs. In one case in the Dominican Republic, a commercial bank, Banco Popular, extends a line of credit of up to a half million pesos to the PVO, ADEMI, which takes the responsibility for screening its credit recipients. ADEMI streamlines the cumbersome and costly process of assessing client risk for the bank by assuming responsibility for its borrowers.

After using ADEMI's collective collateral to obtain credit from the start, solidarity-group members are encouraged to "graduate" and apply for individual loans from commercial banks. Micro-entrepreneurs benefiting from the ADEMI program who build up enough capital by receiving incrementally larger loans, investing them, and earning more income are good candidates for individual formal sector loans (Olvares 1986). Borrowers' experience with the PVO-sponsored ADEMI program allows them to earn the credit rating to qualify for commercial loans. While the ADEMI program did eliminate its clients' barriers to access to commercial banks, it maintained control over the disbursement and collection of funds to its members. PVOs can go further than ADEMI did in leaving the handling of the money management to the bank, as the following cases illustrate.

In the Tototo Home Industries project sponsored by the NCCK in Kenya, savings groups of women, called "harambee" groups, obtain credit from commercial banks. A women's bank, The Kenya Finance Trust, assists solidarity groups in securing bank funds (Mutua 1986).

Another method of giving small rural borrowers access to commercial funds through groups involves the sponsoring organization placing a deposit with the bank to guarantee loans which the bank then makes to approved groups. In this case, banks are responsible for financial procedures involved in lending to groups. OXFAM sponsored this types of project in Andhra Pradesh, India where marginal farmers and landless laborers received credit in this fashion to recover from the cyclones of 1976 or 1977 (Pratt and Boyden 1985). All participants in these schemes have holdings of 2.5 acres or less and would otherwise have been totally excluded from the formal credit market. These schemes have to date achieved a 90 percent repayment rate (Pratt and Boyden 1985). In Gujarat, India, the Rajpipla Social Service Society made a deposit with a commercial bank to secure a loan equal to three times the amount of the deposit for a group of Adivasi (scheduled caste) dairy farmers to enable them to buy milk buffaloes and to establish a marketing cooperative (Pratt and Boyden 1985).

These commercial bank group lending programs eliminate the barriers to lending to individuals in the rural sector: security risks and the cost of administering loans to small borrowers isolated or scattered in villages. Cooperative projects take advantage of the different comparative advantages of banks -- efficient financial management -- and of PVOs -- contact with small borrowers. The degree to which a PVO fully exploits the experience of the bank (relative to their own experience) by handing over money management influences the quality of the financial services they offer their clients. Those PVO staffs that lack adequate training in accounting, auditing, and overall financial management tend not to perform financial services as well as banks.

Conclusions. Solidarity groups clearly tend to have a comparative advantage in facilitating access, since one of their primary objectives is to provide group credit to those individuals previously denied. However, they are not likely to reach a large number of people, in light of their financial constraints and commitment to limiting solidarity groups to a maximum of ten people. When solidarity groups succeed in building mutual trust, they are more likely to repay loans on time and to honor their commitment to make regular savings deposits. In the instances when groups established "solidarity" and when default penalties are high, the groups tend to have a comparative advantage in loan repayment. Forming the group themselves also increases their chances of keeping their administrative costs low -- as did FEDECCREDITO and the Working Women's Forum -- and thus having a comparative advantage in economic efficiency.

Banks: Commercial, Development, and Cooperative

Commercial Banks

The cooperative financial institutions discussed above have developed in rural areas as alternatives to commercial banks, which usually do not serve the needs of the poor. Banks, as they are currently structured, are less suited to serve the less well-off; they have a comparative disadvantage in access, but not in scope. Banks which are often national in scope can reach a more geographically disparate group of people, but do not tend to serve the less well-off, with the exception of several cases discussed below. As a borrowing requirement, commercial banks require collateral in the form of land or other assets which the majority of rural dwellers cannot provide. Collateral requirements, which women are less likely than men to satisfy for legal and economic reasons, block women's access to formal credit. Further, transactions costs and application procedures of commercial banks are particularly cumbersome for poor women who are often illiterate and whose opportunity costs of time are high (Lycette 1984).

