

# Task Force 2009

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## From the Bottom Up *Rethinking U.S. Development Assistance*



**Henry M. Jackson School of International Studies  
University of Washington**

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The Henry M. Jackson School of International Studies  
University of Washington

## **Task Force 2009**

### ***From the Bottom Up: Rethinking U.S. Development Assistance***

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## EXECUTIVE SUMMARY

The advent of a new age in American politics, coupled with an extreme economic crisis, has subjected every aspect of the federal budget to scrutiny. Given these challenges, the Obama administration will have to seek new solutions to achieve its goals of increasing foreign aid, and making development a central aspect of its foreign policy. This report examines how the key agencies in this process – namely the US State Department and USAID – can approach development in a way that is justifiable to the American taxpayer and beneficial for the global poor, while fulfilling the objectives of stated US interests. What we term as *bottom-up development* implies profound changes in the way these agencies handle foreign aid. At its core the bottom-up approach re-defines who development experts are, placing the input, initiative, ideas and feedback of the global poor at the center of foreign assistance projects. By respecting the voice of those in poverty we can more effectively remove barriers to economic advancement, producing sustained and sustainable results. We advocate this shift in thinking alongside mechanisms for feedback and evaluation that will help to identify projects that work, and decide how to devote scarce development-related resources. We also identify specific initiatives that demonstrate the effectiveness of bottom-up approaches and provide useful starting places for State Department and USAID funding. In this time when many government agencies and policies are being redesigned for maximum effectiveness we believe that the US State Department and USAID can maintain their relevance and increase their funding by using bottom-up approaches as guiding principles. This shift in thinking and its subsequent policies will provide long-term solutions for the global poor while concurrently achieving US global objectives.





# INTRODUCTION

*Stephanie Arbogast and Alison O’Leary (Editors)*

The current economic crisis has strained every aspect of the federal budget and brought each budget line under scrutiny. For the US to maintain, and hopefully increase, its foreign aid budget will require a dramatic shift in its approach to development assistance. We argue that this shift should be in favor of bottom-up approaches, because of their effectiveness and ability to produce lasting positive impacts on the lives of the poor. Bottom-up approaches are those that arise out of the felt needs of people living in poverty, and not the abstract ideas of academics. It is consequently the poor whose voice is valued, in the design and implementation of bottom-up projects. It is also the poor who provide meaningful feedback as to how their lives have been impacted. By adopting a philosophy that values the participation and inclusion of the recipients of development assistance, the US can better implement programs that work. We advocate as well the thorough, independent and (as far as possible) standardized evaluation and assessment of all development projects. By redesigning development assistance to incorporate the expertise of the global poor, and devoting resources to project evaluation, we can see the kind of change in people’s lives that warrants tax-payer investment. A bottom-up approach will help insure the continued funding of US development assistance, and maintain the United States’ commitment to helping the global poor.

## **The Origins of United States Foreign Aid and Development Policies**

Dramatic changes in the world's geopolitical and economic landscapes following WWII gave rise to US foreign aid and international development. Prior to the 1940s wealthy industrialized nations systematically carved up and extracted resources, wealth and people from across the globe without regard to what, if any, responsibility they had for returning wealth back to poor nations. Harry S. Truman’s inaugural day speech of 1949 introduced the concept of foreign aid and social responsibility to the American people and the world. Initially the US used foreign aid to promote free market reforms which greatly benefited the rapidly growing US economy. By the 1950s the threat of Soviet expansion and Cold War ideology expanded the aid objectives of the US to include political and military stabilization designed to prevent the spread of international communism. This new

emphasis on military, strategic and political stabilization drove most US aid funds toward countries bordering the communist bloc, as well as strategic areas of South Asia, the Middle East and Latin America. Underpinned by these two foundations—enabling a growing US economy and political stability—US aid money flowed in a torrent towards governments rather than needy people.

The 1970s and the 1980s did not see much change in US policy toward delivering foreign aid. However, a mind shift in US foreign aid began to emerge after the fall of the Soviet Union in 1991. While an official policy of economic, military, strategic and political security still drove funding for most aid programs there began to be dissention among economists as well as political and social scientists concerning the ignorance and inefficiencies of maintaining the current policy. While the US economy did indeed benefit through US aid and development policies, which effectively opened up overseas markets to US products and businesses, the political, strategic and military security promised by Truman in exchange for US tax payer's dollars did not come to pass. During the 1990s academics and politicians alike began to challenge the assumptions that top-down, government-to-government aid and development programs actually worked.

### **The Current State of Development**

In the 1990s domestic and international policy makers considered new approaches to foreign aid and development; however, the current state of development is in flux on both domestic and international fronts. US policy makers are being squeezed between shrinking budgets and the demands of tax payers who want more value for their dollars while being, on the whole, remarkably uninformed about the volume and composition of US foreign assistance. The UN and the World Bank are seen as either ineffectual or part of the problem—or both.

Most would agree that clean water, education, access to health care, adequate physical infrastructure and agreed upon rules of law are necessary targets for any aid program. The question remains, how do organizations best go about delivering on such basic needs--let alone loftier goals, such as woman's empowerment and sustainable environmental stewardship?

The US State Department, USAID and other foreign affairs agencies budget request for FY 2009 is 39.8 billion dollars, which is just 1.3 percent of the total US budget.

Therefore, it is imperative that these funds be allocated wisely. Budget restraints stemming from the current economic crisis will continue to challenge which programs get funded and how current programs are evaluated for success. We believe that increased scrutiny is beneficial for promoting policies which will ensure that best practices for program development and delivery are carried out. Currently US aid policy is guided by the following principles:

- 1) Monetary resources are centralized through the US general tax collection system (not locally or individually given).
- 2) Information is controlled and flows internally and upward (not horizontally).
- 3) Decision making is done by US government agencies (with limited input from receiving nation's agents) and is mandated and tightly regulated from the top.
- 4) Aid programs are carried out by service providers under direction of line agencies.
- 5) Accountability of service providers flows internally and upward (not from receiving nation's citizens upward).<sup>1</sup>

In summary, these principles ensure that any programs developed and implemented by USAID will continue to be hampered by restraints built into the system. In order to more effectively use scarce and valuable funds this report will draw attention to several innovative programs that seek to partner with aid recipients who will be active players in their own development. We strongly believe that local problems are best addressed with local solutions, which are supported by, but not overridden by the US

### **United States Interests**

The United States' interests in international development have evolved with the increasing interconnections of the global economy. The hope is that economic growth in poor countries will contribute to greater global stability. Greater economic, as well as political participation, will contribute to better governance, growth, stability and sustainable development.

Increased education and vocational skills in poor countries make them more attractive as destinations for US foreign direct investments, and provide those countries with greater opportunities for export and productive entrepreneurship. These measures will help create jobs and contribute to poverty reduction and empowerment.

In our current difficult economic times it is important that US funding and spending on development be transparent, accountable, and efficient, since there will be many competing claims on funds. We need to know more about what works and what does not work in order to help maximize the effectiveness of US foreign assistance. Many new models have to be tried out and evaluated properly in order to maximize program effectiveness and funding allocation. We need feedback and information from the poor about what works and what does not: the recipients of aid to be given a greater stake and more power in the process.

US interests in diplomacy and development will be advanced by more US business abroad, and more open trade with poor countries. Improving global communications and bridging the digital divide would contribute to an increase in trade and commerce.

Effective foreign assistance can help reduce the potential for conflict and instability created by poverty and exclusion – making the world a safer place and reducing US exposure to terrorism and wars. Similarly, aid can help reduce the vulnerability of the poorest and most disadvantaged (e.g. women). And finally, more secure and formal property rights can help turn the assets of the poor into capital, spurring growth, employment and the volume of exchange.

### **Bottom-Up Development: A New Direction in Foreign Aid**

The term Bottom-Up is very clearly a reference to previous Top-Down schemes, which have dominated US development assistance projects. These schemes have largely been designed by experts from rich countries, based on handouts to often corrupt governments, and required little or no feedback as to their effectiveness. Even with the advent of the Millennium Challenge Corporation (MCC), which has re-directed aid to countries with better governance, the design and implementation of many projects has often been irrelevant to those they sought to serve. Furthermore they have been measured by the amounts disbursed, and not the results of the projects implemented. Bottom-Up development focuses on input from, and participation by, the beneficiaries of development assistance. One of the most important assumptions of this position is that the poor are the experts on how their lives can be improved. They know what their needs are, they know what kinds of programs work, they often know where and when and how to do what needs to be done. What they lack are resources, and often training which we can humbly provide.

We need to shift our thinking from what can we give the poor, to exploring why they haven't been able to secure those things themselves. In doing so we must discard ideas that academic and bureaucratic specialists, largely in the developed world, are experts on the problems of the poor. What bottom-up development seeks are ways to empower individuals to make lasting changes in their lives. It is intended to be a sustainable approach that values the individuals living in poverty and breaks the cycle of dependency.

The philosophy of bottom-up development is in essence a commitment to participation and inclusion of the poor. Much of what keeps people in poverty is exclusion from the means of wealth creation, and the lack of opportunity to participate in decisions that affect their lives. Bottom-up initiatives focus on the removal of these barriers, and the creation of opportunities for people to exercise choice and better their lives themselves. This approach does not attempt to circumvent governments, or downplay the role that power structures play on the lives of individuals. Issues such as legal reform, land rights, and government accountability, all need to function in a participatory, and inclusive manner to insure that segments of the population are not marginalized. Bottom up development is an equitable approach that can reform oppressive structures as well as inform our approach to effectively providing the poor with the means to ameliorate their lives.

### **Who We Are and Why We Care**

Every graduating senior at the Jackson School of International Studies is privileged to be part of a Task Force Report as their culminating project. This Report draws upon regional, cross-cultural, and comparative studies in various disciplines including, economics, geography, history, political science, sociology, language, literature and religion. It is an honor to put into practice the theory behind several years of academic study and research. While this report is hypothetical in nature, it nonetheless has been researched and written by the next generation of business professionals and government policy makers who will shape and implement the domestic and international policies and programs of the 21st century. Underpinned with that awareness, this report seeks to illuminate the weaknesses in current development policies and then advocate for real and sustainable change based on knowledge gained while at the Jackson School. Each Task Force member who contributed to this report has chosen a specific topic that they feel strongly about. In the course of

researching and writing their chapters the editors and instructor have witnessed each author's journey: from that of interested but unsure supporter, to a passionate enthusiast for policy change. The hope of the Jackson School is that through the process of creating a Task Force Report, its graduating seniors will be armed with the tools necessary to deliver national and international programs and policies that are culturally and politically suitable and economically sustainable. As the editors of this task force we believe that the hopes of the Jackson School have been achieved.

### **Structure of Report**

This report argues for a shift in the guiding principles behind development assistance, as well as specific policies. It is therefore divided into these two parts and subdivided into thematic chapter clusters. The structure is as follows:

### **Part 1 Overarching Themes and Structural Conditions**

#### **Accountability and Governance**

This cluster establishes the need for a transparent system of aid distribution built on feedback and evaluation. It also examines how bottom-up approaches can be employed to correct top-down issues, in terms of governance.

Chapter 1 provides an in-depth assessment of the current system of aid distribution, its flaws and inefficiencies. This chapter focuses specifically on the lack of analysis, which has fostered a system of waste and ineffectiveness, and explains how bottom up approaches can address these issues.

Chapter 2 examines the role of political empowerment through participation and its effect on development policy. This analysis focuses on the importance of locally produced knowledge and innovation, and demonstrates the centrality of rights and capabilities in determining the success of development projects. This chapter also addresses how government initiatives in poor countries can move away from top-down approaches through participation, which is a key issue for subsequent chapters.

Chapter 3 establishes the importance of good governance and examines what mechanisms are already in place to measure and foster these practices. This chapter argues for a stronger bottom-up influence in terms of input from poor countries whose perspective and participation increases the effectiveness of mechanisms like the Millennium Challenge Corporation (MCC).

Chapter 4 looks at a specific governance concern: corruption and examines how bottom-up solutions involving participation and accountability can be employed to combat the problem.

### **Economic Freedom and Improving the Business Climate**

While the previous cluster focused on participation, this cluster deals with the centrality of inclusion in bottom-up development. The three chapters herein address structural issues rooted in poor countries' legal systems. Each chapter illuminates the importance of legal and governmental structures that are inclusive and accessible to the poor. Together they provide guiding principles of how US policies can advocate inclusive reforms, without attempting to implement pre-fabricated top-down solutions.

Chapter 5 details the importance of legal property rights in terms of capital creation, and their centrality in poverty alleviation.

Chapter 6 examines this issue in terms of women's rights to land ownership and inheritance.

Chapter 7 looks at method of formal and informal contract enforcement.

These three chapters are extremely relevant in the promotion of entrepreneurship and sustainable methods by which the poor can better their situations themselves. Given that mortgages provide a huge source of capital the fuels entrepreneurship legal property rights are central in the promotion of bottom-up schemes. Contract enforcement provides the needed support for small business to succeed expanding the network within which people can do business.

## **PART 2 Key Issues in Development Policy**

The second half of the report addresses specific sectors and examines how bottom-up approaches are working or can be implemented in areas crucial to global development. The remaining three clusters are education, microfinance and information and communications technology (ICT).

### **Education**

This cluster addresses the fact that although education is always a development priority, many schemes have been largely ineffective. The two chapters herein argue for different models and new forms of evaluation in the hopes of developing lasting results.

Chapter 8 focuses on new solutions to the ongoing problem of promoting education in poor countries, specifically primary and secondary education.

Chapter 9 identifies an important gap in education funding, that of technical training and vocational education which can increase employability and provide solutions for sectors not currently being served. Both of these chapters look at how small-scale projects implemented with systems for evaluation can be effective in improving education and subsequently employment rates.

### **Microfinance**

The most visible, and arguably most noteworthy accomplishment of bottom-up development. While the positive effects of microfinance are widely known, we focus here on how this incredible tool can be improved.

Chapter 10 addresses the importance of making micro credit accessible to the poorest in poor countries and how the US can aid this process. This chapter also looks at the importance of transparency in microfinance institutions, and examines how they could be regulated or commercialized to the benefit of the poor.

Chapter 11 considers the possibilities of microfinance paired with other vital services like healthcare and education targeted specifically at women. The effect of microfinance on women's empowerment has been substantial, and here we seek solutions to further expand its reach.

### **Information and Communications Technology (ICT)**

The final cluster of the report examines a sector whose importance cannot be overstated in the development of poor countries, and the US's approaches to aiding them.

Chapter 12 examines peer to peer lending, an exciting model for aid that has received a lot of press lately wherein individuals are able to loan money directly to entrepreneurs in poor countries. This chapter provides ideas for ways USAID can evaluate this model and possibly incorporate it in development assistance.

Chapter 13 discusses the proliferation of cell phones in poor countries and how bottom-up schemes can capitalize on this widespread technology. This chapter argues for the continued funding and research of cell phone technologies and explains their many possible applications.



Chapter 14 addresses the importance of developing ICT solutions that are relevant to the poor. While this chapter deals with this as a specific ICT issue, it functions also as an overarching commentary for the ideas presented here. We are advocating small-scale transparent projects designed for, and often by the people they've been created to help. Advances in all sectors should value local knowledge and through participation and inclusion, work to address specific issues.

Following the chapters, which each include individual recommendations based on their targeted research, we provide the overall conclusions and recommendations of the report. It is here that we bring together the multi-faceted aspects of this topic, which provide both a set of guiding principles, as well as specific action items, and identify bottom-up development as a key policy in the future of US development assistance.

### **Concluding Remarks**

In its sixty-year history, foreign aid and development has been invented and reinvented several times over. We are now at a cross-road where foreign assistance can truly do what it set out to achieve and that is to improve the standard of living for all people of the world. This report will demonstrate how bottom-up development, driven by local people, with specialized, regional knowledge is the best solution to the development dilemma. We will examine how governance and accountability, along with improved economic, finance and business climates, coupled with increased opportunities for women can enable specific projects to flourish. Several of the projects that we will highlight embrace technology as a tool to connect the poor to each other, and the rich to the poor.

Furthermore, as tensions mount between rich and powerful nations and those at the bottom of the economic pyramid, it is vital to our national security that growing efforts continue to be made to fight global poverty. The link between poverty and hopelessness is abundantly clear. In today's increasing climate of global terrorism it is imperative that the needs of the poor receive positive attention which aims to elevate their economic situation, rather than a continuation of poverty driven hopelessness. Therefore, this report recommends that culturally sensitive and economically sustainable foreign development programs and policies be encouraged from the vantage point of those at the bottom of the pyramid. We are mindful that this is a new and fresh model of implementing foreign aid and we understand that there may be skeptics. Nonetheless, case studies presented in this

report will demonstrate that a bottom-up approach does indeed work. Occasionally a hybrid approach of top-down and bottom-up development may provide the best answer to a problem; in these cases this report recognizes this convergence of the two models.

By embracing bottom-up development the US can not only achieve its goals of continuing to be the world's leader in foreign aid and development programs and policies, but it will also set an example for new and inclusive methods of aid delivery which other nations may also implement. In the last 60 years, foreign aid and development programs have failed to eradicate poverty and raise the standard of living of the world's poor. Currently more than 4 billion people live on less than \$2.00 per day, do not have access to clean water and live in squalid conditions. We have learned a lot since 1949 and should not continue on a path that has produced such dismal results. The recommendations in this report may appear radical—after all how often are the voices of the powerful displaced by those of the disenfranchised? Nonetheless, our belief is that it is time to try a new approach to eliminating poverty.

<sup>1</sup> Pritchett, Lant, and Michael Woolcock, "Solutions When The Solution Is the Problem".  
In Easterly, William (ed.), *Reinventing Foreign Aid*. Cambridge MA: MIT Press, 2008.

## **Chapter 1**

### **INCREASING THE EFFECTIVENESS OF OFFICIAL DONORS**

*Maddie Cunningham*

#### **ISSUE**

The development business within the United States currently lacks any standard form of accountability or transparency. The Government does not evaluate several of its development projects, ultimately leading to a failure of adapting its foreign aid policy to strategies that are successful and eliminate approaches that are obsolete. Taking this into account, it is time that the United States starts to learn from its mistakes and evaluate the ramifications of its development programs. Furthermore, it is necessary to incorporate the local voice in impact surveys to determine what is deemed as successful.

#### **BACKGROUND**

##### **Introduction**

In recent examination of foreign aid, it is becoming increasingly apparent that the United States is fostering an ineffective development aid “business.” The contemporary structure and organization of the foreign aid sector is fueling cycles of development assistance that are often called into question; their ultimate impacts and ability to diffuse sustainable economic growth are debatable and the ability to diminish the number living in poverty is contestable. Furthermore, the current government and development institutional organizations are arranged in a compartmentalized and multilayer manner that causes fragmented development plans, ultimately impacting the effectiveness of aid assistance. The US favors a process that rewards rapid and large scale dispersal. It emphasizes loan reports and places minimal focus on development outcomes. This approach to aid distribution creates quick project cycles with ineffective follow-through, monitoring, accountability, or participation from the local civil sector. In essence, it creates a development practice with no long term monitoring or evaluation system that is responsible for holding the government accountable to its intended outcomes or beneficiaries.

With the advent of bottom-up development and an increasing focus on grassroots participation, the development assistance model of the US proves to be outmoded. Its structure, budget, policies, and approaches have, in essence, followed the same mentality since the creation of the Marshall Plan in 1961. This is not to mean to question the intention or purpose of the government's foreign aid service, but rather highlight that the current and traditional "top-down" and large-scale foreign aid process is inefficient. It is now, with the advent of the bottom-up lens of development that reform must occur.

Even though the contemporary foreign aid structure contains several junctures through which inefficiencies can be addressed, we propose that emphasis should be placed on accountability, transparency, and project monitoring. Through monitoring the outcomes of its projects, the government can gain a greater awareness of development impacts in local societies, how it is received, its level of sustainability, or whether it was correctly implemented. Furthermore, the US needs to break the current aid dispersal techniques and create a sustainable development approach that does not repeat previous mistakes.

## **Current United States Development Challenges**

### **Structure of United States Foreign Aid**

In order to expand on the importance of accountability, transparency, and development evaluation in relation to increasing aid effectiveness, a clear understanding of the structure of foreign assistance and development aid is needed. Ranging from non-governmental organizations, private organization, multiple individuals, and the government, the US participates in a multitude of development projects. Foreign aid is impacted by a myriad of influences that help dictate budget, policy, and research. Although all donors contribute to the international arena of development, this chapter focuses on the State Department and the United States Agency for International Development (USAID) as the main players in US development aid.

### **How the Current Aid System is Ineffective**

More so than ever, the effectiveness of US development aid is being questioned, and it is contended as to whether or not it is creating appropriate and sustainable projects. Over the past two years, the US aid assistance has decreased 22% and has dropped from \$27.0 billion in 2005 to \$21.8 billion in 2007.<sup>1</sup> It has experienced a shift away from the

poorest countries most in need towards those with stronger governance. Although this chapter ultimately focuses on improving aid through increasing accountability and transparency, it is important to gain a greater understanding of many of the fundamental inefficiencies within the contemporary system. Many of these shortcomings are deeply embedded within the structure, organization, and collaboration among domestic aid organizations. It is due to organization fragmentation, lack of funding for public goods, a decreasing participation in multilateral organizations, cycles of aid disbursement, lack of including locals into ownership of local development programs, and a lack of program feedback loops and evaluation that the aid business is ineffective.

### **Fragmentation**

As of now, the US development strategy, both in theory and implementation, is fragmented. Including domestic organization, international involvement, program implementation, and interactions with beneficiaries, the US experiences several levels of involvement. There is no one single theory or organization solely responsible for development. This multitude of players has led to policy incoherence, conflicts and confusion of responsibilities, discrepancies between governments and non profit organizations, and overall ineffective project implementation.<sup>2</sup> Furthermore, several of the development branches within the US have started using USAID as a contractor which has, in part, transformed the organization into a contracting agency, rather than an independent development organization.<sup>3</sup> Overall, this has increased risk, the likelihood of corruptions, and has diminished the intrinsic value of development programs.

