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Balancing Perspectives on Informal Finance

Otto Hospes
Wageningen Agricultural University

There is a growing need and understanding of the value of tailor-made financial services. Suppliers of such services take into account scale of operations, competitive claims on scarce resources, and savings practices of their (potential) customers as well as the environment under which loan provision and deposit taking are to take place (Abugre 1994). Although it looks rather tautological, it is still hardly realized that millions of agents and mutual societies that offer tailor-made financial services to poor people, operate in low-income countries.

Best of All Biases

To target grievances about cycles of poverty and to legitimize implementation of cheap credit and easy money policies, these agents and societies were traditionally stereotyped as usurious moneylenders or remnants of local culture at best. However, it was grudgingly accepted that many moneylenders proved much less usurious than was assumed. Opportunity cost and risk premium rather than monopoly profit turned out to be main determinants of interest rates on their loans (cf. Adams 1992: 14-16; Ghate 1992: 139-152). Also, it was recognized that there is much more "occuring outside the regulation of a central monetary or financial market authority" (Adams 1992: 2) than practices of moneylenders only: financial and quasi-financial services in low-income countries that are used by poor people on a large scale, are those provided by merchants, pawnbrokers, loan brokers, landlords, friends and relatives, money guards, ROSCAs and ASCRAs. Because of a sheer inability to find a better word covering their diversity of services, the concept of informal finance has been coined as best of all biases, that is, as much better then words like "unorganized" or "non-institutional" but still carrying these misleading connotations.

From Sustainable Failure To Balanced Perspectives

The increased recognition of informal finance should be seen against a wider background: the "sustainable failure" of state-regulated suppliers of cheap credit to help small farmers, and more generally, a critical view on the overdevelopment and centralization of the Third World state (cf. Holmen 1990), have led to a re-assessment of private initiatives to foster development with regard to the privilege to intervene and organize (NGOs), to generate income and employment (microenterprise) and to define appropriate financial technologies (emulating informal finance).

One of the most effective mechanisms to sustain failure and slow down innovation (of practice and thought) is to uphold circular arguments, such as: "Poor people can neither save nor organize themselves. They need cheap credit and some cooperative education. High default rates mean that people are too poor to repay loans and do not understand how to use a loan in a productive way. More credit, training and monitoring is needed to offset these deficiencies as people cannot save and organize themselves". This "circle" of thought has long fueled recycling of Specialized Farm Credit Institutions (Von Pischke 1983) in Third World countries. It is now popular among many NGOs that indulge in revolving funds and micro-enterprise credit -- using easy money to compensate for shrinking funds and a supposedly lack of entrepreneurial spirit (cf. Abugre 1994; Adams and Von Pischke 1994; McLeod 1992; Seibel 1994).

The main aim of this paper is not to acclaim the virtues of informal finance in the abstract as this brings us back to easy generalization, but rather to discuss questions and methodologies that lead to more balanced insights on informal finance. The most important stance in this connection is not to underestimate the importance of empirical and comparative research on informal finance. It is rather odd to say that such a research would be too costly, and at the same time approve money-losing credit projects. Of course, investigation through casual encounter or snapshot research is cheaper and less time-consuming, but cannot grasp the complexity and dynamics of informal finance. Consequently, such investigation cannot generate insights to offset simplistic ideas on informal finance that are used at convenient times to increase the budget on money-losing credit projects. It is hard to understand why many bankers and development agents simply assume that systematic research on informal finance is neither relevant nor rewarding when informal finance is much closer to the common man's and women's world than any donor-driven credit scheme (Abugre 1994) or commercial bank (Bouman 1994: 105-122). If poverty-oriented bankers are to monitor something very closely, than it should be informal finance rather than borrowers of cheap loans -- with the aim to learn, not to overtly regulate or provide sudden financial injections.

Balanced perspectives on informal finance take into account its diversity and change. In this connection it is of utmost importance not to be tied too much -- when embarking on empirical research -- to acronyms or models extracted from the rich world of informal finance. The most appealing one is ROSCA, short for Rotating Savings and Credit Association. Research on financial self-help has, up to now, mainly focussed on ROSCAs, which becomes a self-perpetuating process.