Bankers also tend to be suspicious of lending to farmers. Small loans to "unreliable" farmers turn out to cost more than they earn, an unappealing option for commercial banks, profit-making concerns that cannot operate at a loss. As suggested above, commercial banks may offer credit to solidarity groups to overcome the two key obstacles to lending to small farmers: lack of collateral and high administrative costs.

In spite of their lack of enthusiasm, commercial banks in several countries, such as India and Pakistan, are required by law to devote a certain percentage of their loanable funds to agricultural purposes. Yet, in these instances, banks are inclined to concentrate on loans to larger farmers with acceptable security (World Bank 1981). Commercial bankers have tended to lack technical expertise in lending for agricultural purposes, and do not offer savings and loan packages appropriate for farmers' needs. And in urban areas as well, it is rare when commercial banks specifically orient their services toward poorer clients. The following discussion of commercial banks which do serve the less well-off are notable exceptions. The first two, The Philippine Commercial and Industrial Bank (PCIB) and the Banco del Pacifico in Ecuador are in urban centers. The third, the Grameen Bank in Bangladesh, operates in rural areas.

The PCIB's Money Shops program was a success because the bank was prepared to adapt its methods to the milieu of market stallholders. The bank set up stalls in urban marketplaces and thus operated in a manner that was familiar to potential clients. Moreover, the program relied upon relatively informal methods for assessing creditworthiness, such as a prospective borrower's reputation with other stallholders and creditors; thus, it was able to make unsecured loans. By doing so, it overcame the major problem faced by small borrowers -- their lack of collateral (Farbman 1981).

The Banco del Pacifico was successful in reaching micro-entrepreneurs because of the mechanisms it developed to lower costs and to reduce the risk of loan failures (a major disincentive to bank-lending in the micro-enterprise sector). The following conditions were prerequisites to selection for the program: (1) the shop had to be organized and have a 'working environment'; (2) products had to be of an acceptable quality; and (3) the recipient had to prove him or herself a responsible person by providing references, a positive credit history, and a solvent co-signer. The first loan was small, to enable the client to become used to bank credit; part of the loan was deposited into a savings account, and checks were often made out directly to suppliers. Collection procedures were also strict. Another reason for the scheme's success was its use of students as staff members, which lowered personnel costs. Lower costs removed the previous disincentive to bank lending in this sector: high costs per loan.

The Grameen Bank in Bangladesh provides an example of an unusual commercial bank which has adopted the features of the "solidarity group" model, and, as a result, has a comparative advantage in access. The Bank has succeeded in reaching its target group, landless rural people, often in the most remote areas. Like the solidarity group model, the Grameen Bank uses peer pressure to encourage discipline, unity, and pride, blending it with group support to the individual and the concept of individual responsibility and self-interest.

Unlike most commercial banks, the Grameen Bank actually reaches out to clients (rather than the reverse) by holding weekly village meetings where loans are approved, savings are collected, and loan payments are made. A person who wants to borrow must find four other non-related people who will become members with him or her. No other group member can get a loan until the first person has repaid promptly for six weeks. Although group members do not co-sign the loan, the group mechanism is used as a support service. Given that the collective self-interest acts as a form of security, no collateral is required for the loans, but saving is mandatory.

The forced savings scheme enhances self-confidence, self-reliance, and in the long-run helps reduce client dependency on the bank. It also gives the group some element of insurance against disaster and gives members some experience in money management (Ack, Prince and Robinson 1986).

The Grameen Bank's highly-motivated and specialized staff has played a major role in the success of its programs. Staff members are required to live in the villages in which they work, in order for them to better understand that particular community's problems, people, and economy. The key to keeping the Grameen Bank's highly-motivated staff willing to work in remote areas is that they believe they are doing important and specialized work. They share a common ideological spirit whereby they are all striving to eradicate poverty in Bangladesh. The interaction between beneficiaries, bank workers, and branch managers has improved implementation: by allowing for responsiveness and flexibility; by permitting adaptation to local conditions; by providing access to information that otherwise may have gone unnoticed; and by allowing for generation of new ideas and activities (Acka, Prince and Robinson 1986).

The staff's strong commitment to the organization has contributed to the bank's excellent loan recovery program. The amount of overdue loans after two years of loan disbursement is less than 1 percent. The bank prides itself on perfect accounting, (or as close to perfect as possible). Each branch submits a daily reporting form to the zonal office. The form covers key variables such as daily figures for cash disbursements, receipts, and stocks of idle money. The daily reporting ensures that managers are keeping close contact with the activities in their areas (Ack, Prince, and Robinson 1986). The per capita income of the lcanee households increased by about 32 percent over a period of two years, when the per capita income of Bangladesh increased by only 2.6 percent. The additional employment generated for women significantly contributed to the increase in income.