The impacts of US foreign aid fragmentation are evident when examining the US development involvement in Tanzania in 2000-2002.

#### **Case Study 1: Tanzania**

The US disbursed about \$100 million of aid in Tanzania, financing 50 different projects at an average of just \$2 million a piece [...]. With more than 1300 projects altogether in that period, and an estimated 1000 donor meetings a year and 2400 reports to donors every quarter, Tanzania several years ago announced a four-month holiday during which it would not accept donor visits.

(Source: Birdsall 2005)

By examining the US involvement in Tanzania through this case study, it becomes evident that the organization, communication, and lack of a unified strategy created ineffective development; too much development without a succinct and coordinated implementation process created chaos and inhibited progress. It even caused Tanzania to close its doors to development donors and take a four-month “holiday” in order to avoid poorly coordinated development. Furthermore, this highlights how the missing coordination from the bureaucracies at the “top” can create negative impacts for those at the “bottom.”

Additionally, a large fragmentation exists within the underlying theory of development approach and aid investment. The US convolutes its own needs versus the needs of intended recipients; a large portion of its development aid is dedicated towards short term political security needs, while only a small amount is dedicated towards long term development goals. For example, the recent increase in aid since 2000 has been towards Iraq, Afghanistan, and HIV/AIDS programs. As of 2007, aid towards Iraq and Afghanistan accounted for 24 percent of US assistance.<sup>4</sup> This increase in aid shows that underlying fragmentation exists between short term political and security needs of the US and long-term sustainable development.

### **Lack of Funding of Public Goods**

The US has failed to invest in both public and regional goods. Public goods lack solid investment but hold the potential to create sustainable development and mitigate larger developmental challenges. A public good is an object or information that impacts individuals in the same manner across borders; it can include research on medical vaccines, farming methods, or environmental mitigations. It also extends to economic infrastructures and can include the harmonization of stock markets, multi-country roads, or shared electricity grids. Although recent trends have seen a small increase in investment of public goods, the US has historically contributed an insignificant amount of their budget to this sector. For example, of the \$60 billion disbursed for aid development in 2002, it is estimated that only \$1 to \$2 billion was spent on projects fostered by multinational programs in developing countries.<sup>5</sup>

Much controversy and reluctance exists over investing in public goods. Undefined ownership, political involvement, budgeting, and financial support limit the involvement of

the US. Furthermore, investment in public goods does not yield immediate results and can often appear to neglect direct requests or needs of local governments. Although there is little emphasis on public goods within the US, multilateral organizations and banks have been responsible for the majority of investment in public goods.

One specific form of public goods that is significantly underinvested in, which this chapter will later examine, is programs which monitor the effectiveness of development plans. Known also as impact evaluations, the US government significantly under invests in the public good that can bring awareness of how to improve the practice of development. By failing to invest in public goods, the US fails to reflect the globalized and international manner of development, ultimately weakening its own development success.

### **Decreasing Involvement in Multilateral Organizations**

One of the greatest shortcomings of the contemporary foreign aid department is the decreasing involvement in multilateral organizations. A multilateral organization can be regarded to as any type of an organization that participates in development that has multiple donors or more than one nation. As of 2007, \$4.5 billion of US foreign aid was delivered bilaterally whereas \$1.3 billion was channeled through multilateral organizations.<sup>6</sup> As of December 2008, the US only channeled 10 percent of its aid budget to multilaterals whereas other countries donated up to 33 percent.<sup>7</sup> With this decrease, the US loses an overall advantage in the international field of development. It loses leverage, influence, and assertiveness in policy making, priority setting and budgeting.

Currently, the US provides between 15-20 percent of the funding for major multilateral organizations.<sup>8</sup> This creates a missed opportunity to participate in more successful development policies. According to William Easterly and Tobias Pfutze, multilateral organizations cultivate the most efficient and successful types of development.<sup>9</sup> Overall, the decreasing involvement in multilateral organizations has proved to undermine the strength of the US in the development field, debates its authority, and questions the future influence of the US in multilateral organizations.

### **Cycles of Development**

One of the most ineffective practices of development aid is the process through which the government designs and implements projects. Also known as project cycles, the government currently favors a system of large scale and rapid execution. Frequently, this

is accompanied by a form of donor impatience and development assistance adopts the front of a business transaction rather than a humanitarian cause.

Budgets frequently run the pace of development cycles. Banks and the US government want to meet disbursement schedules and run “on time”. Accomplishing budget transactions and completions is of more importance than development performance.<sup>10</sup> This leads to an impatience to disburse money and legislatures fear that if they do not spend money on time, it reflects their own inabilities.<sup>11</sup>

Additionally, development institutions often focus on loan reports and budget achievements.<sup>12</sup> The implementation of projects, rather than its outcomes, remains the main priority. This mentality causes the purpose of the project to be lost and leaves no room to evaluate the successes or failures of implemented aid. Overall, the US fosters a cycle of development projects that is dominated by a rapid fire implantation process guided by annual budgets.

### **Encouraging Participation and Not Ownership**

One of the largest shortcomings in the contemporary aid business is the failure to truly incorporate locals and civil society into the ownership of development projects. Ranging from budget decisions, policy approach, governing techniques, and forums to express concern, development programs are designed without the influence of those who are most impacted. Program schemes and projects are created from the outside, diffusing an external concept of what is “appropriate” or “needed.” Furthermore, locals are expected to “own” the programs by participating in what is thrust upon them. This creates a disconnect between locals participating in an authentic development project through which they have contributed versus an external development project that demands participation.<sup>13</sup>

The US currently encourages participation in development projects. What the US fails to address is that simple participation does not create or indicate significant ownership of programs.<sup>14</sup> By continuing to encourage participation rather than ownership, the US is furthering the ineffective and locally insensitive mentality of top-down development.

### **Lack of Feedback Loops**

The US fails to listen to the voices that provide the greatest feedback about development projects. The US neglects to gather feedback from local communities and the opinions of the local voice remain missing in development program completion. There is



no designated forum for the poor to express their view of development projects or for the US to tap into to the most valuable voice of those most impacted.

In part, this creates a certain mentality within US government that undermines the knowledge that individuals have of their own society. It surpasses the ability to tap into what could, perhaps provide the most relevant tool to modify their development policies to what is most successful and relevant. Furthermore, it undermines the ability of local individuals to eventually intertwine and take ownerships of local projects.

## **Recent Attempts to Improve Aid**

This section will highlight recent steps taken by the government towards improving foreign assistance. Despite these attempts, the US development business remains ineffective. This section will start by highlighting reforms beginning in the Bush administration including the Millennium Challenge Account, the reorganization of USAID, the creations of the Presidents Emergency Plan for Aids Relief (PEFFAR), budget reorganization, and the implementation of the F-process. Furthermore, it will highlight current attempts the government has taken to increase development accountability and transparency. It will draw on examples from recent trends initiated by the Government Accountability Office (GAO) aimed to increase impact results and development evaluations. Overall, it will support that even though the US has started to adapt its foreign policy to the needs of the twenty-first century, it still falls short of an effective, transparent, and well organized business.

### **Millennium Challenge Account**

The Millennium Challenge Account (MCA) was created in 2002 by the Bush Administration in attempts to change the requirements and process of aid distribution. The MCA urged for a transition of aid from the poorest countries to those who foster better practices in governance, economic policies, and health and education programs.<sup>15</sup> The Account was geared towards increasing development effectiveness and gave the recipient country ownership and accountability of the aid.

We examine the details of the MCA and the Millennium Challenge Corporation (MCC) created to distribute the funds in chapter three, but in terms of accountability the MCA has failed to fully evaluate the results of its programs. This lack of accountability

and failure to terminate inefficient programs, exemplifies the US government's short term development goals.<sup>16</sup> Furthermore, this plan was created with new legislation, outside of the already existing development organizations. It added chaos to the already fragmented order and undermined the power of USAID.

### **The President's Emergency Plan for AIDS Relief**

The President's Emergency Plan for AIDS relief (PEFAR) is an initiative created in 2003 that called for a \$10 billion increase towards HIV/AIDS initiatives. The increase occurred over five years and grew from \$5 billion to \$15 billion. The plan gave 83 percent towards bilateral programs and 16 percent towards multilateral organizations focusing on tuberculosis, AIDS, and malaria.<sup>17</sup> It signified a broad shift in both development aid and foreign policy because it called for a greater emphasis on health issues and the geographic region of Africa.

The plan was met with initial success and has been known as one of the most effective attempts to mitigate HIV/AIDS. PEFAR has connected over one million people with antiretroviral therapy, aided over two million impacted youth, and continues to globally distribute the most condoms.<sup>18</sup> It has encouraged medical training within developing countries, ultimately pushing for more local involvement.<sup>19</sup> Aside from specific results, perhaps the most impacting component of this program is that it created a development organization that will continue to operate. It is a movement towards a more sustainable development practice.

Although it has proven to be successful, PEFAR still contributes to aid complications. Although it invests in a global public good, the method through which it does so adds to the fragmentation of aid organization. PEFAR runs across several executive branches including the State Department, USAID, the Department of Health and Human Services, including both the Centers for Disease Control and Prevention and the National Institutes of Health.<sup>20</sup> Furthermore, the large emphasis (both numerically and thematically) on HIV/AIDS leads to controversy based on whether or not the government is creating a narrow focus within its budget. By spending such a large amount on one health concern, several other health programs are overlooked. An example of this is demonstrated in Ethiopia.

### **Case Study 2: Ethiopia**

The 2007 aid donation to Ethiopia, one of the poorest countries in the world, is a great example of this imbalance. Approximately 50 percent of US assistance to Ethiopia went to HIV/AIDS prevention, 38 percent to emergency food relief, and 7 percent to child survival, family planning, and malaria prevention and treatment. Only 1.5 percent went to agriculture, 1.5 percent to economic growth, 1.5 percent to education, and one percent to governance.

(Source: Atwood, McPherson, and Natsios 2008)

Through this example, it becomes evident that the high emphasis on HIV/AIDS neglects several other sectors that need foreign aid. It demonstrates the imbalance of receiving aid. Overall, even though PEFAR has proven to be successful, it has contributed to many of the challenges facing development assistance.

### **Budget Reorganization**

Perhaps one of most transparent changes made during the Bush Administration was a reorganization of the Official Development Aid budget. Although this is a component of development that remains in flux annually, it has experienced recent restructuring that has altered the impacts of development assistance. The first is an increase in aid to Iraq and Afghanistan and the second is an increase in debt relief.

Since 2001, the majority of the increase in the foreign aid budget is seen through aid given to Iraq, Afghanistan, and various surrounding countries. As of 2007, aid for Iraq and Afghanistan was \$5.1 billion dollars, or 24 percent of the US budget.<sup>21</sup> Although this has changed over the years, the highest aid increase was \$11.2 billion given to Iraq in 2005. This is followed by \$4.7 billion in 2006.<sup>22</sup>

This increase in aid to Iraq and Afghanistan has not occurred without ramifications. The two largest impacts have been further fragmentation of US foreign aid and the supporting of short-term development projects. The Department of Defense has been in charge of this aid dispersal. This is challenging because it is traditionally only in charge of 22 percent of the foreign aid budget, and the current amount of aid is much more than that.

This also leads to further fragmentation of the aid industry and is distributing authority among other governmental organizations.

Debt relief is another major contributor that has changed the manner of aid dispersal. Starting in the Clinton Administration, debt relief has experienced an increase in official development aid. For example, it accounted for 15 percent of the budget in 2005 and seven percent in 2006.<sup>23</sup> Increasing debt relief has been given to Iraq, Nigeria, and the Democratic Republic of the Congo. The increasing amount of debt relief has been accompanied by a gradual transition away from the involvement of multilateral organizations and placed an increasing emphasis on bilateral aid assistance.

Although there have been recent increasing trends, the impacts of debt relief can be misleading. The benefits of the aid are not immediately felt and it represents a future cash flow. The money is dispersed as a forgiveness of debt rather than immediate development assistance and the ultimate impacts are never really evaluated. Countries also experience a decrease in aid the following year. Debt relief instigates development cycles that question efficiency of aid. It lacks tangible results. Both the change in aid to Iraq and Afghanistan and increasing debt relief contribute to the cycles of development that lack aid evaluation and long term development.

### **The “F Process”**

In attempts to mitigate the fragmented nature of the Domestic Foreign Aid industry, Secretary of State Condoleezza Rice in 2006 initiated the “F Process”. This process was geared toward creating deeper reform and bridged the State Department and USAID, created a new Director of Foreign Assistance, and created a new Foreign Assistance Strategic Framework.<sup>24</sup>

The “F Process” was a great step towards a reform that focused on the deeper structural obstacles within the US. However, the reform was not as comprehensive as intended and left several US key development players frustrated. The process failed to acknowledge development plans outside of State Department and USAID and avoided restructuring any coordination with the executive branch or Congress.<sup>25</sup> It omitted several key players and programs. Although the “F Process” proved to be successful, it has, and will continue, to contribute to the fragmentation of development endeavors.

## **Accountability, Transparency and Evaluations**

Although the US Government has recently made several attempts to modernize and improve the effectiveness of foreign aid and development strategies, several areas remain overlooked. Perhaps one of the most neglected areas in development strategies is that of accountability and transparency. Accountability and transparency, which in essence are monitored by various forms of evaluation and impact assessments, are the key elements contributing to effective, sustainable, and community relevant development projects. They are the key elements through which development aid proves to be a success or a failure. This section will highlight how the US fosters a weak evaluation system, which in turn, gives way to poor accountability and transparency. It will then examine the importance of how adequate development feedback can increase the efficiency of the US aid business. It will acknowledge previous and ongoing attempts of the US in project evaluation, but will argue that these initiatives fall short of what is needed. Finally, this section will draw on examples of effective large scale evaluation systems from multilateral institutions, and smaller impact and accountability surveys from specific development projects.

The correlation between how impact evaluations examine the accountability, transparency, and overall success can be seen in a myriad of levels. According to the Global Center for Development, impact surveys improve development projects by learning how to avoid costly mistakes, identify successes, and gain insight from the local community. Project evaluation tries to answer the question “what difference did this program make?” and “what happened with the program and what would have happened without it.”<sup>26</sup> It attempts to monitor the ramifications of the social, economic, or political development prescription that was written from the outside.

### **Existing Forms of Accountability in the US**

Overall, the US lacks any form of a comprehensive evaluation organization. There is no unified system or department to monitor impacts. This has been called into much debate with recent modes of foreign policy modernization, which have tried to increase accountability and effectiveness. Additionally, what convolute this situation is that previous attempts have been made to instigate evaluations programs, but none have been comprehensive or have received enough power. They have ranged in size, sponsorship,

location, and effectiveness. None have been the panacea for accountability and the aid business still lacks a unified evaluation method. This section will highlight examples using the Facts and Facts Info systems, the Government Accountability Office, and recent resolutions within the House of Representatives.

#### **FACTS I, FACTS II, and FACTS INFO:**

FACTS I, FACTS II, and FACTS INFO are all data information systems that monitor US development projects abroad. They are used to demonstrate the diversity in project evaluation and focus on a more technical and logistical side of accountability. Created in 2006 as part of the “F Process”, the FACTS I and FACTS II databases are designed to collect information on development budgets, planning, reporting, and numerical data.<sup>27</sup> They are based in several countries including Peru, Kenya, Haiti, Ethiopia, Jordan and Ukraine. After trial and error with FACTS 1, it was replaced by and updated version, FACTS II, in early 2008.

FACTS INFO, was another information system that was created to report data on development aid. FACTS INFO was simultaneously created with FACTS II in 2008 and combines the budgets and performance results from FACTS 1 and FACTS II to help create an overall performance report.<sup>28</sup> Together, all three information systems increase the accountability and transparency of aid by monitoring the planning, budgeting, and reporting of foreign assistance.

Despite the intended goals of the three monitoring systems, their creation highlights the fragmentation within the foreign aid business; it only collects certain information from certain foreign assistance programs in certain countries. Furthermore, they are slow running, unreliable, structurally risky, and purely objective.<sup>29</sup> They also lack a concrete relationship between gathered information and new policy creation.

FACTS I, FACTS II, and FACTS INFO are examples of a logistical, small scale project evaluation used to increase accountability and transparency. Although it demonstrates an attempt to monitor programs, it simultaneously highlights the challenges of creating successful evaluation mechanisms.

#### **Government Accountability Office**

The Government Accountability Office (GAO) is an evaluative organization located within the legislative branch of the US government. It is designed to monitor the

budget of the Federal government and ensure that no federal programs are participating in fraud, financial mismanagement, abuse, or waste. It is known as the “Congressional Watchdog” and provides reassurance to the American people that their taxes dollars are being spent in an effective manner.<sup>30</sup> In essence, the GAO is designed to uncover inefficiencies within the government. The State Department and USAID are incorporated in the list of organizations subject to the monitoring of the GAO.

The GAO has participated in several evaluations of both the State Department and USAID and has failed to find any financial negligence within recent projects. According to USAID, all of its programs have been marked as successful according to the GAO.<sup>31</sup> By meeting the requirements set by the GAO, the State Department and USAID, are “effectively” spending their allocated budget.

Although the GAO serves as the main organization focused on accountability within the US government, its approach towards accountability does not ensure successful or sustainable spending. For example, by placing emphasis on the wants of tax payers rather than monitoring spending of development aid, the GAO fails to monitor the long term impacts of projects, gain local feedback, or gage whether the programs are meeting the needs of local citizens. It fails to grasp the long term relationships and consequences that development spending has on the ground; rather it focuses on the domestic US budget and guaranteeing that the wants of US tax payers are being met. Furthermore, the monitoring of the GAO in the past two years has primarily been focused within the Middle East, ultimately leaving several places and programs around the world left unaccountable.<sup>32</sup>

The GAO is an example of an evaluation organization within the US that enforces accountability and transparency in government spending. Despite this, it highlights the weakness in approach and yielded outcomes. Additionally, it reinforces the idea that meaning of “success” resides in short term financial organization rather than long-term outcomes.

### **House Resolution 1268**

On June 11, 2008, the House of Representative passed a resolution, House Resolution 1268, that attempted to create a new approach to US foreign assistance. It recognized that foreign assistance is one of the most critical devices for asserting the power

of the US and it should become a national priority. It should be through a strong collaboration with the Congress and the Administration that this should be implemented. The resolution had five main points: provide enough resources to meet goals, increase the number of individuals who are trained as development experts, increase impact surveys and evaluations, work closer with recipient countries to increase accountability and decrease transparency, and more closely mold development assistance to the needs of recipients.<sup>33</sup>

House Resolution 1268 demonstrates the attempt to modernize aid assistance in many ways starting from the top-down. It places emphasis on the overall need to restructure the domestic priorities in order to achieve more successful development on the ground. It acknowledges that a need for an improved development assistance is needed both in regards to how it is received on the ground, but additionally how it impacts the overall international power regime. This resolution highlights the initiative to restructure aid, but because it is so new, its ramifications are yet to be discovered.

### **Multilateral Organizations**

Evaluation and impact surveys acquire a new meaning and level of success when examining their use within multilateral organizations. Multilateral organizations, according to William Easterly and Tobias Pfutze, generally foster more effective development practices. This is, in part, due to an increased transparency. Strong transparency draws on several components of the organization, but partly lies within the evaluation system. Several multilateral organizations exist in today's development business, all fostering different levels of success and types of development. This section will highlight the practice of development aid evaluation by examining various practices within different organizations. Furthermore, it will highlight how multilateral organizations are more transparent in their design. It will conclude by examining how the United Nations demonstrates how multilateral organizations are not always successful and will highlight strong evaluation mechanisms from the Inspection Panel of the World Bank.

To begin, it is important to understand that multilateral organizations are inherently more transparent and require better evaluation systems. First, multilateral organizations receive funds from several donors. This requires clear transparency of their development plans and a strong accountability of what their funds do. Second, because of their size,



multilateral organizations frequently have independent departments dedicated towards evaluation and impact surveys. Although this differs between each organization, the evaluation departments are stronger within the multilateral arena than within the bilateral. Finally, multilateral organizations experience overall less fragmentation than the US and are able to more easily monitor their projects.

Despite the inherently accountable structure of multilateral organizations, they are not always prone to have strong evaluations nor are they held responsible for their development policies. An example of this is the United Nations and several of its development departments. Including the World Food Programme (WFP), the Population Fund (UNFPA), and the High Commissioner for Refugees (UNHCR). The UN has poor accountability and evaluations mechanisms due to poor data, financial, and project implementation reporting. Furthermore, the UN fails to fully record the amount of support they give to nongovernment organizations.<sup>34</sup> Overall, the UN highlights how multilateral organizations are structurally predisposed to have high accountability, but a specific sector or department must be dedicated solely to evaluation or impact surveys.

Although the UN proves to have poor accountability, several multilateral organizations demonstrate strong accountability and transparency through specific evaluation systems. Examples of these include: the Inspection Panel of the World Bank, the Data Collection efforts of the OECD Development Assistance Committee, the International Monetary Fund (IMF) Global Monitoring reports, the IMF Independent Evaluation Office, IMF Randomized Control Trials, The Asian Development Bank Compliance Review. All of these groups demonstrate different evaluation mechanisms used to increase accountability, but the Inspection Panel of the World Bank is an exceptionally strong evaluation body. The following section will examine the impacts of the Inspection Panel by drawing an example from Nigeria.

## **The World Bank**

The World Bank is just one multilateral bank that exemplifies how project evaluation and accountability and transparency can lead to more effective development aid. The World Bank provides guiding innovative and trend setting examples of how to

evaluate projects, and in turn, provide better development for their beneficiaries. Because the World Bank is such a large organization, this section only covers accountability within their Inspection Panel.

Overall, the transparency and accountability of the World Bank is highly regarded in the realms of multilateral banks. According to William Easterly and Tobias Pfutze, the World Bank cultivates one of the most transparent forms of development aid dispersal. This includes low overhead costs, avoided ineffective aid channels, and remaining selective on where their aid goes. In fact, these findings led the World Bank to be categorized as the most effective aid practitioner as of spring 2008.<sup>35</sup> Additionally, the World Bank, although still fostering several shortcomings, sets examples for other multilateral banks including the International Development Banks and the Asian Development Bank.