Because there is an increasing amount of literature available on ROSCAs, (new) students of finance tend to concentrate on this popular rotating form, blissfully unaware of the existence of other types of associations that might be as universally popular as the ROSCA, like for instance, the ASCRA (short for Accumulating Savings and Credit Association) or one of the many "hybrids", that is, associations with both a rotating and accumulating fund (Bouman 1994: 375-394). Researchers, unfamiliar with the local language, easily overlook that the local idiom for ROSCA might also include the ASCRA and/or intertwined forms (contrast Maters 1993; Hoeben 1994).

For a better understanding of the complexity of informal finance, it is necessary to develop integrated approaches, analyzing savings and credit transactions of both individuals and institutions in relation to (changing) contexts (cf. Hospes 1994: 229). Inherent to such approaches is a comparative look at "informal" and "formal" institutions through the eyes of (different) individuals looking for possibilities to borrow, to save and/or to guarantee social security. Because "the poor" in low-income countries are such a heterogeneous company, it is quite difficult to generalize on decisions of these poor related to savings and credit. Still, under many different circumstances and for different reasons "informal finance" will be the first choice.

The First Choice

If it is true that the complexity and diversity of informal financial contracts mirror decisions of poor people related to financing and the management of scarce money resources (Schmidt and Kropp 1987), then it should be worthwile exploring these decisions and the conditions under which they are taken[1]. Here I concentrate on three key methodological entries that lead to balanced insights on informal finance.

Financing Options

Rather than starting from target groups (like micro-enterprises or women) in the abstract, presumed credit needs, and how finance institutions ought to be managed in order to deal with them, I suggest to start the other way around, that is, to take the common man or women in search of money as the starting point and analyze his/her changing financing options. This can lead to unexpected findings (cf. Wagenaar 1991) for those who assume that lack of capital or lack of access to credit (usually narrowed down to formal finance) is the major bottleneck of the target group, as McLeod (1980; 1992) demonstrates through his extensive study of small firms in Yogyakarta, Indonesia: "Many of the firms interviewed relied

1. An actor analysis implies the use of terms such as "decisions" or "preferences" to denote financial behavior rather than donor-driven words like "credit needs" or "wants".

heavily on self-finance for their expansion, and they often did so by choice -- not because they were denied outside finance" (McLeod 1992: 255). Both McLeod (1992) and Liedholm (1992) found that the external sources of finance that are first mobilized by evolving microenterprises are informal ones. Only, "At a later stage in their evolution, microenterprises may begin to have access to the formal financial market" (Liedholm 1992: 275). Both the late interest of the traditionally conservative banks in financing microenterprises and the mere struggle of these enterprises to survive in the initial years (ibid: 267) point to harsh conditions and insecure environments under which microenterprises evolve. Informal financial agents seem best equipped to operate under such conditions and environments.

Savings Practices

Financing options presume savings practices -- as evolutionary patterns of microenterprises illustrate. With regard to savings practices, economists easily assumes liquidity preferences to be the guiding principle, calling for money guards or savings accounts that are safe and can be quickly mobilized in case of unexpected but highly rewarding investment opportunities. However, this is to overlook the significance of illiquidity preferences that lead to savings forms other than money, such as "jewelry, livestock, resaleable farm machinery, individually and collectively stored crops, household furniture, and radios" (Shipton 1992). Such savings forms are common strategies of many rural-based African microenterpreneurs -- as Shipton found in The Gambia -- who face enormous pressure on scarce money resources and probably struggle on a different evolutionary path as their "colleagues" in urbanized areas of Indonesia, Thailand or the Phillipines (Liedholm 1992: 268-269).

In low-income countries the pressure on scarce money resources comes from many sides. First, monetary instability and lack of dependency of the banking system might very well explain illiquidity preferences. A balanced perspective on informal finance is to explore the background and motives for non-monetary transactions and the conversion of cash to kind and vice versa; in other words, to study the impact of uneven processes of monetization and financial deepening on the emergence and scope of informal finance.