Project and program planners should look carefully at the Grameen Bank model in designing credit and savings programs which successfully reach the rural poor and successfully recover their loans (Hossain 1984; Houghton 1985; Huq 1986).

These projects illustrates that dynamic comparative advantage in terms of access can apply to banks. While previously, commercial banks rarely tended to serve poorer clients, in these instances the banks modified their mode of operation to suit this segment of the population. Incentives may be necessary to convince other commercial banks to follow suit.

Development Banks

In response to this obvious mismatch between the interest of rural farmers and commercial bankers, many countries have established Development Banks. They may be called Land Mortgage, Credit, or Agriculture Banks, and may be wholly government controlled, quasi-government controlled, or privately owned. The main objectives of development banks are to grant loans under terms and conditions that commercial banks find difficult to accept; by definition, then, they are more accessible to the agricultural sector. However, they are often legally limited to providing only medium and long-term credit, so they cannot fully serve farmers' seasonal needs. The fact that borrowers cannot obtain all credit under one roof, and must resort to other sources, may lead to inadequate seasonal financing. The result may be poorer loan repayment to the development bank (Spall 1981). Since development banks do not tend to provide for all the farmers' credit needs, they do not tend to have a comparative advantage in loan repayment.

Another impediment to the quality of service to farmers is that development banking expertise is in short supply. Staff are sometimes not directly employed by the institution concerned, as in the case of the Agriculture Refinance and Development Corporation of India (ARDC), where the staff were provided by the Research Bank of India (Spall 1981). Naturally, when the staff's primary loyalties lie elsewhere than the Development Bank, it will function less effectively.

A notable exception is the KUPADES (General Rural Credit) program in Indonesia, initiated by the Bank Rakyat Indonesia (BRI) through its "Unit Desa" (village unit) system (Patten and Snodgrass 1987). Unit Desa staffs are encouraged by financial incentives geared to the profitability of the unit and its success in attracting savings. 10 percent of the profit from those "unit desas" that are profitable is returned to the staff as an incentive bonus. Bonuses are intended to push the staff to be energetic in looking for additional credit and savings customers, and to increase efficiency (Patten and Snodgrass 1987). Employee incentives and easy access to Unit Desas have contributed to their profits, and their success in mobilizing deposits (CPIS, BRI 1986).

Unit Desas' emphasis on excellent service and personal relations contributes to their widespread popularity and success. Employees are encouraged to recruit new savers, educate them about the advantages of the system, and treat them with respect and consideration. Two other key factors in the success of Unit Desas are the timely availability of credit and their convenient locations, even the most remote villages (CPIS and BRI 1986; Patten and Snodgrass 1987).

The KUPADES program departs from past government programs which have been dependent on the government, both for resources to lend, and for continued subsidization to cover operating costs. It aimed to develop a financially viable unsubsidized rural banking system. To do so, KUPADES set its rates with a spread between credit charges and savings payment that covers operating costs and loan losses.KUPADES accomplished this goal when it attained the loan level at which it could make profits (Patten and Snodgrass 1987).

The Central Java Provincial Development Bank (BPD) initiated and provides technical supervision for another Indonesian rural credit program. This program, which blends the speed and convenience of traditional moneylenders with the operating philosophy and profit margin of a commercial bank, is administered by local bodies known as "BKKs," the Badan Kredit Kecamatan (Goldmark and Rosengard 1983). The BKK program has a comparative advantage in access: its highly decentralized structure, with villages as the focus of its operations, offers credit to widely-dispersed farmers in rural Java.

However, the BKKs have suffered from poor staff quality. Misuse of funds by BKK staff accounted for 52 percent of the failed BKKs, which were operating either at very low levels or had closed. Over 90 percent of the BKK failures were caused by dishonest, misinformed, or unaggressive staff, i. e., staff who did not pursue delinquent clients (Goldmark and Rosengard 1983).