Perhaps the higher level of accountability and transparency of the World Bank come from the Inspection Panel. The Inspection Panel is a group within the bank that is designed to integrate the local community voice into development projects. It provides a forum through which individuals or communities can come if they feel as though they have negatively been impacted by the bank or they believe the bank is violating its own policies. The Inspection Panel was created in 1993 after a seven year debate between the Bank, NGOs, and the Sardar Sarovar dam project in Western India. This specific project changed the evaluation process of the bank and has created better evaluation and civil voice into the development process.<sup>36</sup>

A specific example of the impacts of the Inspection Panel can be highlighted through the 2008 West African Gas Pipeline. This project consists of a 428 mile pipeline used to transport natural gas from Nigeria to neighboring countries. The implementation of the pipeline did not go as foreseen and created impacts that were not intended. The project diffused additional environmental consequences, impacted the livelihoods of local merchants, spurred larger economic concerns, and added to the already dangerous gas flaring. Frustrated by these unintended consequences, several individuals took their concerns to the Inspection Panel.

In turn, the Panel expressed the concerns to the Board of Executives and plans were made to mitigate these impacts. In response to the Panel, Ms. Obiageli Katryn Ezekwesili, the World Bank Vice President for the Africa Region stated the following:

Catalyzing private sector investment for infrastructure development is vital for Sub-Saharan Africa's future. [...] The Bank appreciates the Inspection Panel's work, and is committed to implementing the Action Plan so that the project – one of the earliest regional projects in the portfolio – delivers lasting development results to benefit people and the environment.<sup>37</sup>

In addition, the Bank provided more money for other development assistance and political support. It was agreed upon that the Panel would provide an update to the Board every six months and continual consultation.<sup>38</sup> Overall, the Inspection Panel connected the voice of the local community to that of the Executive Board and helped implement various forms of mitigation of the West African Gas Pipeline.

The Inspection Panel is just one method that is geared towards increasing project evaluation, accountability, and transparency. Although it significantly improves the effectiveness of aid, it still contains several shortcomings. It is simply a forum through which individuals can express frustrations; it has no power to change policy or enforce development projects. Furthermore, it is an organization within the World Bank, so ultimately it reports to the organization that created and runs it.

Overall, the World Bank is just one example of an aid agency that highlights the benefits of project evaluation in creating more effective aid. Furthermore, it has created a form of evaluation that works closely with those who are most impacted by the development projects.

### **Concluding Remarks: Challenges and Opportunities**

The US currently fosters a development business that lacks accountability and transparency. The State Department and USAID frequently implement development projects but fail to examine their impacts. The government participates in a development mentality that rewards large scale and rapid monetary dispersal. Development projects are in essence conducted based on budget cycles and meeting deadlines. Rarely are policies implemented and conducted based on their impacts or successes in the daily lives of their

intended beneficiaries. Furthermore, there is no enforcement that requires the US to be transparent through its development process or accountable for its original goals.

With the recent advent of bottom-up development, it is more crucial than ever to create an enforcement mechanism that holds the US responsible for its development plans. Through evaluation mechanisms or impact surveys, the US has the potential to learn from its mistakes, listen to the needs of those it most impacts, and adapt its policies to create sustainable development. Evaluation mechanisms have the potential to increase the overall efficiency and effectiveness of US development aid.

Recently, the US has started placing emphasis on the importance of the evaluation process and has made several attempts to reorganize development theories and decision making bodies. Although these attempts have created success and have fueled new development mentalities, they fall short of complete evaluation and lack a connection back into development policy. Furthermore, they have failed to effectively work in tandem with the local voice and incorporate the opinion of individuals who matter the most. It is now, with start of the Obama Administration and the surge of bottom-up development that the US needs to use evaluations to improve the effectiveness of its development aid through increasing its accountability and transparency.

## **OPTIONS**

After examining how inadequate project evaluation is one of the leading contributions in today's ineffective aid business, it is necessary to begin to address these shortcomings. In doing this, we must acknowledge the structure of the current aid system and how this provides several challenges. Evaluation systems must be sensitive to the current development aid budget; they must run on a low cost and avoid removing substantial amounts of money from development projects. Furthermore, the evaluation and impact projects must function on two levels with two departments. It must have a section based in foreign countries, ultimately conducting the evaluations. Secondly, there must be a domestic organization that receives the information and incorporates it into future or preexisting policy. This section proposes the following options to address the current evaluation gap: increase the amount of money dedicated to multilateral organizations,

create a specific evaluation organization, redesign development aid budgets, and increase local feedback and voice.

- **Option: Increasing the Amount of Funding for Multilateral Organizations**

Increasing the amount of money directed towards multilateral organizations is a way to increase not only evaluation of projects, but overall development success. As previously noted, the amount of money the US contributes to multilateral organizations is far below what it should be, both in general and in comparison to other countries. Multilateral organizations have overall better project evaluation and impact assessments. As a result of having several donors, the business of multilateral organizations requires more accountability and transparency. The organization needs to prove to its donors that their money is being used, and being used beneficially. There is more than one actor and multiple financial sources influencing policy and desired outcomes.

Additionally, multilateral organizations are more likely to have preexisting and often independent evaluation organizations. An example of this is the Inspection Panel in the World Bank. Furthermore, multilateral organizations and impact surveys conducted by larger organizations often yield information that can be deemed a public good. They help produce public information that increases the access and knowledge of local, regional, and international public goods that can improve development assistance around the world.

- **Option: Create a Specific Domestic Evaluation Organization**

The current development system receives criticism for its structural organization, or rather a lack of organization. With this growing criticism is a growing pressure to reorganize and regroup various levels and departments within the government. With this anticipated reorganizing, the US should create a cabinet within the State Department focused specifically on development evaluation. This department should work closely with USAID and the development branch of the State Department, but should remain independent in financing and policy creation.

As previously proved by examining evaluation systems, specifically the Inspection Panel, project evaluation is more effective when some independence exists between the policy creators and those who conduct the inspections. Some degree of space is required to

provide both incentive and validity to the results of project evaluations and how these findings are reworked into future policies (or already existing projects on the ground).

- **Option: Redesign Development Budget Cycles**

Perhaps one of the largest contributors to both ineffective aid and project evaluations is the current development budget cycles. The favored large-scale, rapid, and continual money dispersal runs on a calendar timeline rather than one based in the progress of projects. The US fosters the mentality of favoring its own domestic budget deadlines rather than remaining flexible and acting in accordance with project outcomes or local reactions.

If the US were to restructure this mentality, it would create more effective aid by treating each project with a focus on its purpose, implementation process, and success, rather than a domestic financial deadline. It would provide more time to examine the impacts on local communities and how the projects are received. Furthermore, this would help create a more sustainable development approach because it would allow the opportunity to learn from previous mistakes. It would allow the US to take the time to observe how their projects are impacting, or not impacting, its intended beneficiaries. This specific recommendation does not address how project evaluations or impact surveys would occur. It merely recommends that the US government can create space and time by addressing its budget cycles in which the evaluation can occur.

- **Option: Increase Local Feedback and Incorporate Local Voice**

Perhaps one of the largest shortcomings of development projects is that a weak feedback loop exists. There is no direct connection between the voices of those who are most impacted to those who are most influential. By increasing the voice of development beneficiaries through evaluation, policy makers authentically gain a greater understanding of what is effective and sustainable. Furthermore, by working closely with those impacted, US development agencies must be transparent and accountable for the intended outcomes.

The Inspection Panel of the World Bank demonstrates how strong feedback loops of the local voice can improve aid. By listening to the concerns and locals, the Inspection Panels has changed policy at the top level within the World Bank and redirected the implementation process of already occurring projects. Furthermore, the Inspection Panel has demonstrated that connecting the local voice to policy makers is the key creating and modifying successful development.

The US can increase feedback loops in several ways. First, it can augment already existing systems and add subjective components. For example, the US could add additional parts to the FACTII and FACTS Info systems; instead of simply fostering numerical and budget data, these systems could include a section dedicated towards the voice of locals. Secondly, the US could fund an organization similar to the Inspection Panel. It could create a body focused to gage the voice of local communities. This panel could additionally serve to hold the projects accountable for their intended purpose.

Finally, the US could create incentives for locals to participate, help design, and provide feedback for development programs. By providing incentives for giving feedback, the US is more closely involving locals into the development projects and improving access to their feedback. Incentives could come in various forms depending on the project but could include greater participation and ownerships of development projects, economic incentives (including food, agriculture tools, or even money). Increasing the feedback of individuals who are most directly impacted by development projects can help improve aid by learning what works and how to appropriately adapt policy.

## **RECOMMENDATIONS**

After gaining a greater understanding of the need for improving US aid through a new evaluation system, we recommend that the Obama Administration create a specific domestic evaluation organization. The advent of a specific evaluation organization would satisfy the development needs and goals of both the US and individuals throughout developing nations. Furthermore, with the change in mentality towards bottom-up development, it is crucial for the US to create opportunities to learn from its mistakes and foster sustainable development. It is now, more so than ever before, that the US needs to

learn from its development mistakes, bring accountability and transparency into its practice, and create an effective development business.

With the recent economic downturn, the independent evaluation organization would be extremely beneficial. It would increase transparency of development money for both the government and tax payers. It would allow the government to monitor whether or not it's spending is of benefit while simultaneously diffusing awareness to tax payers. Although it might be costly to instigate and implement, the long run financial benefits of learning from costly mistakes would outweigh the initial costs. It would create a domestic and international mechanism that would ideally assess development dollars during this challenging economic downturn.

Creating an independent organization would be appropriate in the Obama administration because several evaluation mechanisms exist that could provide examples and theories of how to successfully run evaluations. Several of these include the Inspection Panel of the United Nations, the Center for Global Development, Transparency International, and countless other non governmental organizations and think tanks. Furthermore, the US has some of its own evaluation mechanisms through which the new organization could draw examples, collaborate, or merge preexisting mechanisms. These include the Government Accountability Office, FACT II and FACTS INFO, and various groups within the Department of State and USAID. The Obama Administration would be wise to implement a new evaluation organization because there are several preexisting evaluation mechanisms; it is merely a matter of deriving techniques and theories that most strongly support the goals of the US.

Finally, an independent evaluation organization would be apt for the Obama administration because it would connect the local voice of beneficiaries directly to the US. It would create an opportunity to tap into the opinions of those who are most impacted and connect them to those who have the ultimate power to create change. It is, perhaps, the first step towards listening to the voice of those who bear the impacts of development.

We recommend that the Obama Administration take the initiative to create a domestic evaluation and impact survey organization. This concept would be financially beneficial in the long run and would support sustainable development. Several organizations exist that can provide guiding examples of how to implement effective



evaluations. Finally, this proposed organization would help ensure that the voice of the individuals being impacted by development would have the opportunity to be heard and hold the US government accountable for its development business.

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<sup>9</sup> William Easterly and Tobias Pfutze, “Where Does the Money Go? Best and Worst Practices in Foreign Aid,” *Journal of Economic Perspectives* 22, no. 2 (2008) [www.nyu.edu/fas/institute/dri/Easterly/File/Where\\_Does\\_Money\\_Go.pdf](http://www.nyu.edu/fas/institute/dri/Easterly/File/Where_Does_Money_Go.pdf)

<sup>10</sup> Birdsall, 4.

<sup>11</sup> Ibid., p 5

<sup>12</sup> William Easterly, *Reinventing Foreign Aid* (Cambridge: The MIT Press, 2008) 1-43.

<sup>13</sup> Birdsall, 14.

<sup>14</sup> Ibid., p 15

<sup>15</sup> Herrling and Radelet, “US Foreign Assistance for the Twenty-first Century.”

<sup>16</sup> Herrling and Radelet, “The White House and the World: A Global Development Agenda for the Next US President.” 11.

<sup>17</sup> Abaracar, Radelet, and Schutte, 10

<sup>18</sup> Herrling and Radelet, “The White House and the World: A Global Development Agenda for the Next US President,” 11

<sup>19</sup> Atwood, McPherson and Natsios, 8

<sup>20</sup> Herrling and Radelet, “The White House and the World: A Global Development Agenda for the Next US President,” 13.

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<sup>21</sup> Abaracar, Radelet, and Schutte, “What’s Behind the Recent Declines in US Foreign Assistance?,” 5.

<sup>22</sup> Herrling and Radelet, “The White House and the World: A Global Development Agenda for the Next US President,”

<sup>23</sup> Abaracar, Radelet, and Schutte, “What’s Behind the Recent Declines in US Foreign Assistance?,” 8.

<sup>24</sup> Herrling and Radelet, “US Foreign Assistance for the Twenty-first Century,” 10.

<sup>25</sup> Herrling and Radelet, “The White House and the World: A Global Development Agenda for the Next US President,” 15.

<sup>26</sup> Herrling and Radelet, “The White House and the World: A Global Development Agenda for the Next US President,” 15.

<sup>27</sup> U.S Government Accountability Office. [www.gao.gov/new.items/d0952r.pdf](http://www.gao.gov/new.items/d0952r.pdf).

<sup>28</sup> U.S Government Accountability Office. [www.gao.gov/new.items/d0952r.pdf](http://www.gao.gov/new.items/d0952r.pdf).

<sup>29</sup> Ibid

<sup>30</sup> Ibid

<sup>31</sup> United States Agency for International Development, <http://www.usaid.gov/policy/budget/>

<sup>32</sup> United States Agency for International Development, <http://www.usaid.gov/policy/budget/>

<sup>33</sup> “House Resolution 1268 on Modernizing U.S. Foreign Assistance,” <http://www.reuters.org/world/article.asp?id=3539> (accessed Feb. 15, 2009).

<sup>34</sup> Easterly and Pfutze, “Where Does the Money Go? Best and Worst Practices in Foreign Aid,” 18.

<sup>35</sup> Easterly and Pfutze, “Where Does the Money Go? Best and Worst Practices in Foreign Aid,” 13.

<sup>36</sup> Ibid

<sup>37</sup> “World Bank Board Discusses Inspection Panel Report on West African Gas Pipeline Project and Approves Action Plan,” *The World Bank*, <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21865241~pagePK:34370~piPK:34424~theSitePK:4607,00.html> (accessed Feb. 1, 2009).

<sup>38</sup> Ibid



## Chapter 2

### EMPOWERING THE POOR THROUGH PARTICIPATION

*Matt Reed*

#### **ISSUE**

Although participation has been long understood as a vital component of development assistance, recent research is revealing the importance of generating political empowerment. Political empowerment through participation is a “bottom-up” approach that enables individuals to make the necessary choices to realize their own desired needs and wants. Direct, local, and flexible, encouraging political empowerment through participation is a cost effective strategy that can yield immense benefits. By relying on locally produced knowledge, innovation, and motivation, engendering political empowerment through participation provides development agencies with new avenues for diplomacy and engagement with communities throughout the world. In a time of economic uncertainty and tense international relations, a strategy of political empowerment through participation can provide the United States with renewed legitimacy and respect as the global leader of innovation and progress in development policy. Current experiences demonstrate that encouraging political empowerment through participation incorporates the lessons learned from past development failures alongside broader “bottom-up” development ideas to establish a successful model for development assistance.

#### **BACKGROUND**

##### **Introduction: What is Empowerment?**

Empowerment is the process of eliminating the barriers to decision-making by giving individuals and communities political voice and control over their own lives. Empowerment requires the participation, collaboration and deliberation of political actors in creating change. Through an understanding of development as a process of undergoing progressive change, empowerment is understood as a process of redistributing power

relations, enabling individuals and communities to gain political power while equally reducing the political power of oppressing or dominating agents or structures. In order to effectively incorporate the broader ideas of empowerment, development practitioners created a conceptual framework for examining and understanding empowerment. More precisely, defining empowerment required an understanding of how individuals related to power. Development theorists identified four different relationships of power:

- Power over: the control or domination over a subject
- Power to: generative or productive power creating new possibilities without domination
- Power with: the ability of individuals to realize self-strength and uniqueness through group approaches
- Power from within: the advocacy of individual self-strength and uniqueness, leading to self-acceptance and broader acceptance of others.<sup>1</sup>

These four conceptualizations of power inform the research and practice of development practitioners, with each understanding of power leading to different development strategies. Policy makers have interpreted and translated these broad notions of empowerment in a plethora of ways, emphasizing and engaging the different complex components. These conceptualizations of power necessarily involve participation as a means that involve the subjects of development interventions and enable them to make their own choices and define their own needs and desires. This understanding has led some to describe political empowerment as an “instrumental form of advocacy,” allowing for the process of development to remain open-ended and free from the constraints created by “top-down” development programs.<sup>2</sup> As development strategies for addressing empowerment emerged, the notion and role of participation in development policy became increasingly important, opening up new theoretical landscapes and directions for development policy.



## **What is Participation?**

Participation within the field of development is defined as the act of engaging in the processes and decisions that affect the ability to live. More specifically, participation, either by the individual or as collective, is understood as the appropriate means for enacting empowerment strategies. Participation by local actors allows development practitioners to rely on local knowledge, local resources, and provides policy makers with direct feedback, allowing for more flexible development projects. Moreover, by relying on participation, development practitioners can devote fewer resources to understanding the local contexts and practices that can plague development projects.

Participation involves two main approaches. The first focuses on the subject(s) of development intervention, while the second is aimed at increasing the level or scale of participation in order to produce positive outcome. From these two basic concerns, participation then can generally be divided into four major types.

- Nominal – Participation is used mainly to legitimate the necessity for a development program.
- Instrumental – Participation is understood as necessary for implementing local projects such as the construction of schools.
- Representative – Participation of the locals provides policy makers with feedback, giving the locals a political voice.
- Transformative – Participation is understood as necessary for the empowerment of local actors.<sup>3</sup>

Political empowerment requires choice and freedom to be more equitably distributed among individuals and groups so that their concerns and needs are more substantially met. From this framework, strategies that advance political empowerment through participation are then, by definition, transformative. Through this lens, promoting participatory development programs that advocate political transformation thus become both the means and the ends for building political empowerment. An understanding of the historical maturation of participatory strategies is crucial for understanding the emergence and importance of producing political empowerment.

## **The Expansion of Participatory Strategies within Development Thinking**

During the 1970's the international development community became increasingly disillusioned by the failure of development programs. Many development projects failed to provide relief to millions of impoverished people throughout the world, as the proliferation and application of scientific knowledge concerning economic growth, the promised era of "peace and prosperity" was far from being a reality.<sup>4</sup> Adding to this realization, many critiques of development began to emerge and gain traction within development schools. The critiques presented by Dependency theorists, feminists and environmentalists challenged the mainstream development dogmas and argued for the incorporation of alternatives knowledge and resources into development projects. Strategies promoting participation emerged from the "development crisis" as methods that could overcome the difficulties faced by imposing development programs from the "top-down".<sup>5</sup>

From this period various participatory development models were created and deployed that promoted "consultation", "partnership", and "collaboration."<sup>6</sup> Although there was little consensus on a single understanding or operation of participatory development strategies, the success of the participatory development approach taken by the Grameen Bank and the Self Employed Women's Association (SEWA) inspired development practitioners to incorporate participatory models into more development programs. Majid Rahnema lists six reasons for the widespread acceptance of rhetoric within the international development community.

1. Governments and institutions no longer understood participation as a threat to state sovereignty as the methods and goals for enhancing participation became aligned with state interests.
2. Politicians found advantages in the political attractiveness of participation.
3. Participation corresponded well with the desire to employ cost effective and low cost development measures.
4. Participation connected local knowledge of social institutions and networks of relations to international development organizations.
5. Governments and donors perceived participatory methods of development as more

politically and economically viable, leading to sustained government and donor support.

6. Participation could be linked well with private sector and business sector interests that were understood to be more efficient and effective in producing successful development outcomes.<sup>7</sup>

In particular, scholars noted that participatory methods of development could address the complexities involved in development programs in ways “top down” program of development could not.<sup>8</sup> Thus, propelled by the “development crisis” and difficulties that “top-down” development approaches experienced, participation became understood as a strong answer to ineffectiveness in development policy, and became a key component for emerging development models.

The United States government moved quickly to incorporate participatory strategies in development programs, amending the US Foreign Assistance Act in 1966 and 1973 to require the “involvement of ‘beneficiaries’ of American Aid in planning and implementing projects, and in the sharing of the gains of development.”<sup>9</sup> Affirming the momentum of more integration of participatory methods into development programs, the 1967 World Employment Conference and the United Nations Economic and Social Council encouraged development agencies to adopt participation into their development programs.<sup>10</sup> Moreover, the UN ECOSOC produced a resolution that attempted to define participation for development, articulating that participation require the voluntary and democratic involvement of people in the production and decision-making of setting development agendas and goals in order to maximize the benefits of development. With these declarations, both non-governmental organizations (NGOs) and governmental aid agencies began to incorporate participatory approaches to development that attempted to produce political empowerment, most notably with credit provision and micro-credit lending.

Between the 1970’s and 1990’s, a variety of participatory strategies of development were widely implemented and promoted. Driven by the emergence of Paulo Freire’s *Pedagogy of the Oppressed* and influence of Kurt Lewin’s notion of “action research,” the strategies of Participatory Action Research and Participatory Rural Appraisal became the most prominent methods for engendering political empowerment through participation.

These methods promoted the “self reliance” and “self help” of individuals in poor and marginalized settings by directly involving their voices and knowledge into planning and creating development programs. Through collaboration with local NGOs and local community actors, these participatory strategies focused on building local capacities in order to give the individuals and groups most affected by development interventions more control and political influence. More generally, PRA and PAR guided development strategies sought to act as a facilitator of development programs, and worked to provide the necessary resources for ensuring that community organizing produces “the necessary social momentum” for development.<sup>11</sup> Moreover, these programs provided policy makers the flexibility needed to more effectively address the local contexts of development interventions.