Another pressure on scarce money resources comes from "inside", that is, kin and neighbors claiming their share. Illiquidity preferences (in a social sense) refer to savings practices that constitute a socially acceptable argument to deny claims for financial assistance from people belonging to the same social or socio-spatial unit (household, clan, lineage, neighborhood). The most sophisticated and widespread examples of such a savings practice are the ROSCA and ASCRA (Bouman 1994: 375-394) that prove to evolve as new social units in developing economies (Hospes 1992). Illiquidity preferences (in a social sense) are close to what might be described as senior claims -- with illiquidity preferences putting more emphasis on savings practices and senior claims on repayment strategies.

Senior Claims

Another entry to assess informal finance (and herewith formal finance) from an actor perspective is to explore obligations that the borrower considers more important than repaying the lender. Such obligations can be described as senior claims (Von Pischke 1994: 63). Inquiries about senior claims will demonstrate that individuals have their own "personal hierarchies of creditors and that the newest, most distant, and least familiar lenders rank at the bottom" (Shipton 1992: 28).

Senior claims do not only refer to competing claims of informal and formal suppliers of finance but also include paying school fees, house construction material, medicines, food and contributions to social events (Von Pischke 1994: 63). Heidhues (1994) argues that informal loans in Cameroon and Benin show high repayment rates exactly because they are mainly used for these popular purposes. A balanced perspective on informal finance is not only to recognize the role of informal finance helping microenterprises to evolve and seize extraordinary opportunities, but also to explore the popularity and persistence of informal financial arrangements providing social security services -- especially so at a time when macro-economic reform programmes seem to further erode government assistance at this point.

Informal Finance in Context

Maybe the most important and best way to balance perspectives on informal finance is to analyze informal finance in context (cf. Baas 1994; several chapters in Bouman and Hospes 1994). Not to develop a contextual approach leads one simply to expect informal finance in particular places only, like far-distant and "unbankable" areas, or on the contrary, to assume the wider context of evolving forms of informal finance to be one of economic stability or growth. Taking a more contextual look at informal finance, brings one to unexpected places and critical questions.

Unexpected Places and Practices

It is not exceptional to find ROSCAs or ASCRAs flourishing at bureacratic places or behind bank-windows in developing countries. Employees of banks and credit cooperatives privately design these associations within their own organization. Frustration with the inefficiency of these institutions[2] and the lack of deposit services, in particular, undoubtedly figure high on their list of motives (cf. Adams 1993). But also among staff of schools, the police, the military and local units of the state administration, ROSCAs and ASCRAs are being organized. In some countries these associations are used by local government extension services as a tool to mobilize women to attend meetings (Hospes 1992).

The physical features of banks and state administration do not necessarily mark frontiers of informal finance. Even if informal financial groups are not inside formal frameworks, this does not mean that only bureaucratic rules sustain these frameworks. Our understanding of the "performance" of poverty-oriented banks and donor agencies would be much improved if we could provide detailed information on how bankers and rural developers make decisions related to loan portfolio management, which is sometimes synonym to risk management (Von Pischke 1994), but more often a matter of dumping easy money and indebting people.

2. Someone, commenting on the long, and seemingly unmoving rows of customers in front of bank-windows in a certain Asian country, dryly observed that the clerks behind the windows believed one could measure their status and prestige from the length of the row.

Structural Adjustment Patterns of Financial Self-Help Organizations

One way to demonstrate the diversity of informal finance, is to concentrate research on one (major) type of informal finance only (cf. Ghate 1992: 23-42).

> Descriptive studies are a critical first step in science and are indispensable in understanding phenomena as complex as informal finance. It would be possible, however, for the small number of researchers who are working on informal finance to spend all of their time only in describing and detailing the multitude of nuances found within a country and in various regions of the world in just rotating savings and credit associations (ROSCAs) (Adams and Ghate 1992: 355)

Although it is necessary to update our knowledge on evolving forms of informal finance, it is even more important to contextualize our findings, that is, to undertake analytical studies explaining the "multitude of nuances" in terms of changing macro-economic, political-administrative and agro-ecological conditions. Such a step is not only critical in science but also for policymaking directed at promoting private enterprise and self-help initiative. I will explain my argument concentrating on "structural adjustment patterns" of financial self-help organizations.