Despite these staff problems, the BKK, which sets interest rates on borrowing high enough to cover operating expenses, covers its cost of funds, administrative expenses, and capital erosion due to inflation. It is one of the few publicly-funded and administered credit programs that makes money from providing loans to small enterprises. BKK's interest rates on borrowing -- high in comparison to other programs, but low by most informal sector standards, can cover their costs of funds, administrative expenses, capital erosion due to inflation, and any reasonable bad debt losses.

In sum, development banks may tend not to have a comparative advantage in efficiency unless the quality of their programs' staff, training, incentives, and, consequently, performance is improved. While development banks in the past have had problems with loan repayment and efficiency, they do open access to formal credit and savings instruments to rural dwellers.

Costs of Rural Savings Mobilization to Banks: Commercial versus Development Banks

Not only do commercial banks generally not extend credit to rural farmers, but the conventional wisdom is that mobilizing rural deposits is not worth the cost (Meyer 1985). As a result, commercial banks often rely on "cheap" sources of funds: interest-free government deposits; direct capital investments; special rediscount provisions; or targeted lines of credit (Bourne and Graham 1983). But recent research indicates that mobilizing rural deposits may be cheaper then lending "cheap" funds obtained externally. In a comparison of the cost structure of the Agricultural Development Bank (ADB) in Honduras with a commercial bank, the ADB could expand most efficiently by mobilizing more deposits, while the commercial bank could expand most efficiently by increasing agricultural lending.

Thus, "economies of scope" -- providing both credit and savings services -- may be more important than the economies of scale attained -- through increased lending. The reason for the difference in costs could be that the ADB mobilized less of its funds (40 percent) than the commercial bank (90 percent); donor-funded loans cost 8 percent to loan, compared to 1 to 6 percent to loan the bank's own funds. This evidence confirms the recommendations made in the first two chapters: that savings and loan projects should generate as much of their financing as possible internally, and reduce their dependence on outside sources.

As Table 1 illustrates, it appears that commercial banks have a comparative advantage in lending efficiently while development banks have a comparative advantage in access. Development banks are clearly more attractive alternatives than commercial banks for providing financial services to the rural poor.

Conclusions

The preceding discussion has indicated that certain institutions do not always have clear-cut comparative advantages in the four criteria for good savings and loan projects: access and scope, loan repayment, savings generation, and efficiency. Nonetheless, some general trends have appeared.

Of the non-commercial institutional options, government coops appeared to be the weakest in all four areas, with the exception of scope; they frequently do not offer access to the rural poor; they fail to offer repayment incentives and generate savings; they are often inefficient and corrupt; but they do often have the financial, organizational and administrative capacity to reach a larger number of beneficiaries than private coops or solidarity groups. NGO coops appear to do a better job at reaching the poorest, but they may have trouble with repayment if severe default penalties are not imposed; and they must concentrate resources on reversing their comparative disadvantage in efficiency through training members and managers in financial management.

Traditional commercial banks have emerged as the least appropriate institution for rural borrowing or group saving, since they are simply not interested in bearing the financial or administrative burden; nor are their staffs equipped to serve the needs of rural people. However, the examples of the Banco del Pacifico, the PCIB, and the Grameen Bank indicate that commercial banks could change their attitudes -- and hence their lending programs -- toward poorer borrowers in the future. Development banks look more promising as agents for rural borrowing, but their focus on longer-term lending may not suit agricultural borrowers.

This exploration of institutional comparative advantage has identified typical stresses that certain organizations are likely to experience in providing financial services in rural areas, on the basis of past organizations' experience with savings mobilization. The severity of these stresses will be enhanced or resisted by the specific socioeconomic conditions that exist in the project environment. Project planners must carefully scrutinize the needs of their target population and the limitations of its context, before the most appropriate institutional choices are made.

Table 1

Areas of Comparative Advantage for Institutions offering Savings and Credit Projects.

Institutional Type

	Distribution: Access	Distribution: Scope	Savings Mobilization	Loan Recovery	Efficiency
Type 1 Government Coops	High to Low	High	Low to Medium	Low	Low to Medium
Type 2 Non-Government Coops	High	Low	High	Low to High	Low to Medium
Type 3 Solidarity Groups	High	Low	High	High	Medium to High
Type 4 Development Banks *	High	Medium to High	High	Low to Medium	Low to Medium
Type 5 Commercial Banks	Low	High	High**	High**	High

* Including land mortgage, credit and agricultural banks.

** Commercial banks tend to successfully mobilize savings and recover loans from their clients but the rural poor are rarely their clients, because they do not have confidence in them paying back their loans.