The UN continued to increasingly support participatory methods, from establishing an inter-agency Panel on People’s Participation in 1982 to the use of participation as a central theme within the United Nations Research Institute for Social Development (UNRISD). This rapid deployment of participatory methods by lenders, donors, NGOs and governments lead some to argue that participation has become a common sense development strategy.<sup>12</sup>

### **Redd Barna Uganda: A Case Study of Participatory Rural Appraisal in Kyakatebe, Uganda.**

In 1994, the organizations Redd Barna Uganda (RBU) and the Sustainable Agriculture Program of the International Institute for Environment and Development (IIED) began implementing the strategies of Participatory Rural Appraisal (PRA) in order to promote community development. The program focused on three main principles:

- 1) Working with and alongside local actors and organizations.
- 2) An emphasis on the most marginalized social groups
- 3) Strengthening capacity and institution building by employing participatory methods and analysis.

In 1994, the IIED began inviting community leaders to attend PRA workshops. At these workshops, the IIED began networking with community members, building local alliances and fostering collaboration. After training local community actors, the IIED stepped back, acting as a provider of resources not directly available to the community actors. These actors began to develop community and group action plans. In 1995 the PRA trained community actors began administering their own PRA workshops, further building community support and allowing RBU to play a less direct role in development within Kyakatebe.

(Source: Guijt, 1996)

#### **Analysis of RBU**

Although the PRA process moved slowly and methodically, the immediate successes have proved to be extremely beneficial and promising. Within two years, Kyakatebe had launched a community-based organization, built two schools, and began to actively seek external funding. The IIED found that homes were cleaner, there were fewer cases of acute disease, school attendance rose from 60 to 360 students, household incomes rose and gender relations improved.<sup>13</sup>

Based from this experience in Kyakatebe, the RBU developed a specific model for implementing PRA in other communities. They found that RBU staff needed to be directly involved in the initial community meetings, ensuring that the marginalized community members were represented. After the initial direct involvement, the RBU staff would then act in partnership and collaboration with community leaders and actors, acting as

facilitators and mediators. The PRA model developed by RBU emphasizes the need for building RBU staff capacities and knowledge about the conditions within their focus communities in order to best serve as facilitators and mediators of community projects.

Although the IIED found much to praise regarding the RBU's experience of PRA, three major weaknesses were noted.

- 1) RBU provided inadequate attention to the enhancement of local actor capacity,
- 2) The RBU insufficiently focused on the most marginalized,
- 3) RBU paid a disproportionate amount of attention to community-level organizations, failing to address the concerns of smaller groups.

Moreover the IIED report addressed the broader problems concerning PRA approaches. The report reveals that the RBU's lack of formal and prominent institutions that can monitor and be more involved within local community prevented the full expression of community-initiatives. This concern reflects an internal tension within PRA approaches, the need for more NGO involvement within the development process even though PRA stresses community driven and maintained action. Most importantly, although the PRA approach in RBU did increase participation of community actors, the approach did not lead to their political empowerment due to the heavy reliance on NGO support.

## **Shifting Models: Participatory Poverty Assessments and Participatory Monitoring and Evaluation**

Throughout the 1980's criticisms of the participatory approaches began to surface. Most prominently scholars and practitioners found multiple contradictions within the participatory programs, highlighting the failure of the broad and general notion of participation to reduce political, economic and social inequalities. They found that organizations promoting a program of participation often became increasingly became more involved and controlling, failing to place more control into the hands of local actors that would lead to political empowerment.<sup>14</sup>

Practitioners found that highly centralized governments interfered with the ability to establish a participating community. Scholars argued that participatory models of

development led to the professionalization and institutionalization of participatory strategies, a notion best summarized as, “democracy turns into bureaucracy”.<sup>15</sup> Additionally these scholars argued that participatory models failed to address the broader social, political and economic structures that prevented participation and marginalized individuals and communities and thus failing to empower the communities they intervened in. Some participatory approaches also were unsuccessful in keeping local populations actively engaged over longer periods of time. Although these approaches incorporated local knowledge and gave voice to development subjects, control nonetheless laid within the hands of the aid agencies rather than in the hands of the subjects. Instead of utilizing participation as a transformative process, national and nongovernmental agencies employed participation as nominal, instrumental and representative.

Other critiques of participatory strategies demonstrated the need to implement parallel processes of participation need to be undertaken at all levels of society, so that NGO’s and state development agencies do not establish a patron-client relationship, thus requiring long term resources and not leading to the political empowerment of local actors. Practitioners and theorists began to recognize that in order for empowerment through participation to occur, a clearer understanding of how individual agency is interdependent with broader political, social and economic structures was needed.<sup>16</sup>

To address these issues, development strategies shifted from emphasizing “partnership” and “collaboration” to instead explicitly promoting “empowerment,” through the decentralization of governance and initiatives to make the subjects of development assistance ‘stakeholders’ of the development programs.<sup>17</sup> These strategies attempted to revive individual agency and power and reconcile development programs with the broader struggle to control and manifest self-desired goals and directions by addressing the politics of choice by individuals.<sup>18</sup> In short, these strategies attempted to bring a participating public closer to and with the governing structures.<sup>19</sup>

Despite the “islands of success” that had been achieved by PRA and PAR, development agencies sought to “mainstream” participatory strategies in order to address these criticisms.<sup>20</sup> The *World Bank’s* Participatory Poverty Assessments (PPAs) are the most explicit attempt to mainstream participatory models that promote political empowerment.<sup>21</sup>

These new approaches highlighted the importance of establishing good governance, by addressing citizen participation and incorporating the voices of the poor in creating and managing development programs. Questions such as “Whose reality counts” and “Who benefits and who learns from the process of evaluating and tracking change?” are central to this renewed emphasis on participatory strategies of development.<sup>22</sup> The new and renewed strategies of Participatory Poverty Assessments (PPA) and Participatory monitoring and evaluation (PM&E) provided policy makers with a new set of tactics that encouraged and drew on local agents to motivate and drive development.<sup>23</sup> PPA and PM&E attempt to provide people with the enhanced ability to articulate and advocate their needs and expectations, and thereby empowering individuals to engage in the process of development. Reflecting this change, the World Bank defines PPAs as “an instrument for including poor people’s views in the analysis of poverty and the formulation of strategies to reduce it through public policy.”<sup>24</sup> Additionally, PPA and PM&E serve as more effective tools for evaluation, relying on local stakeholder evaluations of participatory strategies, thereby promoting self-reliance and problem solving by the local actors. By understanding these strategies as long-term processes, policy makers attempted to involve and demarcate the various stakeholders in development projects and transform their positions vis-à-vis the broader political, economic and social structures. These actors would become empowered through conflict negotiation, capacity building, and creating new forms of mutual accountability and governance.<sup>25</sup>

Popular PPA and PM&E approaches attempt to incorporate individuals into governance institutions, thereby linking grassroots politics to the larger state apparatus. By establishing a more direct relationship between political actors and their larger governing institutions, the PPA and PM&E approaches engage in democracy building through transforming individuals into “makers and shakers” from “users and choosers.”<sup>26</sup> These strategies attempt to transform the relationship between individual actors and the broader political, economic and social institutions that affect their lives.



### **Case Study: World Bank Participatory Poverty Assessment in Niger**

In 2000 the Government of Niger and the World Bank commissioned a PPA to collect clear and precise information on the living conditions, opinions and ideas of the population of Niger in order to actively include the participation of the Nigerien population in the creation of a development program. The Nigerien government and World Bank sought to better understand poverty and the broader structures that limit opportunities for self-improvement. By incorporating localized knowledge and experience, the PPA studied the various impediments to development in order to provide policy-makers with the necessary information for implementing a successful development program.

After careful analysis, the PPA found that;

- 1) Poverty is experienced in the everyday lives of Nigeriens,
- 2) Nigeriens understand poverty to involve incapacity, dependency and the lacking of necessary goods and materials,

The PPA found that Nigeriens recognized the need to develop localized capacity alongside a policy of reforming the political, economic and social institutions that prevent self-advancement. The PPA additionally assessed the multiple development programs in-progress in Niger, finding that these programs include “inappropriate strategies” and fail to give ownership of development initiatives to the local populations affected.

(Source: World Bank, 2003)

### **Analysis of PPA**

Overall, the PPA provided policy makers with a fresh understanding of what constrains political empowerment through participation. The report found that a wider range of political adjustments needed to be made in order to transform the relationship between the Nigerien citizens and their governing bodies for the development of the poorest and marginalized.<sup>27</sup> PPAs incorporate the voices of local individuals and groups in order to understand how development programs best address those most affected. This process of incorporating local subjectivities politically empowers local actors by giving them more control and power to make their own decisions. Critics of PPA nonetheless maintain that PPA relies heavily on outside intervention. Like the earlier action research methodologies, PPA methods unsuccessfully address the underlying problems that

continue to prevent successful development.

## **Rights-Based Approaches**

Along with PPA and PM&E, other strategies emerged that focused on addressing the politics of voice and choice, most notably the “rights-based” and “capability-based” approaches promoted by Amartya Sen and Martha Nussbaum<sup>28</sup>. Through a focus on human rights and individual capability, Sen and Nussbaum argue that development be understood as a process of expanding the opportunities for individuals to choose, thus mediating individual agency with broader political, social and economic structures that limit and adversely effect individual choice. Sen and Nussbaum are among the pioneers of the United Nations Human Development Reports that measure individual capabilities within countries, further enunciating the importance of addressing the structures that prevent political empowerment through participation. Corroborating this point, the 2001 OECD’s Development Assistance Committee guidelines for addressing poverty explicitly argue that the deprivation of capabilities and rights prevent the political empowerment of individuals to undergo a successful development process.<sup>29</sup>

Some scholars further stress the importance of rights and capabilities, arguing that strategies that address “citizen” participation can enable individuals to more actively participate and exert control over governing institutions.<sup>30</sup> From this emerged the notions of Sustainable Human Development (SHD) and People Centered Development (PCD) that incorporated participation as a right into mainstream development programs. However, critics have been quick to point out that a prerequisite to citizen participation is the creation of a “political space” that allows for democratic deliberation and debate.<sup>31</sup> Opening up “political spaces” for promoting increased rights and capabilities has proven to be ambiguous and difficult, leading to many critiques of the rights and capabilities based approach. Critics have argued that a rights based approach is “blindingly legalistic and removed from rights implementation” where as other critiques focus on the dilemma of enforcing international rights at the behest of state sovereignties.<sup>32</sup> Additionally, others have argued that SHD and PCD approaches are too abstract and have shown little progress, demonstrating that much more study and implementation of these approaches are needed before further implementation.<sup>33</sup> Aside from the criticism, the strength of a rights-based

approach is that political empowerment through participation remains central.<sup>34</sup>

The United Nations Development Program (UNDP) and United States Agency for International Development (USAID) are the two most visible organizations promoting rights and capabilities-based approaches. UNDP and USAID promote and advocate rights-based approaches by requiring their development programs to include rights-based measures and accords. UNDP and USAID also produce annual and bi-annual reports that analyze human rights around the world.<sup>35</sup> The rights and capabilities-based programs advocated by the UNDP and USAID do not aim to politically empower the subjects of development intervention, but instead are employed as an argument supporting the decentralization of governance institutions that do not necessarily address political empowerment.

The Department For International Development (DFID) additionally actively incorporates rights and capabilities-based approaches in their fight against poverty.<sup>36</sup> The DFID Quality of Governance (QG) program is a hybrid of a rights and capability based approach that uses PPAs for incorporating individual and group participation.<sup>37</sup> This hybrid of the two approaches combines the strategies of producing participation and addressing politics of choice and power in order to most effectively promote political empowerment through participation.

Another example of a hybrid program that deploys PPAs and rights-based approaches is the Regenerated Freirean Literacy through Empowering Community Techniques (REFLECT) approach. The REFLECT model most notably promoted by ActionAid, links critical pedagogy to empowerment by strengthening the capacity of individuals to know and act through active, participatory communication. This model attempts to produce political empowerment through participation by addressing location specific power relationships using individual creativity.

### **Case Study: ActionAid's REFLECT Strategy**

In 2000 ActionAid implemented the REFLECT strategy in Nigeria with the primary focus of building individual and institutional communication capacity. By incorporating a PPA strategy and a rights-based approach, REFLECT sought to empower the local individuals and communities to take control of development programs and initiatives. By working in concert and partnership with the local NGO's and community-based organizations, REFLECT focuses on facilitating and supplementing locally motivated projects instead of relying on outside experts and energy.

REFLECT facilitators establish a series of group or community meetings allowing the participating population drive the conversation and keep participation high. REFLECT community meetings discuss the various issues and impediments of individual development. Action plans are generated from these meetings and are carried out by the participating groups. This model provides incentives for more thorough community participation while additionally empowering individuals to take control of development programs.

Through these meetings and actions, REFLECT "circles" are produced, a safe space for democratic debate and discussion. REFLECT emphasizes the use of these "circles" in order to establish a basis of equality among the diverse actors and individuals. These circles provide groups and individuals with the opportunity to build confidence and the leadership skills necessary for greater control and power of development programs.

(Source: Newman, 2004)

### **Analysis of REFLECT**

By acting as a facilitator, ActionAid attempt to strengthen agents' ability to communicate, create a democratic or deliberative space, and foster a more inclusive community.<sup>38</sup> ActionAid incorporates these components into a single development program in the attempt to transform and empower individuals through active participation. Although the community meetings and actions set up by REFLECT provided a space for deliberation and debate, it is unclear if individuals and groups have come away politically empowered to act and control development programs. Moreover, while the REFLECT approach is able to effectively address the direct and most immediate needs, the REFLECT

approach has not adequately developed a model for addressing the underlying political, economic and social structures prohibiting political empowerment through participation.<sup>39</sup>

## **Participatory Democracy**

Additionally throughout the 1990's, the notion of participatory democracy emerged. Participatory democracy requires direct citizen involvement regarding political decisions leading to democratic deliberation of policies by the population most directly affected by them.<sup>40</sup> Also known as radical democracy, participatory democracy attempts to bring together the politically powerful and the politically marginalized in one political forum in order to make decisions that benefit more people in an equitable manner.<sup>41</sup> Key to this model of political empowerment through participation is the use of deliberation within an equal setting and in equal opportunity so that the process of decision-making is more inclusive and viewed with legitimacy. This method relies on the process of deliberation and democracy to transform individual actors into politically empowered agents in order to address poverty and other development needs. By deliberately addressing the politics of development, participatory democracy leads to increased decentralization of political power, therefore leading to the increased incentivization of local actors and groups to enact more inclusive development programs. From this perspective, the inclusion and integration of social movements into mainstream development programs becomes important. As scholars have increasingly noted, social movements mark the mobilization of an interested, participating public that directly challenges the power relations that produced inequality and state of underdevelopment.<sup>42</sup> By confronting the politics of political, economic and social development programs, social movements epitomize transformative participation.

Linked to the strategy of participatory or radical democracy, participatory budgeting (PB) and city development strategies (CDS) seek to politically empower individuals through participation by directly addressing mechanisms of governance that control and determine the success of development programs.

Participatory budgeting has been introduced throughout the world, and produced many positive results. Since its invention in Porto Alegre, Brazil, over 16,000 municipalities have introduced PB.<sup>43</sup> PB, an extension of participatory or radical democracy, requires direct participation of citizens and stakeholders in the political

decisions that affect their lives. As a method that attempts to correct social injustices and inequalities, PB provides an organized forum and framework for policy makers to voice their praises and their concerns. This strategy creates a greater sense of equality among the participants, providing new public avenues for engaging and voicing concerns. The experiment of PB in Porto Alegre has received acclaim from development practitioners and development subjects, becoming a successful model and example of PB.

Although the example of Porto Alegre offers a glimpse of success, the broader idea of PB has fallen into question. First many practitioners question the content and meaning that increased participation has meant. Participation has not necessarily led to increased political empowerment, and questions have emerged as to whether or not the PB process has overcome the political, economic and social inequalities within specific contexts. Local political parties and affiliations also contest the viability and authority that PB as an alternative to representational democracy. Regardless of these critiques, PB offers exciting opportunities and avenues for research in developing a model for engendering political empowerment through participation.

Another model of participatory or radical democracy is found in the creation of CDS. Promoted by the United Nations Center for Human Settlements (UNCHS), the Cities Alliance provides yearly reports and strategy handbooks that promote increasing participation in city and community planning.

### **Johannesburg Development Strategy: A Case Study of the City Development Strategy in Johannesburg, South Africa.**

Along with participatory budgeting and citizen focused participation, the emergence of the City Development Strategy (CDS) sought to more systematically incorporate the voice, knowledge and resource of development subjects into policy creation process. CDS seek to use local participation in everyday municipal functioning, promoting greater social integration and thus ensuring more equitable policy recommendations.<sup>44</sup> CDS are guided by nine principles or “essentials”:

- 1) Assess the state of the city and its region
- 2) Develop a long-term vision
- 3) Act now with a focus on results
- 4) Value the contributions of the poor
- 5) Encourage local business growth
- 6) Engage networks of cities
- 7) Focus on implementation
- 8) Concentrate on priorities
- 9) Foster local leadership<sup>45</sup>

Following the financial crisis in 1997, the city council of Johannesburg sought to incorporate more people into city planning and development. This strategy attempted to administer city services and decision-making more efficiently and equitably and more generally bring together the different voices and members of the city in order to create a “renewed, common discourse on the city.”<sup>46</sup> These measures were organized into a cohesive plan, iGoli 2002.

(Source: Lipietz, 2008)

### **Analysis of CDS**

The iGoli 2002 plan introduced a new political process into Johannesburg that provided a forum for equitable city planning and involvement, and provided a space for unions, political parties and other civil society organizations to participate in the creation of policy. This energized political atmosphere led to the creation of the iGoli 2010. Although public participation and energy for the iGoli 2002 plan was high, the iGoli 2010

process did not emerge successful. Participation fatigue and the disillusionment by particular groups in the participation process led many to simply not attend the frequent meetings and committees. Moreover the political party in control used the iGoli planning process to exert control and maintain political power. Although participation in city planning and governance increased, the ability to control and influence the planning processes unequally favored the political and economic elites. The broader political, economic and social structures could not be adequately addressed and made more equitable within the CDS. Although increased participation of civil society in the creation of policy was achieved, little progress was made to politically empower the civil society to control these development programs.<sup>47</sup>

## **Concluding Remarks: Challenges and Opportunities**

Recent scholarship and practice has shown the need for greater emphasis on transformative participatory approaches to development. The early developed PAR and PRA models have proven to increase participation, but have not necessarily led to the changes in political, economic and social wellbeing. The more recently developed PPA, rights-based, and participatory democracy approaches have shown considerable promise as successful development strategies through their abilities to address political empowerment through participation. An increased focus on transformative participation requires understanding development as a long-term political process that places control of development programs into the hands of those most affected. Disparate organizations ranging from the United Nations Development Program to ActionAid and to Bangladesh Rural Advancement Committee (BRAC) advocate participatory approaches with the primary goal of politically empowering local actors.

Through the rhetoric of transformative participation, there is an emerging consensus that political empowerment of individuals can only happen if participatory approaches recognize the need to change the pre-existing political, social and economic structures that produce poverty and marginalize individuals. Political empowerment through participation requires a shift of power, from broader, centralized institutions to decentralized and localized actors willing to participate within a democratic setting and space. Successful attempts to producing political empowerment through participation require targeting the



local opportunities founded by local capabilities and abilities, and allowing individual desire and motivation drive the development process. This type of approach requires development agencies focusing on participation to remain explicitly as facilitators of local needs, allowing individuals to own and control their development process.

## **OPTIONS**

Recent experiences of participatory strategies and approaches to development provide policy makers with a wealth of knowledge for generating and proposing new directions. Any participatory approach however must be transformative for the involved population. This means that participation must lead to political empowerment for success to be achieved. Though the options presented here have not, in practice, led to political empowerment, they are nonetheless important frameworks that have the potential to produce political empowerment through participation.

- **Implementing Participatory Poverty Assessments**

PPA approaches arose from the need to “mainstream” participation within development agencies, addressing the inability for local participation to adequately address the broader political, economic and social structures that affect development programs. By incorporating a broader range of variables for understanding why development has not occurred, PPA provides the comprehensive analysis necessary for acknowledging and confronting the impediments of development programs.

**Strengths:** The strength of PPA is its ability to act both as a means and ends to correcting failing and failed development programs. By involving local knowledge, direct interaction and reliable feedback, PPA allows individuals and groups to engage development as a process of meeting self-imposed desires and needs, preventing development “experts” and “outsiders” from taking control.

**Weaknesses:** PPA approaches do not necessarily produce political empowerment due to the heavy reliance on outside actors. Development institutions control PPA approaches, rather than the local population most affected by development projects.

As the case study in Niger reveals, understanding the locality of poverty and political, economic and social marginality is key for creating effective development programs. Implementing PPA can provide USAID with the necessary analysis and means for

producing political empowerment through participation.

- **Advocating Rights-Based Approaches**

Rights-based and capability-based approaches to development place the individual as center to any development program. By arguing that individuals intrinsically and normatively must be the foremost consideration of development programs, rights-based approaches most directly involve political empowerment. Furthermore, rights-based approaches attempt to address the politics of development programs by highlighting the right of citizens to actively be involved in the production of policy that affects them.

**Strengths:** The strength of a rights-based approach is in the relentless pursuit of establishing more equitable and just power relationships. By arguing that individuals and groups have the right to participate and control the processes that affect their lives, individuals and groups are placed within a more equal field of political relations. Through this perspective, individuals become empowered and capable of managing their own advancement and development.

**Weaknesses:** Although rights-based approaches specifically attempt to produce political empowerment, translating political empowerment into productive development programs has proven problematic. Moreover, rights-based approaches that emphasize the decentralization of governance structures (UNDP, USAID) do not necessarily politically empower individuals and groups to take control and command of development projects. Strategies that promote political empowerment through participation require that control of development programs be transferred to the local actors most affected, rather than remain vested in broader and removed institutions.