In many developing countries dramatic changes of the political, administrative and economic organization have been planned or are taking place. Many of these changes are supposed to generate more and better possibilities for individuals and groups to articulate their interests in a more pluralistic socio-political system. Macro-economic reform programs, like structural adjustment programs and financial sector reforms, are meant to give more room to private enterprise and self-help initiatives. In this connection, government agencies are expected to redefine their administrative responsibilities by placing more emphasis on facilitative interventions: these agencies should create favorable pre-conditions for private enterprise and self-help initiatives. The reduction of state controlled enterprises, subsidies and civil servants constitutes a major element of structural adjustment programmes. At the same time, leading politicians and their followers are supposed to further the development of public-private relations in such a way that the political system develops proper checks and balances to create a broader and more legitimate power base.

There are indications that the political and legal administrative measures based upon these economic and administrative policies have weakened rather than strenghtened the economic position of the poorer segments of the population, increased social and economic insecurity and even led to social and political turmoil. My thesis is that these negative, unintended consequences could be limited if self-help initiatives at the local level were to be facilitated by policies improving pre-conditions for membership-based financial self-help organizations.

Although recent political-administrative and macro-economic reform measures are supposed to give more room to self-help and self-regulation, little is actually known about the impact of political-administrative and macro-economic changes on the actual operations of self-help initiatives of small-scale organizations at the local level. The description and analysis of organizational and functional changes in the operations of financial self-help organizations (SHOs) should include:

a. adjustment procedures in situations of monetary (in)stability in terms of contributions (in kind or cash), length of cycle (ROSCA) or savings period (ASCRA); both the absence or decline of ASCRAs (with permanent funds) and shortening of cycles of ROSCAs might be an expression of monetary instability (due to inflation or the lack of a foreign currency standard); contributions in kind might also be an expression of this instability;

b. changes in the nature, location, geographical distribution and number of participants of SHOs in case of dependable or non-dependable banking systems; a breakdown of the banking system might result in an increase of the number of financial SHOs; stability and expansion of the banking system might result in transformation of ROSCAs in ASCRAs that deposit their permanent funds at rural banks; an unplanned result of the reduction of government subsidies for development banks might be the mushrooming of savings and credit groups supported by NGOs;

c. changing sets of relations with other forms of financial intermediation (at the individual and organizational level) when banking services become more or less dependable;

d. changes in the normative-institutional framework (registration, conflict regulation, enforcement of bye-laws) when perceptions of members of SHOs regarding local-traditional leadership and the organization of public services change; a comparison rural/urban environment might be very revealing here, since tradition and conservatism loose much of their value in migration from rural to urban environment (compare Bouman 1994: 375-394);

e. changes in the use of funds (agricultural inputs, working capital, food, medicines, education, housing, etc.) in times of increasing insecurity of food provision and income flows (that in turn are possible effects of political-administrative and macro-economic reform); a comparison between areas or times of economic expansion and decline might be very revealing (compare Crow 1994);

f. changes in the significance of financial SHOs as part of livelihood strategies of urban and rural people.

The study of the use of financial SHOs is useful to gain insights in illiquidity preferences and restricted mobility of funds[3] as a function of financial sector liberalisation and other macro-economic reform measures. Strategies to meet these preferences might be of strategic importance for rural people (and women in particular) in periods of economic reform and social insecurity. Many structural adjustment programs prescribe considerable cuts in government budgets, leading to a deteriotation of living conditions in rural areas in terms of housing, health and education. As a result, it might be necessary to mobilize own funds and to limit the drain of these funds out of rural areas because these scarce financial means are urgently needed to meet minimum social security

3. Preferences for limited mobility of funds refer to practices of SHOs to limit the circulation of funds to prevent scarce financial means from leaking away.

needs. Financial SHOs often have been perfect tools to accumulate local funds to finance expenditures for housing, health and education.

In addition, or maybe as a substitute, people resort to family help and traders credit at times of social-economic insecurity. It would be particularly revealing to analyze how women -- with both productive and reproductive responsibilities -- cope with such insecurity (cf. Verstralen forthcoming). It is largely ignored that many women select suppliers of financial services with the aim to start and consolidate their social security network -- realizing that a greater emphasis on income-generating activities cannot take place when social security has not been guaranteed.