Range: High, Medium, Low.

CHAPTER 3

THE POLICY ENVIRONMENT FOR SAVINGS MOBILIZATION PROJECTS

Types of Policy Arenas Planners Should Assess

In designing and implementing savings projects and programs, planners must consider carefully the government policies that influence their project environment. An awareness of the powerful role of government policies in easing or impeding the project's development is critical to effective project planning. This chapter maps out the policy arenas at which planners should look when designing savings projects. From the start, planners should examine two types of policies that directly influence the outcome of savings projects:

1) Interest Rate Regulation
2) Credit Controls, Guarantees, and Rediscounting Facilities

Further, project planners should look beyond these areas of direct policy influence to other broader economic policies that influence their project's outcome, including trade and exchange rates, agricultural pricing, taxation, and subsidization. Finally, in designing savings mobilization projects, planners should take into account national rural development policies regarding infrastructure development, health, nutrition, family planning, and education. Integrating the outcome of policy analysis on each of these three level should lead to more appropriately designed projects.

Direct Policies: Interest Rate Regulation, Credit Controls, Guarantees, and Concessionary Rediscount Facilities

Low interest rates on borrowing -- often legally required or at least encouraged -- have been key features of financial projects in the past that have stymied potential for savings mobilization. In most developing countries, governments have either explicitly or implicitly imposed on the formal banking system interest rate ceilings or credit controls that have tended to keep interest rates artificially low (Haggblade, Leidholm, and Mead 1986; Von Pischke 1984; Adams 1983). The World Bank's review of formal sector interest rates in 34 countries and Page's 1979 survey of African countries revealed that in several cases, real interest rates were negative (World Bank 1975; Page 1979). Government reluctance to raise interest rates in line with inflation further prevents financial institutions from maintaining the real value of their assets (Argyle 1984).

Why have policy-makers chosen to impose or not to correct methods that impede the ability of organized financial markets to attract savings? The two reasons Von Pischke suggests offer a good explanation: (1) governments, reinforced by donor agencies, direct large amounts of funds into agricultural credit programs, and relieve them of responsibility for covering their costs; and (2) policy makers believe the poor will not save voluntarily, as discussed in Chapter 1 (Von Pischke 1983).

Project planners should be knowledgeable about credit controls, guarantees, and concessionary rediscount schemes that will influence their project's financial environment. Traditionally, credit controls -- imposing an explicit tax on financial institutions -- have tended to worsen financial institutions' savings mobilization capacity, by lowering the rate of return on intermediation functions and reducing the supply of financial instruments. Consequently, lower interest rates on savings, higher interest-costs of investment and greater transactions costs to society ultimately result in falling savings (Omotunde 1984).

Planners should also be aware of how concessionary rediscount facilities at central banks, credit guarantees, and refinancing schemes influence the project environment. Traditionally these policies have reinforced distorted financial market structures by supporting cheap credit programs (Kane 1984). The likely result has been that lenders' incentives to mobilize savings diminish. These types of guarantees tend to encourage commercial and government banks to participate in inefficient lending practices by guaranteeing artificially low rates of interest (Kane 1984).

These policies should be considered alongside interest- rate policies in deciding upon the most appropriate and feasible interest rates. Planners should evaluate the extent to which the above policy constraints will alter their project's success, and perhaps even will make it completely unfeasible. When policies do support cheap credit, planners should consider means of recouping their costs other than high interest rates, such as charging user costs (see Chapter 2's discussion of setting interest rates, suggestion #2).

Indirect Policies: Demand-side Incentives and Disincentives to Save

In addition to the direct policies explored above, project planners should be aware that the general economic policy orientation has a powerful impact on overall rural development, and specifically on the potential of rural financial markets to foster saving (Steel 1986; Ray 1983). The following discussion suggests that a coherent policy framework promoting rural development is the best means of generating voluntary savings in the rural sector. Project planners should assess the extent to which their project's policy environment promotes rural development, and what this level of support implies for the savings project.

Rural versus Urban Investment Priorities

Policies biasing investment in favor of industrial urban development result in deficient rural infrastructure, lack of new technology, and low rates of return on investment in the rural sector. Heavy government investment in housing, transport, and sanitation in urban areas has reduced profitability of agriculture by underwriting costs of living in the urban sector and encouraging labor migration. A vigorous and healthy economic environment in rural areas, and good transportation, communications, health, and other facilities, are necessary to ensure rural dwellers higher and more stable incomes that will enable them to increase their savings.