The successes that the DFID's Quality of Governance program and ActionAid's REFLECT strategy produce illustrate the importance of a rights-based approach for development. REFLECT promotes the rights and capabilities of individuals and employs PPA strategies for incorporating individuals and groups into their programs. Through advocacy, USAID could incorporate a rights-based approach similar to DFID's QG and ActionAid's REFLECT in order to better address political empowerment.

- **Supporting Participatory Democracy**

Arguably the most direct strategy for individuals and groups to control development programs, participatory democracy strategies squarely address the politics of development programs. Participatory democracy requires the decentralization of governance mechanisms and institutions, giving more policy-making control to the individuals most affected by policy. More local control of development programs incentivizes local actors and groups to enact more inclusive and socially just policies.

**Strengths:** The strength of participatory democracy is in its reliance on local motivation. From this perspective, social movements become important players and participatory democracy strategies can redirect social movement's collective energy into productive policy-making.

**Weaknesses:** Participatory democracy programs did not address the concerns of the most marginalized sectors of societies, revealing the most significant weakness of participatory democracy. Political parties and other civil society organizations are able to use participatory democracy as a tool for their own concerns and needs, rather than supporting all aspects of society.

Nonetheless, the successes of participatory budgeting and city development strategies further corroborate the importance of employing local motivation and energy into productive policy creation. Supporting programs such as Porto Alegre's participatory budgeting or Johannesburg's city development programs provides USAID with innovative means for producing political empowerment through participation.

## **RECOMMENDATIONS**

In order to effectively produce political empowerment through participation, the United States should create and promote a hybrid strategy that incorporates the methods of participatory democracy and advocates a rights and capabilities-based approach. These approaches rely on local knowledge and motivation to plan development programs and as a result, enabling individuals and groups to assume more control over development programs. Moreover, encouraging the creation of participatory democracy models such as participatory budgeting and city development strategies, alongside advocating human rights rhetoric, addresses the politics of development through democratic community

debate and discussion. Drawing upon the successful models established by Porto Alegre's participatory budgeting and Johannesburg's city development programs, and recognizing the successes of ActionAid's REFLECT model, USAID can provide the institutional capacity and innovative ability to mainstream these approaches.

With the new administration and the current political and economic constraints, USAID should develop a new strategic plan that focuses on promoting participatory democracy meanwhile continuing to promote rights and capabilities-based strategies to produce political empowerment through participation.

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## **Chapter 3**

### **IMPROVING GOVERNANCE IN RECIPIENT COUNTRIES**

*Yuko Oso*

#### **ISSUE**

Participants in development projects around the world, including the U.S. government, have been putting a great amount of effort and resources into the projects in countries where governance interferes or prevents those projects from succeeding. It is impossible to ignore the role of governance in development of poor countries. Economic growth and improvement of people's living standards in poor countries can be extremely difficult and costly without effective supply of public goods, such as property rights, security of contract, and universal enforcement of laws. Proper supply of public goods will result in smoother aid delivery, encourage bottom-up approaches, and participation of the public, and allow improvement to take place in more cost-effective manner. Determining what factors contribute to effective governance and the ways to incorporate them into the US government policies is a key to improving the effectiveness of many development projects.

#### **BACKGROUND**

##### **Introduction**

Recent discoveries and great breakthroughs made by the spread of bottom-up development have shed light on new approaches and brought development to a whole new level. Many new microfinance companies have been established, causing several NGOs and international organizations to rethink their ways of operating aid delivery and development projects to incorporate a bottom-up approach into their schemes. However, in the area of improving governance in poor countries, it seems that the change occurs at a much slower pace. The idea that good governance is important for promoting development is not old. In fact, it is relatively new—new enough that anyone has not yet

found a structure that is guaranteed to work. People agree that improving governance in poor countries is important, but many of those projects, despite the amount of money put into them, have not resulted in significant breakthroughs in achieving wealth creation.<sup>1</sup>

There are many development projects around the world that are not directly targeting governance, including health care, education, disease prevention, promotion of human rights, economic growth, and technological improvement. However, no matter how good those projects are, if the government of developing countries is not willing to cooperate, or worse, is trying to interfere with the developmental efforts, it can be extremely difficult to make maximum use of resources put into those projects. It is inefficient to ignore the impact the supply of proper public goods has on people's lives. Poor people do have savings and assets, but they have no legal system to make use of their possessions.<sup>2</sup> They do not have access to property rights, thus to credit, and thus to transactions that can potentially make their lives better. Even if people do have access to certain public goods, the cost of accessing them is often too high that people cannot afford to make use of it.

We need a system in which people have access to public goods at low cost. Promoting effective governance will lead to more inclusion and participation of people into the economy. This will allow them to contribute to the economic growth of a country. If we can achieve participation of more people, it will be easier to foster a bottom-up approach because those at the bottom would be able to voice their needs.

This chapter will explore two of the most famous projects that are designed specifically to improve governance in poor countries and provide some case studies to show what has been going on in this area, what are some successes and challenges, and whether we can learn anything from these to further promote effective governance. The chapter also draws attention to some cases of failed or failing states, in an attempt to make a clear distinction between governance and a government.

## **The World Bank: Worldwide Governance Indicators**

The World Bank is the biggest international organization that focuses on development. Since it was established in 1945, the World Bank has been one of the main players in the field of development through various projects, large-scale loans and aid to

help developing countries. It has also been promoting improvement of governance in poor countries. However, its emphasis on effective governance has been a relatively new concept. In 1996, the World Bank has started what is called “The Worldwide Governance Indicators Project (WGI).” This project is designed to assess and report both aggregate and individual governance indicators for 212 countries and territories for six dimensions of governance:

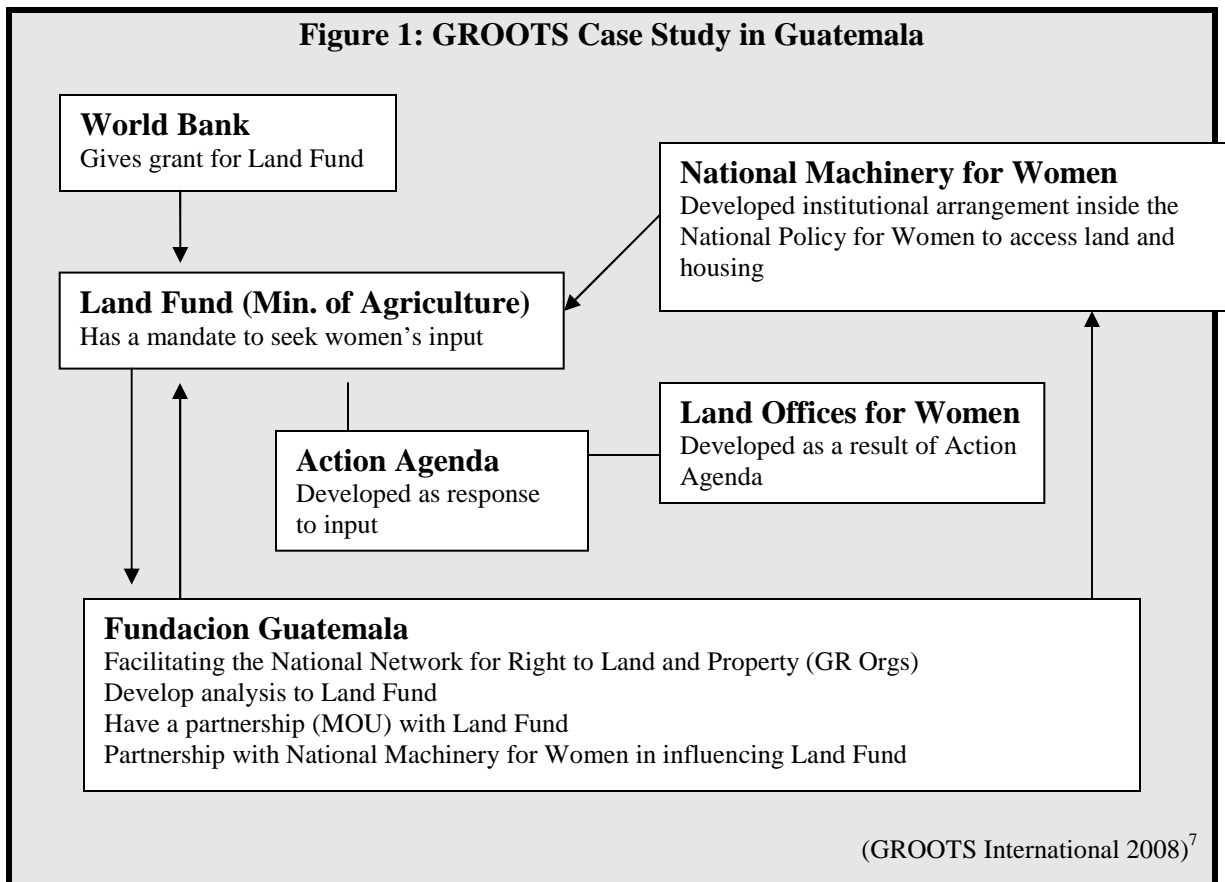
- **Voice and Accountability:** the extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
- **Political Stability and Absence of Violence/Terrorism:** the likelihood that the government will be destabilized by unconstitutional or violent means, including terrorism.
- **Government Effectiveness:** the quality of public services, the capacity of the civil service and its independence from political pressures; and the quality of policy formulation.
- **Regulatory Quality:** the ability of the government to provide sound policies and regulations that enable and promote private sector development.
- **Rule of Law:** the extent to which agents have confidence in and abide by the rules of society, including the quality of contract enforcement and property rights, the police, and the courts, as well as the likelihood of crime and violence.
- **Control of Corruption:** the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests.<sup>3</sup>

These indicators are used to measure performances of governments in relations to countries/regions, indicators, and time. In other words, this database enables us to compare data between different countries and measure how any of above six indicators varies over time. There has been a long standing fallacy that governance cannot be measured. This project by the World Bank challenged this assumption, based on the belief that improving governance would require means of measurement and comparison. Although the World Bank admits that none of the indicators are perfect and has some degree of measurement errors, many meaningful comparisons can still be drawn from this

data, leading to feasible policy analysis.<sup>4</sup> WGI is used by many policymakers and civil society groups to monitor and support various governance reform projects. Aid donors also use WGI, recognizing that the quality of governance is one of the key determinants of development programs.<sup>5</sup> For those members within the development field, WGI can be quite useful. Since they now have visual, aggregate figures that they can refer to and compare when trying to improve governance of a country, instead of struggling with abstract and vague sense or opinions of how the government of a country is performing. WGI is offering a new approach to improve governance and reshape “the framework in which governance reforms are designed, implemented, and assessed.”<sup>6</sup>

### **Case Study 1: From Beneficiaries to Citizens: Grassroots Women’s Groups Drive the Demand for Good Governance**

An international organization called Grassroots Organizations Operating Together in Sisterhood (GROOTS International) has been reinforcing the importance of good governance through focusing on: 1) Shifting the identity of organized women’s groups from that of beneficiaries to citizens and problem solvers, 2) Repositioning grassroots women’s networks as users and collaborators for delivery of basic services infrastructures, and 3) Addressing governance by keeping empowerment and engagement at the center. Under the auspices of the World Bank, GROOTS carried out its operation in Guatemala, using the WGI indicators to improve women’s access to land and housing. The project was carried out as indicated in the following figure.



By focusing on empowering women's group instead of implementing policies from top-down, government level, they become successful in influencing government and responding to people's actual needs.

## Challenges of Worldwide Governance Indicators

There are, however, some challenges and criticisms associated with WGI project. As we can see from Table 1, the sources the World Bank uses to measure WGI come from relatively large organizations or groups. These sources on Table 1 are from 2000/01 indicator, and they use 194 separate measures collected through 17 different sources from "a variety of international organizations, survey institutes, risk-rating agencies, and think-tanks."<sup>8</sup> This suggests that there is a potential for error in measuring these indicators. Because it is likely that the voice of people at the bottom—people actually living in the country—is not included in these figures, there may be a gap between what appears on the surface and what is really happening at the bottom. Although it is quite useful to have

aggregate indicators that are more reliable compared to any individual source, these potential errors can, in many cases, still be quite considerable.

**Table 1: Sources of Governance Data<sup>9</sup>**

<u>Source</u>	<u>Publication</u>
Business Environment Risk Intelligence	Business Risk Service
Columbia University	State Capacity Project
Economist Intelligence Unit	Country Risk Service
European Bank for Reconstruction and Redevelopment	Transition Report
Freedom House	Nations in Transition
Freedom House	Freedom in the World
Gallup International	Gallup Millennium Survey
Heritage Foundation/Wallstreet Journal	Economic Freedom Index
Institute for Management and Development	World Competitiveness Yearbook
Latinobarometro	Latinobarometro Surveys
Political Economic Risk Consultancy	Asia Intelligence
Political Risk Services	International Country Risk Guide
PriceWaterhouseCoopers	Opacity Index
Standard and Poor's DRI McGraw-Hill	Country Risk Review
World Bank	Business Enterprise Environment Survey
World Bank	World Business Environment Survey
World Economic Forum	Global Competitiveness Report

The latest aggregate indicators, collected 1996-2007, are taken from 35 data sources provided by 32 different organizations. It is also trying to decrease the measuring gap by collecting many specific and disaggregated individual variables measuring various dimensions of governance.<sup>10</sup> The quality of data is improving over time, but how much improvement will be required to make a truly reliable data is still in question.

Another challenge associated with WGI is that it is challenging, or in some cases impossible, to link *de jure* indications of governance and *de facto* outcomes of governance. WGI project distinguishes between “indicators that specific laws or rules ‘on the books’” and “indicators that measure particular governance outcomes ‘on the ground’”:

De jure rules: codifies details of the constitutional, legal or regulatory environment, the existence or absence of specific agencies such as anticorruption commissions or independent auditors, etc., that are intended to provide the key *de jure* foundations of governance.



De facto outcomes: are indicators which measure *de facto* governance outcomes that result from the application of these rules. For example, do firms find the regulatory environment cumbersome, or do households believe the police are corrupt, etc.<sup>11</sup>

The problem with this distinction and measurement is that rules or policies implemented at governmental level do not always reflect what is going on at the ground level. Policies and constitutions—whether they are on the book or not—are easy to measure; however, whether those are really accessible from majority of people in the country and whether they are benefiting from those rules are difficult to measure, and therefore often not linked to or considered in specific policy interventions.

## **The U.S. Government: Millennium Challenge Corporation**

The Millennium Challenge Corporation (MCC) is a corporation founded by the United States Government and is designed to alleviate poverty by emphasizing good governance. MCC is based on the belief that “aid is most effective when it reinforces good governance, economic freedom and investments in people.”<sup>12</sup> MCC was established by the Bush Administration in 2004, with a mission to reduce global poverty through promoting sustainable economic growth. MCC’s work is based on four main principles:

1. **Reducing Poverty Through Economic Growth:** The MCC focuses specifically on promoting sustainable economic growth to reduce poverty through investments in areas such as transportation, water and industrial infrastructure, agriculture, education, private sector development, and capacity building
2. **Good Policies Matter:** Using objective indicators, countries are selected to receive assistance based on their performance in governing justly, investing in their citizens, and encouraging economic freedom. Because corruption undermines every aspect of sustainable development, MCC has made fighting it one of its highest priorities.
3. **Country Ownership:** MCC works in partnership with eligible countries which are responsible for identifying the greatest barriers to their own development; for developing their own priorities for a compact, with input from the public, as

well as civil, political, and private sector actors; and for implementing compact programs once they have been approved. Participation in the MCA program requires high-level engagement and leadership by the partner government, as well as civil society and other domestic stakeholders to ensure the effectiveness and sustainability of an MCC investment.

4. **Focus on Results:** Assistance goes to those countries that have developed well-designed programs with clear objectives, benchmarks to measure progress, procedures to ensure fiscal accountability for the use of our grants, and a plan for effective monitoring and objective evaluation of results. Programs are designed to enable sustainable progress even after the funding under the Compact has ended, and each Compact is designed to be finished in less than five years.<sup>13</sup>

MCC's basic structure is incentive-based: a country is considered eligible for MCC assistance and programs when a government of the country agrees to implement certain policies or to improve their governance structure. Once a country is selected for projects, that country becomes responsible for maintaining its eligibility by continuing its reform process and seeking to maintain and improve its overall policy performance on the above indicators. Through this mechanism, MCC is aiming to improve governance in poor countries and supply people in those countries with their needs. MCC uses 17 indicators to determine whether a country is eligible for MCC programs (see Table 2).

**Table 2: MCC Indicators for Country Eligibility<sup>14</sup>**

<b>Indicator</b>	<b>Category</b>	<b>Source</b>
Civil Liberties	Ruling Justly	Freedom House
Political Rights	Ruling Justly	Freedom House
Voice and Accountability	Ruling Justly	World Bank Institute
Government Effectiveness	Ruling Justly	World Bank Institute
Rule of Law	Ruling Justly	World Bank Institute
Control of Corruption	Ruling Justly	World Bank Institute
Immunization Rates	Investing in People	World Health Organization
Public Expenditure on Health	Investing in People	World Health Organization
Girls' Primary Education Completion Rate	Investing in People	UNESCO
Public Expenditure on Primary Education	Investing in People	UNESCO and national sources
Business Start Up	Economic Freedom	IFC
Inflation	Economic Freedom	IMF WEO
Trade Policy	Economic Freedom	Heritage Foundation
Regulatory Quality	Economic Freedom	World Bank Institute
Fiscal Policy	Economic Freedom	national sources, cross-checked with IMF WEO
Natural Resource Management	Investing in People	CIESIN/Yale
Land Rights and Access	Economic Freedom	IFAD / IFC

In Table 2, notice that there are many more indicators compared to the indicators used within the World Bank WGI. In fact, five of MCC indicators are actually taken from the World Bank WGI project. This means that MCC is building on the attempt taken by the World Bank by using WGI indicators (and others) to structure their projects.

MCC's operations have received increased attention as well as expectations. The reason for this is precisely that there has never been any development project, focusing specifically on good governance, which compares to MCC's operation scale. With all the resources it has and new ways of tackling poverty and development, people around the world are curious about how this particular project would turn out. For FY2009, MCC has the budget request of \$2,225 million out of entire \$26,142 million requested for Foreign Operations programs. This number is quite substantial, considering the fact that only three other programs have budget request higher than that of MCC (those three include: Foreign

Military Financing (FMF): \$4,812 million, Global HIV/AIDS Initiative (GHAI): \$4779 million, and Economic Support Fund (ESF): \$3,154 million).<sup>15</sup> As far as the funding is concerned, it is the highest funded governance project at this point.

In addition, many of the projects enforced in different countries, with the help of MCC compact, have been reasonably successful. Since it has been only five years since MCC was established, many projects are still in progress. However, far from complete, those projects have been producing some positive results in helping government to implement laws and improving living environment for the poor.

### **Case Study 2: Millennium Challenge Compact in Madagascar Starting to Pay Off**

Madagascar is one of the 27 least developed countries in the world, with over 80% of its population living on less than \$2 a day. And it is identified that one of the major obstacles to improvement of people's standard of living in Madagascar is a weak land-titling system. Land Tenure Project in Madagascar, with \$36.03 million out of \$110 million compact with the Millennium Challenge Corporation, has starting to see some results in improving land security of people in Madagascar. The four-year compact was signed on April 18, 2005 and entered into force July 27, 2005, seeking to increase land security, expand competition in the financial sector and encourage investment in farms and other rural businesses. Since then, Land Tenure Project has restored approximately 105,900 disintegrating land rights documents in 10 of the country's 29 regional land service offices. In addition, more than 82,500 documents have been digitized. The project's local land management offices have issued approximately 7,400 certificates, securing land for more than 4,950 families.

(Source: MCC 2009)<sup>16</sup>

This case study demonstrates how Madagascar's land security has made improvement, even though progress has been a little slower in terms of number. The fact that the government is able to and is progressing to create a framework and a basis for effective land security management is a key step for enforcing more security rights in the future. Moreover, the government accountability and transparency have definitely improved, and

it is likely that those projects and improvements would continue after the compact is completed.

In a number of similar other cases, improvements are seen not only in specific areas of development, such as the number of people who have legal property rights or number of children who are getting primary education (though of course this is important, too), but in areas of governance as well. For instance, Tanzania started its cooperation with MCC from Threshold Program. MCC's Threshold Program is for countries that are not compact-eligible but are willing to improve its governance, and it is designed to help those countries eventually become eligible for compact programs of MCC. Tanzania's Threshold Program, which particularly focused on controlling public corruption, ended on September 30, 2008.<sup>17</sup> The country is now eligible for MCC compact and has signed the five-year, \$698 million compact with MCC on September 17, 2008.<sup>18</sup> This kind of progress has also been happening in many other countries working with MCC Threshold Program, improving their governance structure and making their way to become a compact-eligible country.

## **Challenges of Millennium Challenge Corporation**

One of the biggest criticisms against MCC project has been its slow progress in “getting projects beyond the planning stage to the point contractors can actually build the roads, irrigation canals, power plants and clean water systems that poor countries say they need.”<sup>19</sup> The MCC did not spend its entire budget for the first few years of its operation, leading to a significant budget cut from the Congress: the appropriation for MCC projects were \$2.5 billion for FY2004-FY2005, and cut back to \$1.77 billion in FY2006, \$1.75 billion in FY2007 and \$1.482 billion in FY2008.<sup>20</sup> Because of their slow process, according to some critics in both developed and developing countries, the budget for aid is subject to a significant reduction every year. Although whether the quality of a project corresponds with how much money put into it is debatable, it can certainly be a threat to many countries that rely substantially on aid coming from the United States.

Another concerning problem with MCC's approach to good governance is that it does not quite succeed in reaching to all the people they intend to help. Because MCC has an incentive-based structure, its assistance programs can be implemented only if the

government of a country is willing to cooperate with MCC to meet all the criteria and carry out projects or enforce policies to improve its governance. This means that people in countries of which government is not willing to make any change or to compromise will be completely left out from the reach of MCC projects. Since its foundation in 2004, MCC has been expanding its operation. 26 countries are currently eligible for the Millennium Challenge Account (MCA) compact funding and 13 countries are eligible under its Threshold Program. Over five years of its operation, 18 countries to date have MCA compacts totaling more than \$6.3 billion.<sup>21</sup> However, whether this number is large enough or is expanding at a fast enough rate is questioned by many critics.