Processes of Social Desintegration and Integration[4]

Structural adjustment programs of economies and public administration are usually based on the view that the market mechanism should be the main structuring instrument for the allocation of scarce resources. Such promotion of the free movement of goods and people reinforces processes of commoditification, which means that virtually everything can

4. This final part draws partly on a position paper entitled "Social Change in Africa: Some Themes on Development Strategies" (June 1994) by Dr. Cyprian Fisiy, currently social scientist at the World Bank and formerly researcher at the Department of Agrarian Law, WAU, The Netherlands.

be bought and sold, and rural out-migration of people impressed by "images of limited goods" mediated through radio and TV. Commoditification and migration again strongly affect the social organization of local communities. Non-monetary forms of cooperation with regard to housing, agriculture and community works are put under pressure. There is a danger that the preponderance of monetary exchanges over other forms of culturally defined social security networks is disruptive to social cohesion. The critical question is then whether circumstances allow financial SHOs to evolve and partly offset processes of social desintegration[5].

Countries (like Uganda) that still carry the scars of an oppressive regime undermining bonds of mutual trust, certainly do not offer an ideal scene and starting point in this respect. Not surprisingly, Nagarajan (e-mail comm. 1994) notices that ROSCAs are re-emerging in Uganda in the 1990s[6] with small size of groups and short rotating times expressing more positive but yet insecure feelings about the future.

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5. Processes of social desintegration -- with other backgrounds and ugly expressions, of course -- do not only occur in Third World countries but also take place in highly industralized countries, such as the USA. Instead of bluntly embarking on credit programs directed at the poor in industrialized countries, it would be useful to describe how their urban poor and bankrupt farmers cope with insecurity and what role informal financial arrangements play in this connection.

6. Nagarajan (e-mail communication, May 12, 1994) reports that, "While these groups were performing several functions including social, financial and political ones in the 1960s, they were largely inactive during the 1970s and 1980s."

This brings us to the more encompassing and threatening problem of the -- now not any longer latent -- crisis of the African nation state. The germs of this crisis were already built in at a time when "colonies were arbitrarily cut out by imperialist powers without considerations of the people inhabiting these territories" (Holmen 1990: 50). This put the leaders of the young independent "nations" for an incredibly difficult task, that is, to accomplish development (however defined) ánd build a nation.

> To avoid balkanization, priority had to be given to state over nation. That is, it was conditional for the regime to first build the state as an instrument to build the nation (ibid: 53)... To receive and better utilize development aid, central planning departments and administrative institutions expanded rapidly (ibid: 52)

Overdevelopment and centralization of the Third World state resulted. Unfortunately, "praetorian" states evolved characterized by lack of community and effective political institutions, by their absence of agreed procedures, the fragility of institutions and the lack of widespread sentiment of their legitimacy (ibid: 57).

Not surprisingly, decentralization of state powers, or attempts to do so as part of structural adjustment programs, have either failed or sparkled conflict between ethnical mini-societies about territories, management of natural resources and their revenues, labor "markets" and privileges to work --

explaining the paradoxical emergence of new boundaries and patterns of exclusion in an era of globalization.

The question is how these new boundaries and patterns will affect the distribution and functions of financial SHOs. Financial SHOs might very well mirror ethnical conflict and be re-organized at offices, markets and wards, excluding (potential) members from another origin. Maybe they will not drastically change at all in this connection because many SHOs are already organized along ethnic lines[7]. However, it is also possible that financial SHOs increasingly adopt political and social functions or are incorporated into new socio-political units that are used as building stones of mini-states.

In any case, a minimum of social-political stability (contrast Rwanda) and social cohesion is a pre-condition for people (even from one common origin) to be able to organize financial SHOs at all. For a better understanding of the significance and structural adjustment patterns of financial SHOs (and other types of informal finance but also of repayment records of credit projects) one needs to develop analytical frameworks or contextual perspectives of which insecurity is an integral part.

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7. This certainly applies to (new) migrant populations among which financial SHOs will be used as an (alternative) social safety network and, if economic and social-political stability increase, as a way to accumulate capital for investment purposes.

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