Rural people cannot make extensive use of financial savings facilities unless farming or rural enterprise is relatively good business. Even the best-run financial intermediary cannot make large numbers of good loans if most farmers receive low and unstable incomes.

Trade, Exchange Rate, and Tax Policies Biased against Agriculture

In the past, pricing, exchange rate, import restriction, trade, and taxation policies have often favored the industrial sector, and thus vitiated the effects of input distribution and other efforts to stimulate growth in rural areas. Such distorted policy environments in Africa have fostered smuggling on the black market, as William Steel recently pointed out:

> In the past the best opportunities for African entrepreneurs have been mainly in trade, including smuggling and illegal trade to take advantage of distortions created by overvalued exchange rates, import restrictions,price controls, and so forth (Steel 1986).

In the case of sub-Saharan Africa, government trade, exchange-rate and tax policies have created a bias against agriculture, resulting in negative growth rates for this sector (World Bank 1981). Government reliance on import restriction rather than devaluation to conserve foreign exchange negatively effects the agricultural sector by: lowering agricultural prices paid to producers; raising costs of consumer goods; forcing farmers to buy high-cost inputs such as fertilizer and pesticides. Parastatal commodity boards often offer inadequate remuneration to farmers on their agricultural products, thus reducing incomes and, consequently, their savings capacity.

Trade and exchange rate systems that encourage import-intensive industrialization discourage local demand for raw materials and labor, and destroy potential opportunities for savings-generating growth in the agricultural sector. Sales and excise taxes on service further reinforce the anti-agriculture bias of African development policy.

Policy planners must assess both urban and rural policy environments before making final decisions about savings mobilization projects. The more negative the policy environment, the more important it is to design simple savings projects with clear objectives formulated on the basis of the specific needs of the target group.

Final Conclusions

Project and program planners should draw on the experience of past projects in designing projects with the features of successful credit and savings projects discussed above: (1) savings mobilization; (2) loan recovery; (3) access and distribution to intended clients; and (4) economic efficiency.

(1) *Savings Mobilization.* Past projects indicate that appropriate interest rate structures are critical to successful savings mobilization. While ideally, project interest rates on credit should come close to market rates, it may be more practical for the project to charge lower interest rates on borrowing and compensate for them with user costs or forced savings requirements, in order to insure payment of appropriately high rates of return on savings accounts. One successful solution to the challenge of charging an interest rate that is low enough to attract customers, but high enough to defray costs and give the borrower a sense of the value of the loan was that pursued by NCCK in Kenya. This coop adjusted credit prices upward over time as clients became more trustworthy and familiar with the organization's benefits. Project designers should carefully decide where on the continuum between market and highly subsidized rates they should set their prices, depending on the specific borrowing and savings needs of the target population.

Other incentives to savings mobilization -- safety of deposits, convenient access, and ease of withdrawal -- may be even more important than interest rates in their influence on the response of rural people to savings projects.

(2) *Loan Recovery*. Project planners should try to replicate PFP-Liberia's strict loan recovery policy, which insured a very low default rate. As the group projects such as the Grameen Bank discussed above have shown, solidarity and a strong commitment by individual members to the success of the group provides a further guarantee that loan repayment will be taken seriously. A rigorous loan collection policy -- including strict enforcement of penalties on late and missed payments -- is an essential component of every savings mobilization package.

(3) *Access and Distribution to Intended Clients*. This paper has examined group projects following the solidarity group model and others, such as the Grameen Bank, which have proven to be most effective in reaching the less well-off; their target populations otherwise might not have had access to credit and savings mobilization. The success of these homogeneous groups of poor clients depends on the commitment and motivation of each member to make the group work.

(4) *Efficiency*. The quality of the savings project staff heavily influences its efficiency. The Grameen Bank's highly-trained and committed staff can serve as a guide for planners who wish to design savings projects for target populations with similar needs. Planners should try to avoid dependence on continuous in-flows of funds from donors, which may discourage efficiency by removing incentives to keeping costs down and inhibiting loan recovery.