### **Failed States: Governance without Governments**

A failed state, also called collapsed state, is a state that is missing basic functions of governance and thus unable to provide appropriate public services to its citizens. These states are also often involved in and suffer from civil unrests, political disorders, and poverty. Current examples of failed state would be Somalia, Sudan, and Zimbabwe, the top three countries on the ranking called Failed States Index 2008.<sup>22</sup> This ranking, published annually since 2005, examines countries' sustainability and governance in 12 different categories:

- Demographic Pressures
- Refugees and Displaced Persons
- Group Grievance
- Human Flight
- Uneven Development
- Economy
- Delegitimization of State
- Public Services
- Human Rights
- Security Apparatus
- Factionalized Elites
- External Intervention

Somalia, ranked as the most failed state in 2008, had the top (worst) score for eight out of twelve categories. In Somalia, unpopular transitional government has lost control of most parts of the country, including the capital city of Mogadishu. The fights between the transitional government, with the help of Ethiopian troops, and the remnants of the Islamist insurgency are still intensifying. Moreover, these fights have produced some 700,000 refugees, fleeing Mogadishu in 2007, with even more people left behind in the capital.<sup>23</sup> With these chaotic conditions, government of Somalia is unable to control anything; improving governance and delivering public goods to its citizen are impossible at this point. Similarly, humanitarian crisis in Darfur region of Sudan and economic and political disorder in Zimbabwe have contributed to both countries' high ranking in 2008 index. People in these countries, along with many others, are struggling with severe conditions they live in, but in many cases government of those countries are unable or not willing to improve the situation.

However, there are some cases where governance actually emerged or is sustained without a proper or strong central government. For example, in Belgium, there is an increasing tension between the Dutch-speaking Flemings of the north and the French-speaking Walloons of the south, and recently it has led to constitutional amendments, granting both regions formal recognition and autonomy. This means that the central government of Belgium has practically given up unifying the two regions as one. However, this does not imply that people are not provided with public goods they need in order to succeed socially and economically. Most public goods are provided by each region, and the central government does not have many things to deal with anymore anyways.<sup>24</sup> Belgium is known as one of the economically successful states among Europe, with its GDP per capita being \$38,000 in 2008, \$3,200 more than that of Germany.<sup>25</sup> It is now called "the most successful failed states" in the world.

Another example would be the case of Somaliland, a non-recognized state that branched off from Somalia. In Somalia, as it was mentioned in the previous paragraphs, there is practically no central state. The central government has lost control over what is going on in most part of the country, and people are living in violent, chaotic, and uncertain circumstances every day. Republic of Somaliland, used to be a northwestern part of Somalia, claimed independence from the Union with Somalia in 1991. Since then,

Somaliland has been, especially compared to neighboring state of Somalia, very successful in terms of political and administrative systems and economic prosperity. To illustrate some of its success, Somaliland has held three consecutive elections since 2001, has a parliament controlled by opposition parties, and has a booming economy with the active private sector.<sup>26</sup>

This success has been the result of Somaliland's effort to establish a set of administrative bodies based on "traditional Somali concepts of governance by consultation and consent."<sup>27</sup> This means that Somaliland has constructed its governance structure according to local norms, values, and relationships instead of adopting a Western structure that in many ways does not correlate with local voice. Incorporating traditional governance system into a modern state structure has enabled Somaliland to achieve more unification and legitimacy, as well as accountability of the administrative body by actually representing the society it is meant to represent. Somaliland is not yet recognized as a country, and its governance certainly still has some weaknesses to be addressed; yet, it is far more successful and peaceful than Somalia, which by law is still a country.

From the cases of Belgium and Somaliland, it is only natural to draw on a question: Is having a government or a state necessary for having good governance? In the case of Belgium, it seems that the power of the central government is weakening, but two regions separately are governing themselves well by providing necessary public service to its citizen. In Somaliland, too, although not as a country, it is doing well compared to Somalia and most other African states. These cases suggest that there may be no need for the actual "government" to exist in order to improve people's lives through delivery of adequate public goods. Good governance should always be there, but it does not have to be a government. Also, both Belgium and Somaliland cases suggest that what is important for improved governance is taking in people's voices. Even though the central government is weak, Belgium is successful in vibrating its economy and sustaining reliable governance by listening to local people. Even though it is not recognized as an official country, Republic of Somaliland is still managing to be economically, politically, and socially successful by employing a democratic system to make sure people's voices are incorporated in their governance.



The connection between good governance and bottom-up development is precisely this concept of integrating local voice into the administrative, governance system. The fact that governance should not necessarily be tied to government shows that people's input is important. Any development effort should not ignore the importance of effective governance. However, improving governance should not only focus on building a structure but building a structure that works for its people.

### **Concluding Remarks: Challenges and Opportunities**

From the cases and arguments presented in this chapter, it is obvious that improving governance is a key to development and lifting people's standard of living in poor countries. The World Bank's Worldwide Governance Indicators (WGI) have been a basis for measuring performance of poor countries and used by many other international organizations to monitor their development projects. The World Bank is also carrying out projects aimed specifically at improving governance in developing countries, using the WGI indicators to measure their success. One of the challenges WGI faces, however, is the gap between policies on paper and what is actually happening on the ground. In many cases, even though a good policy is written in constitutions, its benefit may not be actually reaching out to its citizens. Conversely, data and inputs collected from the citizens can be difficult to incorporate into an actual policy.

Millennium Challenge Corporation (MCC), founded and run by the US Government, is one of the largest organizations that build on World Bank's WGI project. Based on its principle that development can be most effective when it encourages good governance, MCC has been focusing on building an incentive-based structure that requires government of developing countries to improve its governance to a certain level, in order to become eligible for the development compact with MCC. In addition, MCC has what is called Threshold Program that is designed specifically to help countries achieve improved governance. This structure has allowed many developing countries, illustrated in the examples of Madagascar and Tanzania, to get resources they needed to achieve a better state.

The problem with the World Bank and MCC program, however, is that they are not reflecting or incorporating the voices of the poor. As this chapter discussed with the cases

of failed states, governance and its functions are more effective when people's opinions are integrated into the administrative system. Somaliland example illustrates how important it can be for the development of a country to translate and include traditional norms, values, relationships, and ways of thinking into the governance structure. However, the current structure of most projects for improving governance, including WGI and MCC, lacks the opportunities where people at the bottom can actually speak for themselves and for their needs. Specifically with MCC, for instance, it only deals with the government of poor countries. This is problematic because it automatically eliminates the program-eligibility of the governance body like Somaliland, which may be more effective in providing its people with what they need than most other developing countries.

As an initial five-year, start-up phase of MCC being nearly complete, it is time to think of possible changes we can make to improve this program. Since it is still a new corporation, whether MCC's practices actually translate into better results on the ground, and whether the incentive-based eligibility structure truly inspires and sustains policy reform in recipient countries are yet to be determined. However, there may be some smaller changes that could be made to overall structure of the program. Because much resources is generated into MCC program, it is important for both the US government and developing countries to make sure those resources are used in most effective ways.

## **OPTIONS**

### **• Continue with the current operation of Millennium Challenge Corporation**

The first option is to continue the current operation of MCC with some small adjustments. MCC so far has been achieving some positive results from its various projects around the world. Since it has been only five years since its establishment, it may be just too early to make any significant change to its structure. If we collect more data and case studies from the current operation, we might find a better plan for change in the future. This option is also relatively easy to carry out, since its focus is to keep the status quo. However, although the current model is achieving some progress, there are margins for improvement. Both critics and supporters of MCC have pointed out some weaknesses of the program that could be improved upon.

- **Keep the current operation of Millennium Challenge Corporation, but with expanded possible candidates**

Another option is to make a change in MCC's structure. Instead of limiting possible clients of MCC programs to the government of poor countries, expand that reach to broader categories of governance: for example, non-recognized governance body like Somaliland. This will allow more bottom-up approaches to take place for improving governance, as seen in the case study with GROOTS International and its operation in Guatemala. This is also likely to result in the inclusion of more countries and more people in the program.

A downside of this option would be that it is more challenging to implement. There are many aspects of the MCC structure that need to be addressed and determined, in order to enforce this change. For instance, it will take some effort to determine how big the governance body should be in order to become eligible for the compact. Because it is impossible to include every single small community into the system, there needs to be other criteria for determining the eligibility. Taking this option would involve substantial changes, and thus require more effort to implement. Also, this option is likely to involve some political effort, since some states would be reluctant to give non-sovereign governance like Somaliland a more recognized status.

## **RECOMMENDATIONS**

### **Keep the current operation of Millennium Challenge Corporation, but with expanded possible candidates.**

The United States government should expand the reach of Millennium Challenge Corporation to include broader types of governance that are successfully governing or trying hard to improve governance and lives of people in its region. One of the weaknesses of the structure of Millennium Challenge Corporation is that its program-eligibility is limited to the government of developing countries. This structure has been excluding people living in countries with bad governance; if the government is not willing to improve its quality of governance, people have no other option but to stay in the current situation. Expanding the eligibility to the program would allow more people to be included in the benefits the program can achieve.

Developmental organizations and projects should focus less on improving “government” but on improving “governance.” If a government of a country is unable to supply public goods to its people, instead of disregarding the country as not eligible for the program, we should try to look for alternatives and help those who are actually able to achieve more effective governance. Aid and development effort should go to whoever can make most effective use of them, and not merely because it has a legal status as a government. From the discussion on failed states, it is clear that when governance was established from bottom-up, with more reflection and contribution of local people and their voice, it was more likely to be sustainable and successful in providing people with what they need. When the same amount of money or aid is sent to Somalia and Somaliland, it is most likely that Somaliland will make more progress with it in improving its citizen’s lives.

This is not to say that the US government is ignoring the existence of non-sovereign governance like Somaliland. In fact, the US government is already helping Somaliland in various ways. But the extent that it can help is limited because Somaliland is not recognized as a country. There is practically no official window in the US government structure to deal with something like Somaliland; therefore, transparency on this issue is also limited. In the future, it is likely that the case like Somaliland will emerge in other places of the world. Then, the United States and other countries will eventually need to rethink the current idea of governance.

Giving non-sovereign governance a new level of recognition is certainly a huge step and is going to be challenging. However, as the world is becoming more diverse, this may be the time to reframe our way of thinking about governance. Promoting good governance is ultimately in the best interest of the United States in terms of both in terms of security and prosperity. Because it is of every country’s interest to achieve a secure world, this approach can also be a multilateral effort. The United States can lead the way to achieving a better world.

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## Chapter 4

### COMBATING CORRUPTION THROUGH E-GOVERNANCE

*Chase Sandbloom*

#### **ISSUE**

Efforts to provide development assistance are often plagued by corruption. With economic crisis currently increasing poverty in the developing world, action must be taken to limit corruption and bring relief to the poor. Current US development policy requires countries seeking development assistance to reform their institutions. This policy must change. Long-term goals for limiting the corrupt distribution of development assistance must be coupled with short-term solutions. The poorest populations in the poorest countries are in need of assistance immediately.

#### **BACKGROUND**

##### **Introduction**

A vicious trend exists in political economy: systems of broken governance breed ineffective institutions, which are unable to provide citizens with national public goods. This contagion makes transactions inefficient and ultimately diminishes the wealth accrued to individuals through the process of voluntary exchange. As a result, poverty is rampant in developing world, as well as the need for foreign assistance. It has been common however, for donors to dump assistance into these countries and rely on the corrupt institutions that govern to distribute aid money. Under these conditions, significant assistance funds are lost to corruption, which causes the poor to continually languish in poverty. Corruption is defined as the extraction of development assistance, which imposes a net loss on society.<sup>1</sup> Statistics reaffirm the destructive power of development corruption. In 2008, the Global Corruption Report found that unchecked levels of corruption added US \$50 billion to the cost of achieving the United Nations Millennium Development Goals on water and sanitation worldwide. This is half the yearly global outlay of aid for this cause.<sup>2</sup>

It is unrealistic, and even impossible for the US to call for the immediate reform of all institutions in the developing world in the fight against the corrupt distribution of aid. This will take decades to complete. Instead, a policy must be developed that meshes long-term goals with immediate results to end the destructive forces that limit the value of development assistance.

This chapter will examine both grassroots participation and government audits in an effort to examine comprehensive methods for limiting corruption. Grassroots participation is found to be a short-term solution for limiting corruption when: (1) local citizens are given adequate information to determine the accountability of development projects and (2) local officials listen to these results. Conversely, government auditing is a long-term method to fight corruption because it requires strong legal institutions as a prerequisite to effectively limit corruption. These often do not exist in developing countries. Only when E-Governance is used to manage the institutions of the state will audits be an effective method to limit corruption. E-Governance is defined as the use of Information and Communication Technology to create a transparent interface between citizen and government.<sup>3</sup> Grassroots participation and auditing each create platforms to significantly lessen the corrupt use of development assistance.

## **Why Addressing Corruption needs to be a Priority**

Cameroon is a country abundant in primary commodities. Although agricultural opportunities exist for each citizen in Cameroon, the government neglects the cultivation of these valuable resources. Agriculture production employs 70 percent of Cameroon's citizens, yet the government budget devoted to agriculture is a scant \$106 million. This is slightly more than then \$105 million allocated for the services of the presidency. As a result, only 10 percent of roads are paved and the unemployment rate is more than 30 percent.<sup>4</sup> These dire conditions faced by the poorest citizens in Cameroon have ignited new attempts to assist those most in need as illustrated by *Case Study 1*. Unfortunately, corruption is endemic in the governments and institutions of Cameroon, which limits assistance provided to the poor

### **Case Study 1: Cameroon Development Contracts**

In early 2009, a local government official attempted to coax Mbanda Leo Ganglii, a poor farmer in Boyo, into piecing together a \$572 kickback. Recently, the village had received a \$1,850 government development contract to assist farmers in planting healthy plantain seedlings in 2009. Only by fulfilling bribe demands are farmers in Cameroon guaranteed future assistance from the government. However, Ganglii was unable to collect the full kickback because the destitute farmers in his local community were unable to put together the necessary funds. It is now believed that no development assistance will be given to Boyo in 2010. This vile corruption has made Cameroon an emerging flashpoint for development project corruption in rural Africa.

(Source: Fitzgerald & Swann 2009)

Citizens in rural Cameroon are disconnected from the use and allocation of development funds. This top-down method of aid and information dispersal gives all authority to officials who do not answer to a formal system of accountability. This causes three problems: (1) aid is spent in ways that does not match the immediate needs of each farmer, (2) these officials limit the value of projects by demanding a large cut of the aid for themselves, and (3) donors do not know how their money is being spent. These three actions significantly hinder the development of rural farmers such as Mbanda Leo Ganglii and the confidence of foreign investors. When corrupt government officials become the unchecked gatekeepers of development assistance, corruption flourishes and the poor are forced into destitution.

The corrupt expenditure of foreign aid poses dynamic effects, especially during times of economic crisis. Current economic conditions are impoverishing individuals at a rapid pace. Since late 2008, 100 million people have been pushed back into poverty. Recently, Robert Zoellick, the current president of the World Bank, called for the United States and other developed nations to devote a 0.7 percent of their stimulus package to a “vulnerability fund” for developing country assistance. This fund would set up new development programs for the poor throughout the developing world.<sup>5</sup> However, before the US and other countries contribute increased sums of money to assistance, a comprehensive method must exist to ensure the accountable and transparent distribution of

these funds. As we illustrated in chapter one, currently, these mechanisms do not exist. A cornerstone for the Obama administration must be to foster methods of accountability that ensures an immediate reduction in corruption.

## **Corruption in Development Projects**

In Indonesia, the Kecamatan Development Program (KDP) is one attempt to alleviate poverty and build strong local and accountable governance in rural areas of the country. This assistance platform is funded through government budget allocations, donor grants, and loans from the World Bank.<sup>6</sup> Although this program has made improvements in bringing assistance to the poor throughout Indonesia, shortfalls continue to limit intended achievement.

Each year, the Indonesian government, with help from the World Bank gives money to 15,000 local villages. This KDP contributes an average of \$8,800 to each of these villages in Indonesia. The money is mostly used to surface dirt roads. Within the KDP project, two different checks exist with the intention of limiting assistance that is lost to corruption. The first method employed is grassroots participation. Under this method, accountability meetings take place forcing those in charge of construction to divulge all information on expenditures to the citizens of the local village. This attempts to employ citizens to limit corruption. Government audits are the second mechanism intended to prevent corruption. Their findings present the possibility of criminal punishment for those who misuse aid.<sup>7</sup>

The fundamental shortfall of this program is that it continues to be susceptible to corruption. This is illustrated by a comprehensive examination of these road projects. By comparing the amount of money requested by each village to the true cost of each project, corruption is expressed as a numerical value. Using input data from engineers and surveyors in Indonesia—well versed in Indonesian building cost—it is estimated that across 608 villages in Indonesia, corruption accounted for 24 percent of KDP budgets.<sup>8</sup>

## **Reducing Corruption in the Short-term: Grassroots Participation**

Information, in the form of expenditures and scope of development projects, is critical for local citizens to fight corruption. However, citizens have varied access to

information depending on their country of residence and connections within their local community. In the developing world, it is common for a limit to be put on the distribution of information. This allows governments to dictate the allocation of resources in an effort to maintain power. The KDP has attempted to limit government control of development by encouraging grassroots participation. This provides citizens with the ability to regulate the use of development resources. The grassroots perspective argues that local citizens have greater incentive to ensure the proper usage of assistance funds when compared with disconcerted central bureaucrats, because they benefit most from new infrastructure.<sup>9</sup>

Grassroots participation can be achieved in a number of different ways. In the KDP, two methods were used to increase the participation of local villagers in the regulation of development assistance spending. The first method attempted to increase participation by distributing anonymous comment forms, which citizens could submit to drop-boxes for reading at accountability meetings. The second method involves the distribution of invitations to these same accountability meetings. At these meetings the village elites divulge all expenditure information on KDP projects. Invitations were distributed in two ways: through village elites and also through local schools.

Invitations increased the attendance of village citizens at accountability meeting by 40 percent and comment forms produced hundreds of telling remarks. However, when the effect of these grassroots participation efforts were measured together only a 2.2 percent reduction in missing expenditure occurred, as depicted in Table 1.

**Table 1: Methods for Fighting Corruption<sup>10</sup>**

	Invitations (overall)	Invitation and comment cards from elites	Invitation and comment cars through schools
Change in missing expenditures (%)	-2.2	2.6	-7.3

It is possible to make valuable conclusions about the best technique for reducing corruption by analyzing each grassroots participation method individually. The anonymous comment forms were ineffective because they do not increase the amount of information given to each citizen. These forms therefore produce ineffective results in

limiting corruption on a grassroots level. Conversely, invitations to accountability meetings provide the means for all citizens to access information on development procedures. But distribution techniques employed to disseminate meeting invitations limit the effect of information in reducing corruption. When elites distributed invitations, corruption increased by 2.6 percent, but when schools in local villages circulated these same invitations, a 7.3 percent decrease in corruption occurred.<sup>11</sup> The difference between these two numbers illustrates the lack of transparency that exists when one group in the community is given responsibility to disseminate invitations.

Given the power to distribute invitations, these individuals tend to distribute invitations towards personal supporters. This is a significant hindrance to the transparent circulation of information, which is crucial to the effective enforcement of accountability from the grassroots level. For accountability meetings to be effective in limiting development corruption, invitations must be provided to all citizens. When this occurs, corruption in development will significantly decline.

## **Making Grassroots Participation More Effective**

Policing KDP projects through grassroots efforts produced only marginal results. However, this attempt by KDP gives insight into techniques that are crucial for implementing a grassroots approach that reduces corruption in the short-term. First, all citizens must be adequately informed. For this to occur, distribution of information, and also the venues for accessing the information must be treated as a public good. Just as the postal service delivers mail to each individual in the US, information on development projects must be distributed in a similar manner. This will equip citizens with information on cost of labor and materials, as well as the scope of development projects. If this small change does not occur, citizens will be unable to effectively enforce accountability in development expenditures.

An example of this information strategy was employed in the Kyrgyz Republic. Although corruption plagues local governance in this country, the World Bank launched a village infrastructure program relying on the participation of local citizens to ensure the proper use of assistance. It required villagers to be adequately informed and involved in the use of grants for assistance. This method of participation required minimal

institutional changes and yielded immediate and effective results. Armed with information, citizens acted as the legal system, scrutinizing all costs and expenditures to effectively hold local officials accountable. This method proved to be a success throughout the Kyrgyz Republic. In one village, a government official was forced to recoup misused funds after the village council found that he had misallocated funds originally intended for a development project.<sup>12</sup> As illustrated by this example, citizens who hold transparent access to information foster accountability in development. When the poor are informed, development assistance brings prosperity to more people and poverty begins to decline worldwide.

The second requirement is to establish a precedent for accountability among local government officials in developing countries. Historically, international agencies such as the World Bank and International Monetary Fund (IMF) have undertaken measures to enforce accountability. Under the guidance of development banks, local elites were not held to any standard for accountability. When programs falter under these conditions local officials direct blame towards development banks and officials are no longer responsible for the prosperity of their citizens.<sup>13</sup>

Local elites must be returned to positions of accountability in developing countries. This needs to be done by establishing a system of incentives. For example, if a local village aspires to build a road with foreign assistance funds, the allocation of these funds must occur in a stipend format. This means that local citizens will regularly review the usage of funds used for a particular project. If it is proven that costs match adequate progress then village officials will receive the next installment of money to continue the project. However, if costs do not match progress then the project will stop until funds are put to appropriate use.

Under grassroots participation, where all citizens have access to appropriate information, locals are given the responsibility as whistler-blowers when cost discrepancies occur. By applying the incentive of citizens, who desire to maximize the value of development assistance, a decline in corruption will occur and bring new value to development projects.

## **Grassroots Participation: Creating Immediate Results**

By giving local citizens adequate information to determine the accountability of development projects and ensuring that local officials listen to these results, corruption will be reduced on a short-term basis. This provides the foundation for the legitimate implementation of development projects. When information is accessible to all local citizens, less waste and greater benefit is provided to the entire community. The benefits of this approach are illustrated in Case Study 2.

### **Case Study 2: The Impact of Information**

In Central Sulawesi, Indonesia a delivery truck driver, with orders from the public works department, delivered a bundle of wood on the outskirts of the village. As villagers watched the delivery occur, they began to wonder what the supplies were for and why the village was not involved in the planning or logistics of this project. After inquiring to the driver about the intentions of the project, the villagers learned that the wood was for the construction of a bridge. The citizens demanded information regarding the cost of the materials and the source of funds for the project. In response to these inquiries, the driver told the villagers to be grateful for receiving materials and to accept the bridge construction. The next night, in protest of this project, villagers wrapped the lumber in white cloth that night – the fabric used to wrap those village members who had died.

(Source: Birdsall)

Because these villagers had been fully involved in a previous road development project, the village was exposed to the corruption that too often plagues development projects. This knowledge allows villagers to protest forms of development corruption. By adequately informing and involving citizens in the developing world in the expenditure of assistance, a new level of transparency and accountability can be assured. The value of each dollar devoted to development assistance under this grassroots model is maximized. This ultimately provides citizens with greater benefits and lessens levels of poverty in the developing world.



# Government Audits and Corruption

A system of audits is another technique employed by the KDP to limit corruption within development projects. This is to ensure that each dollar invested in development yields the greatest possible value. Government audits are conducted by the central government in Indonesia with the intention of monitoring expenditures of local officials in KDP projects. Auditing is an expensive and time-consuming process. As a result, the central government in Indonesia only audits four percent of KDP projects.

To examine the effects of auditing in limiting corruption, it is necessary to make audits be a part of all development projects. By making audits 100 percent certain for all development projects, it is possible to measure the true impact of the auditing process in the reduction of corruption. To do this, the central government notified all local officials whose village had been awarded a KDP grant that all expenditures would be monitored. This notification occurred after funds had been awarded to each village but before construction had officially begun.

**Table 2: Methods for Fighting Corruption<sup>14</sup>**

	Audits
Change in missing expenditures (%)	-8.5

With the legal institution of Indonesia enforcing penalties for corruption, audits should theoretically impose incentive to limit corrupt activity. After the certainty of audits had been increased to 100 percent, the amount of missing expenditure was measured and then compared to the amount of corruption that had occurred when the chance of auditing was only four percent. When audits were certain to occur, eight percent of the total corruption was reduced. These reductions occurred in regard to both labor and material costs. Although corruption decreased by eight percent, as illustrated by *table 2*, it proved to be only a small percentage of the total corruption in development projects in Indonesia. These statistics highlight the glaring incompetence of the Indonesian legal system. When local officials have no fear of being prosecuted for their actions, they have little incentive to make expenditures that benefit of the entire community.

## Government Auditing: a Long-term Approach

Government auditing is an inadequate method for achieving immediate reductions in corruption. Although this system reduces small amounts of corruption in Indonesian development projects, auditing will only achieve full reductions in corruption through the improvement of legal institutions in Indonesia and other developing countries. This is a long process that requires developing countries to create systems that effectively prosecute corrupt local officials. Reforming these legal systems will take significant time. In the fight against corruption, auditing is therefore only a long-term option because it requires that developing countries partake in institutional reform. The small benefits of auditing are illustrated in Table 3.

**Table 3: Cost Benefit Analysis of Audit Treatment<sup>15</sup>**

	<b>Equal Weighted Net- Benefits</b>	<b>Distribution Weighted Benefits</b>
<b>Cost of Treatment:</b>		
Monetary cost	-335	-278
Associated deadweight loss	-134	-111
Time cost	-31	-31
Subtotal	-500	-419
<b>Change in rents received by corrupt officials:</b>		
From theft of materials	-367	-224
From theft of wages	-102	-62
Subtotal	-468	-286
<b>Change in Benefits from Project:</b>		
Net present value of road expenditures	1,165	1,165
Wages received by workers	86	86
Other expenditures	-37	-37
Subtotal	1,213	1,238
<b>Total net benefits</b>	<b>245</b>	<b>508</b>

\*All amounts are in US dollars

By examining the cost benefit analysis of the auditing system, auditing is shown to be an effective tool against corruption in the long-term. In Indonesia auditing saves each project an average of \$245, when accounting for missing expenditures due to corruption. This is shown in *Table 3*. When proper legal systems exist around the world, this will be a cost effective technique for achieving accountability in development projects. However, a strategy for implementing these changes is needed. E-Governance is one method to achieve this task. With technology bringing secure legal institutions to the developing world, the necessary foundations will be established for auditing to be an effective long-term procedure for limiting corruption in development assistance.

### **Revising the Long-term Ideals of US Development Assistance**

For many years the foreign assistance was simply shipped to the developing world without knowledge of how the money was being used. But with the backing of the US, multilateral development banks have increased attempts to create accountability in their development projects. Devoting an increased amount of money to supervision efforts has caused investigators to also limit corruption within development projects. Under this new pressure to ensure the effective use of aid, the MCC, which was discussed in-depth in chapter three, is attempting to increase efforts to make aid expenditures accountable. By requiring the establishment of adequate institutions prior to the allocation of assistance, the MCC believes that the corruptibility of aid money will be significantly decreased. Although the MCC's determination for "effective institutions" is highly debated, better institutions are shown to increase both financial accountability and transparency.<sup>16</sup> In the long-term this is a legitimate option to combat corruption within development. By coupling institutional reform with technology, the prospects for creating a future of accountable and effective development projects is bright.

### **Technology in the Implementation of Institutional Reform**

Technology is the gateway to this institutional reform. The E-Governance platform has issued successful transparency and accountability throughout legal systems in several states in India. The late 20<sup>th</sup> century brought fundamental change to politics in the state of Andhra Pradesh, India. Previously, this government had wallowed in many of the same

problems and inefficiencies that plagued other provinces in India. New chief minister Nara Chandrababu set out to alter this trend. To begin, he laid out a bold set of comprehensive goals for the state to reach with the implementation of *Vision 2020*. While these goals covered many different areas, the foundation of this plan focused on creating *simple, moral, accountable, responsive, and transparent* (SMART) government.<sup>17</sup> The implementation of this system was dependent on E-Governance. The use of this technology has increased the legitimacy of government institutions by focusing on the needs of each citizen.

### **Case Study 3: Citizen-Centric Governance**

Recently, Durgi, a small village in Andhra Pradesh lost power. Kiran, a local stone carver, was unable to continue his work in darkness. He then got up, picked up the phone, and dialed the local power company. An engineer on duty took Kiran's call and immediately checked the power tap for Durgi. Realizing that the tap powering Durgi was having problems, the engineer opened an alternate tap that returned power to Kiran and the rest of his village. Meanwhile, work began on the problematic tap. According to Kiran, the entire process took a total of four minutes. Because of the efficiency involved in returning power, Kiran was able to finish all his work for the day. Each of the interaction between Kiran and the power company was also recorded the information is accessible to both the government and citizens.

(Source: Prahalad 2006)

By meshing technology with government in Andhra Pradesh, an efficient government-citizen interface is created that effectively transfers services to the needs of each individual. *Case Study 3* highlights this fact. Kiran's needs were quickly and effectively attended to allowing him to continue his work. Technology is not limited only to the transfer of services. It also has the ability to create legitimate institutions in the developing world that limit the coercive power of local officials.

## **Technology in the Legal Sector: Karnataka Pradesh, India**

The government of Karnataka, India has applied the merits of technology to the legal institution of their states in an effort to systematize the process of property ownership. Legality, in regard to property, is now defined by efficiency, transparency, and accountability. By limiting corruption and outright neglect, which has plagued property ownership in Karnataka Pradesh for decades, citizens have been given a renewed ability to financially empower themselves by quickly accessing the necessary documents needed to prove land ownership. In this state, the department of revenue has computerized all land ownership records. The impact of this system has had the greatest effect on the 6.7 million farmers in the state, because farmers are required to prove documentation of land ownership—referred to as the Record of Rights, Tenancy and Crops (RTC)—in order to receive a bank loan.<sup>18</sup>

The creation of effective legal processes with the aid of technology has produced legal institutions that reflect the needs of each citizen. Prior to the implementation of these computerized land rights, 9,000 village accountants were responsible for keeping track of land records of Karnataka Pradesh. Accountants were overworked – each one served between three and four villages. In Karnataka two documents are required to prove land ownership. The first document is called a register and it indicates the current ownership of each parcel of land, its area, and cropping pattern. The other document is a village map that depicts the boundaries of each land parcel owned by every citizen of Karnataka. Village accountants were in charge of updating records when the sale and/or inheritance of land occurred. Then, the duty of village accountant was to notify other landowners and the local village office. In reality this rarely occurred and the boundaries of land ownership have become highly problematic. Requesting an ownership update usually took between one and two years. The process of attaining an RTC was equally as challenging. It often took one month to obtain the documents from the village accountant depending on the size of the bribe offered by the farmer. Obtaining an RTC usually required a bribe of between Rs.100 and Rs.2,000, but these prices could be inflated to nearly Rs.10,000. In this situation, accountants held power over local farmers and were held to no standards for accountability.<sup>19</sup>

A new system of transparency and efficiency was recently implemented in Karnataka to end the severe inefficiencies that plagued the previous system of property ownership. Computerized land record kiosks now exist throughout Karnataka, standardizing the process of obtaining RTC documents. A farmer can now obtain his records by walking to his local kiosk and paying a flat fee of Rs.15. This service is now available to all citizens. For any sale or inheritance of land, computers automatically make notices, which are then collected by the village accountants. The time it takes to change the title of land has declined from one to two years to three days. This software uses biogon metrics, which authenticates all users using secure fingerprint data and records all transactions and farmers no longer forced to deal with the inconvenience, harassments, and bribes from village accountants.<sup>20</sup> This is a preliminary step for reforming legal institutions. However, for the auditing process to be an effective tool for limiting corruption in the long-term, technology will to create a platform of enforcement so that audits pose effective consequences for the corrupt.

### **Technology in the Legal Sector: Andhra Pradesh, India**

Andhra Pradesh has taken technology beyond legitimating property rights. The government has instead imposed a “results-based management” approach to governance by measuring outcomes and impacts. This holds officials accountable by implementing a grading system that evaluates performance. With the implementation of an online performance monitoring system, every official in every government department is evaluated. Annual targets for sufficient success are set and agreed upon at the beginning of each year. Officials are subsequently required to meet their predetermined performance standard and performance is evaluated on a quarterly basis to ensure sufficient progress. During these evaluations, the chief minister uses video conferencing, as referred to in *Case Study 4*, to communicate with government officials throughout the state.

The implementation of this technology-based system has reversed the corruption culture that previously plagued Andhra Pradesh. Technology has forced transparency to envelope legal procedures, forcing officials to be accountable. This online performance monitoring system has the ability to expose finance discrepancies, enforce a legal code, and ultimately create better governance. This creates the foundation for development

assistance to be allocated efficiently and bring the most benefit to the citizens of Andhra Pradesh.

#### **Case Study 4: The Legality of Videoconferencing**

The Chief Minister of Andhra Pradesh holds videoconferences on a quarterly schedule. The district collectors from all 26 districts attend these conferences in addition to 50 support staff. Additionally, meetings are recorded giving full access to the public as well as the media. Under these technologically transparent conditions there is intense pressure for officials to meet performance targets. In a recent videoconference, the chief minister was exploring different officials in the government when he came across the official in charge of commodity prices. Under the scrutiny of the chief minister it was exposed that he had greatly exaggerated price data. In some cases commodity prices were off between factors of 10 and 100 and the official was publicly embarrassed in front of his peers. Since then, commodity prices have remained accurate in his district.

(Source: Prahalad 2006)

This example of expenditure examination illustrates the effectiveness of technology being applied to the legal foundations of Andhra Pradesh. With the establishment of transparency through the systems of technology, clear punishment exists for those who commit corruption. The officer in charge of commodity prices was effectively punished for his actions.

Through the development of E-Governance, technology has grown from a device that facilitated the connection between government and citizen produce a platform with the ability to create accountability among government officials. The growth and maturation of this system poses dynamic implications for limiting corruption within development projects. By examining the auditing process in Indonesian KDP projects, it is clear that for auditing to be an effective method for combating corruption, strong legal institutions must exist. E-Governance is a method to provide legitimate legal institutions so that government auditing can be a meaningful tool for limit corruption in development.

## **Concluding Remarks: Challenges and Opportunities**

With the current economic challenges facing individuals around the world, assistance from the US and other developing countries has become increasingly valuable and necessary. However, local officials within these developing countries are often disinterested in the prosperity of their citizens. Instead these officials often prefer to embark on corrupt missions that bring maximum benefits for themselves and their supporters. These destructive conditions cause destitution and severely limit the opportunities of each individual. Because these circumstances have come to define many of the countries that receive development assistance from the US, the government has attempted to reform the process of allocating aid. This has resulted in the construction of the MCC, which has attempted to create a new culture for assisting individuals in the developing world.

The approach employed by the MCC is to establish a set of institutional standards that countries receiving aid are required to meet before the MCC provides aid to these countries. This system has created new debate over the standards that are necessary for aid to flow to a certain country. Overlooked in this system of evaluation is the power of citizen empowerment. By giving individuals the information to enforce the proper use of development assistance, the US can immediately increase the value of each dollar devoted to assistance.

## **OPTIONS**

The US is currently at a crossroads in its policy options regarding development assistance: a new administration has been coupled with a deepening financial crisis. This dynamic has caused many to question the fundamental economic foundations that the United States is built upon. The tactics of aid distribution must be highlighted in the future economic policy of the US. In an effort to limit the corrupt distribution of assistance and maximize the value of each dollar being shipped to the developing world it is important to consider three possible options:



- **Use an evaluation system in the allocation of assistance**

This is the current policy being employed by the MCC. It requires countries to meet certain intuitional standards exist before assistance from the US is allocated to a specific country. These standards attempt to ensure that the value of aid money invested by donors in reflected in the benefits that are accrued to the citizens.

**Strengths:** Enforcing a strict code prior to countries receiving assistance from the US, ensures that each dollar devoted to assistance in the developing world yields maximum value. Also, this technique simultaneously achieves better governance by requiring institutional proficiency.

**Weaknesses:** Because each country is an independent entity with variability in institutions, it is difficult to determine universal method for determining effective from ineffective institutions. Additionally, this system is unfair to the poor in the developing world. For these individuals aid is determined not by their actions, but instead by the effectiveness of their government.

- **Advocate effective grassroots participation in the developing world**

By funding NGOs and creating new methods to enhance citizen participation, the US can inform individuals on relevant information of development project expenditures. This allows citizens to enforce the proper usage of US assistance dollars and bring increased benefits for the poor.

**Strengths:** The strength of this approach is that is can occur immediately. Empowering citizens to act does not require institutional reform or any other long-term input to create results. Further, information gives voice to citizen and directly involves these individuals in the process of their own development.

**Weaknesses:** The weakness of this approach is the difficulty of getting relevant information on development to all interested citizens. Even though effective examples of information decimation exist, this process is difficult.

- **Advocate E-Governance to create effective legal institutions**

Under this option, the US focuses attention towards funding the implementation of technology in the developing world to make governance and institutions electronic. By doing this, audits can be effective mechanism for limiting corruption in development.

**Strengths:** This option for limiting corruption in development projects is effective because it meshes well with the current US method to distribute assistance. Under transparent institutions established by E-Governance, the US is given assurance that their donations are not lost to corruption.

**Weaknesses:** This approach will take a long time to implement. Although it promises to eventually reduce corruption in the allocation of assistance, significant funds will be designated to the development of the E-Governance process. Also, this option will not bring immediate prosperity to those currently wallowing in poverty.

## **RECOMMENDATIONS**

Providing a solution to corruption in the allocation of assistance to the development world is a complex and problematic process. The US must respect the sovereignty of borders within the developing world, while also maximizing the assistance that is provided to the poorest citizens in the poorest countries. This should be the foundation that drives efforts to reduce corruption in development. This chapter purposes a hybrid recommendation from the above options: the short-term benefits of advocating grassroots participation must be coupled with long-term goals of funding reformed institution under E-Governance. By creating the most immediate benefit for individuals who currently suffer economic impoverishment and combining it with forethought of technology and better governance, the US is able to reform their development policy increasing the prosperity of individuals around the world.

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## Chapter 5

### CREATING PROSPERITY THROUGH PROPERTY RIGHTS

*Jose M Lozano*

#### **ISSUE**

Capital produces wealth, and an inclusive legal property system has been proven to create capital. Yet, virtually all developing capitalist nations deny legal ownership of property to the vast majority of their citizens. Governments in the developing world have not realized the power of an inclusive legal property system for producing capital.

Moreover, it is disappointing that little or no attention has been directed to solving the problem of informal ownership in development projects coming from the West. As a consequence poor countries mostly have assets rather than capital. Assets are wealth, but assets do not produce wealth. Capital produces wealth. Capital produces economic development. One way to encourage development from the bottom up is to transform these assets into capital, and an inclusive legal property system is the most effective way to do just that.

#### **BACKGROUND**

##### **Introduction**

Entrepreneurship triumphed in the West because the law integrated individuals under one system of property, giving them the means to cooperate and produce large amounts of surplus value in an expanded market. Formal property freed them from the time-consuming local arrangements inherent to closed societies. Even better, with adequate representation in hand, they could focus on their assets' economic potential.<sup>1</sup>

Economist Hernando de Soto writes in *"The Mystery of Capital"* that an overwhelming majority of the population in developing nations do not legally own property. He explains that this inability to formally own property is a major obstacle for the production of capital and thus, for economic development, because capital is necessary

for the production of wealth.<sup>2</sup> In addition, The World Bank organization reported in 2002 that inclusive property law systems are able to allocate more capital to the general population because more credit is available to people who legally own property.<sup>3</sup> With the current large informal property systems in the developing world, most individuals in that region are excluded from owning capital.

This chapter focuses in the significance of a rule of law that includes the poor into the legal property system and why this inclusion stimulates economic development from the bottom-up in capitalist societies. However, as property may refer to a large number of possessions –both tangible and intangible—I will focus on the major and common property of land.

This chapter will first present the inefficiencies of informal ownership arrangements; particularly, it will emphasize the loss of capital formation from existing assets in the developing world. The second part of this chapter explores the legal rights of property as an instrument of capitalism that increases the total economic output of nations (that is, wealth). A third part in this chapter will zoom-in on the abstract consequences of legal property, such as confidence, predictability and credibility that produce concrete results, such as collateral-loans.

Finally, the purpose of this chapter is not to place legal ownership as the sole solution to the problem of poor economic development, but rather as a necessary part for the expansion of wealth. Moreover, this chapter seeks a bottom-up development approach to the problem of poor economic performance. By increasingly including the subjects of development, the poor, into the legal realm of owning property, they will become active and productive participants in the economy.

## **Capitalism, Dead Assets and the Rule of Law**

Capitalism is an economic system in which the means of production and wealth are privately owned. Under capitalism, largely free of government intervention, the market correctly produces the supply and demand of goods and services necessary within societies because of the self-interest –or invisible hand—of private owners to profit.<sup>4</sup>

In capitalism, though, it is important to underline the main differences between assets and capital because they are frequently confused, and a clear understanding of their



roles in the economy is essential for anyone involved in development work. An asset is anything of value, both tangible and intangible, owned by an individual or a group of individuals. Assets have value, but assets do not produce value.

Capital, on the other hand, is any form of wealth that produces more wealth. Capital can be both visible, such as machinery, and invisible, such as knowledge. Capital is essential for economic growth because it simultaneously captures the physical dimension of assets and creates surplus value. The potential to create surplus value, however, is abstract and must be given a fixed, tangible form to become productive.<sup>5</sup> If the potential to create wealth exists, but if it is not converted into tangible form, then it is dead capital.

Most ownership of property in developing nations is dead capital because most of that ownership is in an informal form, which cannot produce wealth from existing capital. Legal ownership, by contrast, can produce wealth from capital because legality has the capacity to produce surplus value by, for example, being able to use formal property as collateral for a loan.<sup>6</sup> This loan, in turn, can be used to either immediately convert the abstract potential of capital into a tangible form or it can even produce more capital, such as a college education.

Finally, in this chapter we are going to refer to the rule of law as the extent to which agents have confidence in, and abide by, the official rules of society. A strong rule of law, where fair, transparent and predictable rules form the basis of economic and social interactions, is fundamental to efficiency and growth in a market economy.<sup>7</sup>

## **The Politics of Informality**

Economic growth relies on a reliable legal structure that encourages individuals and firms to make investments and engage in profitable transactions by giving them greater certainty about the trustworthiness of economic transactions. However, laws are often designed by and for the interests of powerful minority groups. Government policies take place within developing nations, such as bailouts and subsidies, which from an economic and capitalist perspective do not make sense. Although these unproductive policies also occur within industrialized nations, they are more pervasive in the developing world.

Government policies that are influenced by a narrow (usually wealthy) portion of the population hurt the total economic output of a nation. In “The Logic of Collective

Action” Mancur Olson explains that individuals act collectively to accomplish private goods (rather than public goods). He goes on to say that smaller groups are often more effective when pursuing their interests than large groups.<sup>8</sup> These groups are effective because they concentrate resources and they can more easily organize themselves more easily. By contrast, according to Olson, it is much more difficult to organize a large group of people because it is expensive and the potential benefit is relatively small or hard to see because they are rather in the long term.

The law plays a central role in the creation –or destruction—of capital. A legal system that excludes the vast majority of a population from legally owning property must be seriously examined. The beneficiaries of having a predominantly informal ownership sector may be concentrated groups who want to hold political or economic dominance. Powerful small interest groups who benefit at the expense of the public may strategically influence the law to conveniently –and legally—protect their interests.<sup>9</sup> The law can make criminals out of victims and righteousness out of corruption.