Successful savings mobilization can bring enormous benefits to the individual for improving his or her capital base and for local organizations by creating fertile ground for growth, and integration into national financial markets. Resource institutions should consider the above recommendations for maximizing the currently untapped potential of rural savings. While project and program planners can benefit extensively from lessons from past projects, before attempting to replicate them, they must carefully assess the particular needs of their target population.

Additional research, case studies in particular, should be done on saving projects that have and have not worked. There is currently a dearth of such studies which could offer practical lessons for resource institutions.

Bibliography

Ack, Bradley, Paul Prince, and Rand Robinson. 1986. "*The Grameen Bank: Reaching the Landless Poor in Bangladesh: A Project Analysis.*"

Argyle, Brian. 1983. "Development Assistance, National Policies, and Lender-Type Performance." In *Rural Financial Markets in Developing Countries.* Von Pischke, Adams, and Donald, (eds.). Johns Hopkins University Press.

Ashe, Jeffrey. 1985. The Pisces II Experience: Local Efforts in *Micro-Enterprise Development*, vol. I. Washington, D.C: U.S. Agency for International Development.

Ashe, Jeffrey. 1986. "*Solidarity Groups and the Women's World Bank: Experiences from Cali, Colombia,*" ACCION International.

Bennett, John. 1983. "Agricultural Cooperatives in the Development Process: Perspectives from Social Science." Studies in *Comparative International Development*, vol. 18, no. 1-2.

Berg, Elliott. 1981. *Accelerated Development in Sub-Saharan Africa.* World Bank.

Blayney, Robert, and Maria Otero. 1985. "*Small and Micro-Enterprises: Contributions to Development and Future Directions for AID's Support.*". Washington, D.C.: USAID.

Brooks, James. 1987. "Informal Capitalism in Cameroon," in *New York Times*, Nov. 30, 1987.

Carroll, T.F. 1986. "*Some Issues to be Considered in Research on Intermediary Organizations.*" Unpublished paper.

Cleaves, Peter. 1980. "Implementation Amidst Scarcity and Apathy: Political Power and Policy Design." In *Politics and Policy Implementation in the Third World.* Merilee Grindle (eds.). Princeton: Princeton University Press.

CPIS and BRI 1986. *Savings in the BRI Unit Desa System: Case Studies.*

DeLancey, Virginia 1978. "Women at the Cameroon Development Corporation: How their Money Works." *Rural Africana*, vol. 2, pp. 9-39.

Esman, Paul, and John Uphoff 1984. *Local Organizations: Intermediaries in Rural Development.* Cornell University Press.

Farbman, Michael 1981. *The PISCES Studies: Assisting the Smallest Economic Activities of the Urban Poor.* Washington D.C.: Office for Urban Development, Bureau of Science and Technology, U.S. Agency for International Development.

Goldmark and Rosengard. 1983. *Credit to Indonesian Entrepreneurs: An Assessment of the Badan Kredit Kecamatan Program*, Development Alternatives, Inc.

Gonzalez-Vega, Claudio. 1982. "*Credit Rationing Behavior of Agricultural Lenders: The Iron Law of Interest Rate Restrictions.*" Revised version of paper prepared for a colloquium on rural finance sponsored by the Economic Development Instituteof the World Bank, AID, and the Ohio State University, Washington, D.C. (September).

Hart, Keith. 1982. *The Political Economy of West African Agriculture.* Cambridge: Cambridge University Press.

Hossain, Mahabub. 1984. Credit for the Rural Poor: TheExperience of Grameen Bank in *Bangladesh, Research Monograph* No. 4.

Houghton, Mary. 1984. The Social Impact of a Micro-Enterprise Project on the Individual and the Community. *Proceedings of the Micro-Enterprise Development in the Third World* Meeting: Geneva Park, Ontario, April 22-24, 1985.

Jacquelin, Henry. 1988. Comments made at ARIES-CEEP Credit Management Worshop, Harpers Ferry, January, 1988.

Johnson, Omotunde E. G. 1983. "Credit Controls as Instruments of Development Policy in the Light of Economic Theory." In *Rural Financial Markets in Developing Countries.* Von Pischke, Adams, and Donald (eds.). Johns Hopkins University Press.

Kane, Edward. 1983. "Good Intentions and Intended Evil." In *Rural Financial Markets in Developing Countries.* Von Pischke, Adams, Gordon (eds.). Johns Hopkins University Press.

Lele, Uma. 1975. *The Design of Development: Lessons From Africa.* Baltimore: Johns Hopkins University Press.

Leonard, David, and Dale Marshall (eds.). 1982. *Institutions of Rural Development for the Poor.* Berkeley: University of California, Institute of International Studies.

Lycette, Margaret A. 1984. "*Improving Women's Access to Credit in the Third World: Policy and Project Recommendations.*" International Center for Research on Women (ICRW), Occasional Paper #1, June, 1984.

March, Kathryn, and Rachelle Taqqu. 1982. *Women's Informal Associations and the Organizational Capacity for Development.* Cornell University Rural Development Committee, Monograph Ser. No. 5.

Mauri, Arnaldo. 1983. "A Policy to Mobilize Rural Savings in Developing Countries." In **Rural Financial Markets in Developing Countries**. Von Pischke, Adams, and Donald (eds.). ohns Hopkins University Press.

Meyer, Richard. 1985. "*Rural Deposit Mobilization: an Alternative Approach for Developing Rural Financial Markets.*" Paper prepared for AID/IFAD experts' meeting on small farmer credit, Rome (June).

Moris, John. 1984. "Institutional Choice for Rural Development." *HIID Discussion Paper* No 179.

Management Systems International (MSI). 1987. "*Evaluation of Nimba County Rural Technology Project.*"

Mutua, Elvina. 1986. "Women and Small-Scale Enterprise." Speech at Harvard/MIT Women and Development Annual Conference, John F. Kennedy School of Government, Harvard University.

Olvares, Mirtha. 1986. "Women and Small-Scale Enterprise."Speech at Harvard/MIT Women and Development Annual Conference, John F. Kennedy School of Government, Harvard University.

Overholt, Catherine, Kathleen Cloud, Mary Anderson, and James Austen. 1985. *Gender Roles in Development Projects*. West Hartford, CT: Kumarion Press.

Page, John. 1979. Small Enterprises in African Development: A Survey. Washington, D.C.: *World Bank Staff Working Paper* No. 363.

Paul, Samuel. 1982. *Managing Development Programs: The Lessons of Success.* Westview Press.

Pratt, Brian, and Jo Boyden (eds.). 1985. *The Field Directors' Handbook: An Oxfam Manual for Development Workers*. Oxford: Oxford University Press.

Rielly, Catherine. 1987. Personal observations during fieldwork in Cameroon.

Robertson, A. F. 1984. *People and the State*. Cambridge: Cambridge University Press.

Shipton, Parker. 1986. "Understanding Small and Micro Entrepreneurs," Capacity Building for Resource Institutions for Small and Micro Enterprises. *Draft of chapter for "Strategic Overview Paper,"* ARIES Project, Harvard Institute or International Development.

Steel, William. 1986. "*The Role of Small Enterprises in African Development.*"Paper presented at the World Development Conference, Kennedy School of Government, Harvard University.

Tendler, Judith. 1982. *Turning Private Voluntary Organizations Into Development Agencies: Questions for Evaluation.* Washington, D.C.: U.S. Agency for International Development, AID Program Evaluation Discussion Paper no. 12.

Tendler, Judith. 1983. *Ventures in the Informal Sector and How They Worked Out in Brazil.* Washington, D.C.: U.S. Agency for International Development.

United Nations Task Force on Rural Development. 1984. "*Group-based Savings and Credit for the Rural Poor.*"Papers and proceedings of a workshop, Bangladesh 6-10 November, 1983.

Vogel, Robert. 1982. "*Savings Mobilization: the Forgotten Half of Rural Finance.*" Revised version of paper prepared for a colloquium on rural finance sponsered by the Economic Development Institute of the World Bank, AID, and the Ohio State University, Washington, D.C. (September).

Von Pischke,. J.D.1983. "Toward an Operational Approach to Savings for Rural Developers." In *Rural Financial Markets in Developing Countries.* Von Pischke, Adams, and Donald (eds.). Johns Hopkins University Press.

Wasserstrom, Robert. 1984. *Oral Histories of Social Change.* New York: Praeger Publishers.

World Bank. 1975. Agricultural Credit. *World Bank Sector Policy Paper.*Washington D.C.: IBRD.

World Bank. 1985. *The Small Scale Enterprise Credit Program Under the Second and Third Calcutta Urban Development Projects: An Interim Assessment.* Washington D.C. IBRD.