Finally, in *The Law-Growth Nexus*, Kenneth Dam assures us that the rule of law is the foundation for economic development.<sup>10</sup> Economic prosperity for entire nations greatly depends on the quality of legal institutions. An inclusive legal property system is a characteristic that identifies all developed nations of the world that has been achieved by, for the most part, successfully placing the interest of the general population first. While recognizing that it is not only the written law what counts but all the factors that shape the rule’s influence, from enforcement to culture to private interests, it is important to observe the rule of law in the developed world to extract legal policies that may be applied to underdeveloped societies.<sup>11</sup> Developing nations and development organizations must work towards pursuing legal institutions that seek to benefit the nation as a whole and regulate the interests of powerful private groups.

### **Informal Property Ownership: A Major Source of Dead Capital**

The key to wealth in developing nations lies in making dead capital become alive, particularly the significant dead capital generated from extralegal ownership of property. Statistics from different reliable sources consistently show the significant value of informal holdings; however, those possessions are dead capital because even though they have value

they cannot be used to produce more, at least not in a significant way. From Asia to Africa to Latin American to the Middle East, there is an extraordinarily large informal ownership sector that prevents existing assets from generating value.

The following table estimates the value of informal real estate ownership in developing regions of the world. The combined estimated total value in the table, US\$ 9.34 trillion, is held but not legally owned by the poor, which means that it cannot be used as collateral or other means to produce capital.

**Dead Capital From Informal Real Estate Ownership in Developing Regions of the World (Urban and Rural Combined) in 1997.**<sup>12</sup>

Developing Regions of the World	Total Population (millions)	Value of Informal Real Estate Property (trillion US\$)
Asia	1,747	2.34
Africa	525	.97
Middle East and North Africa	371	.99
South America	328	1.13
Mexico, Central America	161	.45
China and Eastern Europe	1,611	2.96
Other Developing Countries	191	.50
Total:	4934	US\$ 9.34 trillion

Regardless if it is a house, a parcel of land or a small business, without a legal contract of ownership, existing property is unable to grow in value because they do not have the recognition of a legal document. According to the think tank *Center for Global Development*, not having a legal ownership title or contract leads to limited economic returns on investments.<sup>13</sup> Informally owned property generates small, local, unpredictable, and often inefficient transactions.<sup>14</sup>

Economic activity currently taking place in the developing world is in fact strong in economic transactions and in property value (as the calculated US\$9.34 million demonstrates on the table above). Nevertheless, the current lack of legal property systems

creates discrepancies between actual economic conditions taking place and capital formation. Mexico, for example, represents the case of most developing nations struggling to develop economically. Mexico is a country with an extraordinarily large informal property system and a great amount of economic transactions, such as investments. Yet, capital formation in housing from economic transactions is weak.

### **Case Study 1: Mexico, The Paradox of a ‘Rich-Poor Nation’**

Recent data consistently places Mexico among the top recipients of foreign direct investments (FDI) in the world. Between 2004 and 2006 Mexico was ranked as the 11<sup>th</sup> highest recipient of FDI. Mexico has received more FDI than countries like Italy, Australia, Switzerland, Korea and Portugal did in the same period.

However, data on capital formation from housing in Mexico shows poor performance in relation to investments. Mexico does not figure in the top twenty in gross fixed capital formation from housing for 2006 or in value-added to economic activities (including real-estate business) for 2006. Mexico is a “rich-poor nation,” rich in economic transactions and poor in capital formation.<sup>15</sup>

(Source: Organization for Economic Cooperation and Development, <http://stats.oecd.org>, 2009)

To the extent that Mexico –or, for that matter, the developing world— is not able to guarantee the security of property transactions, the integrity of their property rights and the enforceability of contracts under a legal property system, poor capitalization of property will be the result.

## **Legal Property System and ‘Productive Capitalism’**

One telephone is useless: whom do you call? Two telephones are better, but not much. It is only when most of the population has a telephone that the power of the network reaches its full potential to change society<sup>16</sup>

The rules of the game are central in shaping capitalism to be productive, unproductive or destructive. Unproductive-capitalism or redistribution of wealth, and destructive-capitalism or destruction of wealth are the result of the rules of the game being shaped by and for private interests at the expense of the general public. Unproductive and destructive capitalism seek to gain a larger share of whatever output is generated.<sup>17</sup> Unproductive and destructive capitalism is the result of elite of politicians and businesspeople who have the power to manipulate the law, including property ownership, to advance their private interests

Productive capitalism, on the other hand, is the undertaking of productive activities carried out by entrepreneurs that enlarge the size of the total economic output for any society.<sup>18</sup> Entrepreneurs shape capitalism as productive when they are able to be part of a network of secure, fair and predictable transaction. The rule of law is essential in creating a legal property system that entrepreneurs can trust. When the rules of the game provide secure property rights and fairness to all participants, the result will be a large uniform network of entrepreneurs that will increase the total output of the economy. The larger the network operating under secure property rules, the greater that the total economic output will be. Here, it is important to note that the informal property system is not a single network of entrepreneurs exchanging among each other, but it is rather a collection of small networks that produce limited wealth.

Political economy recognizes the right of legal property solely as a powerful instrument for the multiplication of wealth.<sup>19</sup> Entrepreneurship taking place within the legal system lowers transaction costs and provides a safer-business climate that encourages investments, and investments are essential for economic development.<sup>20</sup> Laws –or the lack of them—that poorly allocate entrepreneurial resources (like capital) undermine increasing the size of the total economic output. Developing nations would be able to create wealth by designing an inclusive legal property system that would transform assets into capital. Among developing nations, China is a case in point. China is a developing nation that has

been experiencing steady economic growth for the last three decades by creating and facilitating entrance into a legal property system. Changes in the rule of law have been integrating the Chinese population into a legal property system that has stimulated the economy.

China started a series of economic legal reforms in the late 1970s. It marked the beginning of experimentation of a modern legal structure, including the passage of the first Company Law—the first comprehensive law that fully delineated the rights and responsibilities for modern companies in China.<sup>21</sup> Authoritarian lawmakers in China have gradually introduced new laws in the last three decades that promote the creation of wealth. The state controlled almost every aspect of the economy in this communist country before this legal reform.

#### **Case Study 2: China, Legal Property Reform Enhancing Business**

Major legal reforms have been achieved in property law since the early 1980's in China. In March 2007, Chinese lawmakers passed a law that offered equal protection for property of the state, for collectives and for individuals. China's rankings of business environment have improved along with an increasing number of legal property reforms.

Under the *Global Business Environment* organization's ranking system, the business environment in China improved from ranking 92<sup>nd</sup> in 2006 to 83<sup>rd</sup> in January 2009. Under the World Bank's ranking system, China's land registration system is strong. In January 2009, The World Bank ranked China as 30<sup>th</sup> best out of 181 countries (including developed nations) in its efficiency in registering property. The methodology used by the World Bank for this ranking was the number of procedures involved in securing rights to property, the average number of days needed to secure legal property, and the cost involved in registering property (% of property value), which were 4 procedures, 29 days and 3.2% of property value respectively for China.

(Sources: "Global Business Environment, 2009", "The World Bank, 2009")

Legal rights of property were virtually non-existent in China before the 1980's. However, the rule of law has become the means of a "legal modernization" that currently affects everyday life in China.<sup>22</sup> Chinese lawmakers, despite their authoritarian ways, have

stimulated economic development by adjusting the law to increase the total wealth of the country, instead of seeking to gain a larger share of whatever output is generated.

## **Confidence, Credibility and Predictability**

Adequately documented possessions produce security in national economies.<sup>23</sup> Confidence, credibility and predictability are an abstract but real part of a legal property system. These elements are essential for the creation of wealth within capitalism because they produce concrete results, such as being able to use a legal title as collateral for a loan. Yet, those intangible instruments necessary for productive capitalism are for the most part absent in developing nations.

The abstract potential of the legal property system has been fundamental in the creation of wealth in current industrialized nations, such as the United States and Japan. These countries owe their wealth to their entrepreneurs' confidence of doing business.<sup>24</sup> When entrepreneurs have the security of their exchanges being properly recognized and respected by society, they are more willing to take on business activities. Moreover, more credit is available in economies where property can be used as collateral.

Today, the United States is a country in which the most important source of funds for new businesses is a mortgage on the entrepreneur's house.<sup>25</sup> In the United States, the most industrialized nation in the world, access to credit is central for creating wealth. This is not to say that a legal property system is by itself sufficient for economic development. Other factors such as academic education, enforcement of the law and transparent governance are also vital for development. Yet, legal ownership of property is a major source of wealth because the confidence, credibility, and predictability of legality are necessary for productive economic transactions.

In developing nations, on the other hand, there is a loss of entrepreneurship because many individuals are reluctant to trade in an environment of insecurity. Insecurity stems from the difficulties that informal property ownership produces, such as the difficulty of identifying and verifying addresses.<sup>26</sup> Uncertainty induces excessive savings, which take the form of unproductive assets or dead capital (instead of active-capital). Owning unproductive assets is equivalent to putting money under a mattress in which no added-value is produced.<sup>27</sup>

*The Center for Global Development* advocates a legal framework that allows assets to be used as collateral.<sup>28</sup> Bankers are more likely to give credit to people who hold legal titles to property because it is more secure.<sup>29</sup> In Cameroon, for example, commercial banks commonly request legal titles of land when lending to people. Nevertheless, the lack of land titles often prevents landowners from securing loans from banks because they cannot use their residences as collateral. The result has been fewer loans available from banks and, thus, one less way to finance development in the Sub-Saharan African country.

### **Case Study 3: Cameroon and Shortage of Collateral-Loans**

The best opportunity into obtaining a bank loan in Cameroon is land backed by a legal title. However, in Cameroon the procedure for obtaining a land title is difficult, which has led to the almost complete absence of banks in supporting Cameroon's economy.

Although, owners with legal land property almost unequivocally qualify for collateral loans in Cameroon because of the security that banks require when giving loans, the number of people holding legal rights to property is small relative to those who informally own property. These numbers match with the World Bank's ranking of placing Cameroon as one of the most difficult places to register property and getting credit.

(Source: "By Cameroon Tribune, June 2008.")

### **Comparing and Contrasting Property Registration Systems**

Current industrialized capitalist nations were not born developed. Each of them went through periods of transition. In the 19th century the United States government, for example, gradually recognized squatters' rights to land. The U.S. developed into a nation that integrated its poor citizens (at that time the majority of the population) into a legal property system. The U.S. government facilitated informal settlers of land into legal proprietors of land by changing the law. If squatters showed that they improved the land that they were illegally occupying then they would be able to apply for and acquire legal ownership.<sup>30</sup> No longer was acquiring a legal title to land by purchase was the only option.<sup>31</sup> Alternatives to acquiring legal ownership of property facilitated the entrance of poor people into the legal land system.



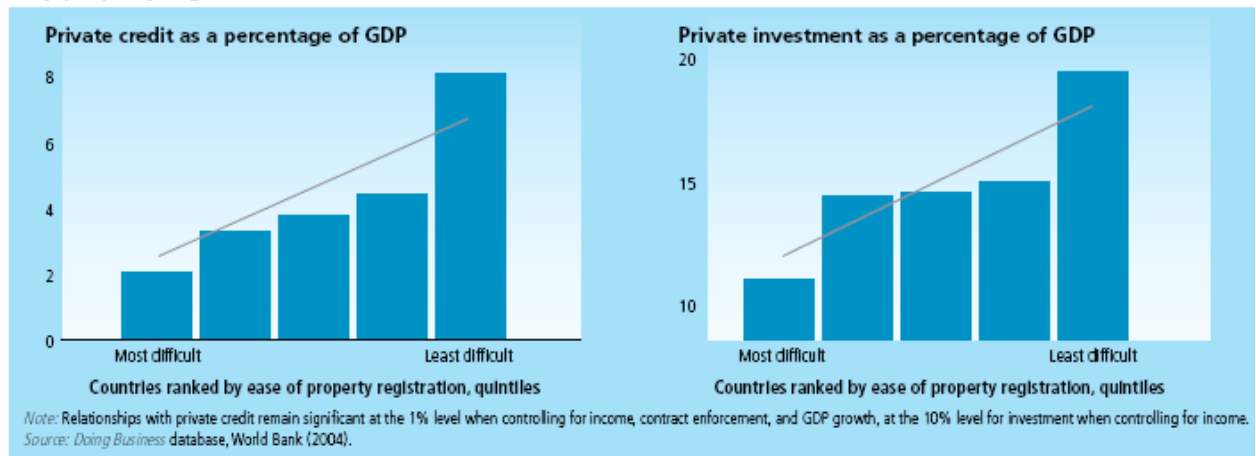
The United States currently remains a country that facilitates entry into the legal property system, and it reflects property registration systems of developed nations (as can be observed in the following table).

Developed Countries	Property Registration				
			Procedures	Time	Costs
			(Steps)	(Days)	(% of Property Value)
<b>United States</b>			4	12	0.5
<b>Canada</b>			6	17	1.8
<b>United Kingdom</b>			2	21	4.1
<b>France</b>			9	113	6.3
<b>Germany</b>			4	40	5.2
<b>Italy</b>			8	27	0.6
<b>Netherlands</b>			2	5	6.1
<b>Spain</b>			4	18	7.2
<b>Sweden</b>			1	2	3
<b>Switzerland</b>			4	16	0.4

(Source: World Bank Group, "Doing Business," 2009)

By contrast, property registration systems in most developing nations today have burdensome entry regulations. High transaction costs and lengthy bureaucratic processes are the norms imposed on property holders attempting to gain legal ownership in those countries. For instance, in the average African country, a simple formal property transfer in the largest business city costs 14% of the value of the property and takes more than 100 days and 26 steps.<sup>32</sup> As a consequence, most property owners choose to operate in the informal economy. The ultimate result of having a large informal economy, though, is economic underdevelopment. As the table below illustrates, easier property registration systems benefit investments.

### *Easy property registration, more credit, more investment*



## **Concluding Remarks: Challenges and Opportunities**

A stable and inclusive legal property system produces capital and, in turn, capital produces wealth. Promoting inclusive legal reforms that help the poor to own property is a solution that will likely have to be implemented from the top-down, but will produce bottom-up results.

In more detail, a legal contract of ownership must be present to provide confidence to individuals in that their transactions will be honored and any disputes, if they arise, will be solved fairly through the legal process. Entrepreneurs will do more business in a country in which the rules of the game are recognized, respected and legally enforced (while this chapter did not focus or expand on enforcement, it is recognized that enforcement is necessary for any legal property system to work). Entrepreneurship is encouraged by the credibility, predictability and security of legal rights of property.

In addition, with any attempt to transition to an inclusive property system that promotes productive capitalism, the technical challenges must be differentiated from the political. Technical challenges will be present in, for instance, the registration, mapping, and quick updating of information. On the other hand, career opportunities and political clout are at stake when development programs seek the economic benefit of the larger population. As we learned in this chapter, when the interests of smaller concentrated groups are at risk, they may react in defense even if it is at the expense of the economic development of an entire nation.

In summary, the total economic output will increase with a legal property system because more investors, both local and international, will want to participate in an economy where there is a formal property system. Although a strong legal property system does not solve the problem of underdevelopment alone, it is in fact necessary for any economic development project because it produces significant capital and capital is the essence for the creation of wealth.

## **OPTIONS**

Based on research provided above, I will present three policy options to achieve integration of informal property owners into a legal property system. Although these options are designed to be used in any developing country, it is important to emphasize that implementing of these options may encounter different difficulties from country to country because factors such as current legal institutions and cultural barriers may vary greatly. Nevertheless, whether encountering easier or more difficult environments, these policy options take complex and diverse situations into consideration.

- **Option: Embark on Outreach Educational Programs**

Embarking on the task of advertising the benefits of a legal property system to the general population through educational programs is necessary to democratically demand an inclusive legal property system from below. Education programs would emphasize legality as the means to create a safe business environment in which investments and transactions would be protected and, thus, stimulated by using legal contracts. Instruction would cover lectures on simple concepts, such as capital and assets, to more complex material, such as the relationship between the law and capitalism, and dead capital formation. This option is an outreach approach that will need steady financial resources and a long period of time to disseminate information about the benefits of a legal ownership as essential for economic development.

A primary objective of this educational approach is to compare and contrast the industrialized nations' legal property systems to those of the developing world. This approach will provide to communities with statistics, reliable sources, and understanding of short and long term consequences of both an informal and formal property system. The

ultimate objective of this policy option is making the general public aware of property law that is rather absent from their lives. The advantage of this approach is that it will be relatively easy to implement as instructors and basic technology, such as a laptops, would be the backbone of this program. The disadvantage is that it may need a long period of time to pass before seeing results and that it will, as a consequence, need steady resources.

- **Option: Collaborate with Lawyers and Politicians on Property Registration**

Work collaboratively with lawyers and politicians to introduce and even institutionalize flexible programs that facilitate property registration. These programs could, for instance, be inspired by some developed nations' histories, and introduce alternative and creative programs, like squatters acquiring a legal title to land if they could show some improvement made to the land they were illegally occupying. Making legal ownership of property available only by purchase restricts the larger population from legal rights of ownership.

In essence, this approach works from the top-down to fix a broken system and to provide people with rules that favor them. As an inclusive legal property system heavily depends on the knowledge and actions of lawyers and politicians, a formal interaction with those groups about our position on economic development must be considered. The goal is to put our development knowledge, financial resources, and advice into directly influencing an inclusive property registration laws in the developing world.

Nevertheless, recognizing the informal ownership of property is the product not only of technological deficiencies or of lack of knowledge about the law, but also about political interests, this policy option may encounter strong opposition from lawyers and politicians. The advantage is, however, that change will take place relatively quickly if there is genuine cooperation from lawyers and politicians.

- **Option: Identify and Implement Technological Needs**

Invest in necessary technical expertise and technology for recording, saving and organizing property information, from basic technology like computers and registries, to advanced technological instruments like engineering systems integration. Providing technical and professional expertise, are necessary for eliminating many obstacles to integrating a legal property system, like time-consuming processes that take even years to

complete because of outdated registries and communication tools. Efficiently recording, saving and organizing information into database systems is essential for facilitating the transition into an inclusive legal property system.

The advantage of this policy option is that technology and technical expertise is readily available in the developed world. However, any investment in technology will only work if there is a political and legal commitment to seek a legal property system. That is, implementing a technological infrastructure supports political and legal property reforms, but it cannot by itself solve the informal property ownership problem in the developing world.

## **RECOMMENDATIONS**

Our primary recommendation is to involve development in political and legal issues by closely collaborating with top level politicians and lawyers in the developing world. Introducing outreach educational programs about the benefits of a legal property system and implementing technology will be most effective if there is the commitment from lawmakers to create inclusive legal rights of property.

It is imperative to respect traditional ownership values of developing nations, such as some communities or families who have deep attachment to land. Our goal of implementing legal rights to property will likely succeed if we can be trusted to spread information about formal ownership. By respecting communal arrangements and traditions we will be able to have easier access to communicate the benefits of legal ownership to the general population.

Also, any policy requires keeping political neutrality when pushing for programs that promote an inclusive legal property system. Our only objectives and public statements must be about achieving economic development through the inclusive legal ownership of property. Therefore, avoiding aligning with or supporting political parties, labor unions or any other political organization is recommended in order to deter accusations of meddling in national affairs.

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## Chapter 6

### SUPPORTING WOMEN'S LAND OWNERSHIP

*Maura M. Harrison*

#### **ISSUE**

The need for a new emphasis on property ownership structures in developing countries has been a recent focus in the aid community. The connection between property and capital is increasingly being shown as one of the most important factors in development. However, the role of women has been neglected in this discussion. A new administration and fresh debate on how aid is disbursed calls for a gendered perspective on the issue of property rights.

Women do most of the agricultural work in the developing world, and yet they are excluded from the enjoyment of the full benefits stemming from the property on which they live and work. Property insecurity leads to economic, social and political exclusion. Additionally, women and their children are vulnerable in the case of a husband's death to "land-grabbing," in which relatives of the deceased husband take all of his property, leaving his wife and children with no productive resources.

Property ownership systems in developing countries are critical for the alleviation of poverty. The links between property and capital formation are numerous, as property can provide collateral for loans, space for entrepreneurship and security in times of famine or economic downturn. As the importance of ownership systems is recognized and addressed in the developing world, it is imperative that women are not excluded.

Women's rights to property ownership, use and inheritance are severely lacking in most of the developing world. As women play such a leading role in development, this fact urgently needs to be addressed. Women may benefit even more than men if included in a formal property ownership system because of the status enhancement that property ownership brings. We must take steps to insure that when implemented, property ownership rights for women are substantial and will effectively increase opportunities.

Nominal ownership will make no difference here. Addressing the issue of women's property rights should be a priority in any discussion of development.

## **BACKGROUND**

### **Introduction**

Women in rural areas across the developing world are denied full access to property; despite their primary role in agricultural production. It is estimated that rural women are responsible for half of the world's food production, and this percentage jumps to between sixty and eighty percent when taking into account only developing countries.<sup>1</sup> Regardless of this reality, there is a significant difference between the amount of work that women put into agricultural production and the amount of control over resource allocation that they exercise within the household.<sup>2</sup> Only one to two percent of all titled land worldwide is held by women. This puts women at an extraordinary disadvantage in terms of securing shelter and receiving income. The disadvantages in property rights that women have in comparison with men exacerbate their already inferior economic and political status. Furthermore, inequality in property rights has been linked to other development-related problems such as lack of education, nutrition and healthcare.<sup>3</sup> In South and Southeast Asia, fewer than one in ten female farmers owns her own land. Land insecurity is synonymous for farmers with food insecurity.<sup>4</sup> Female farmers are particularly vulnerable since their production is usually confined to sustenance rather than cash crops.

Even for those women who are fortunate enough to own their own land, access and control are still limited. In much of the developing world, decisions about production (e.g., what to produce and how to allocate inputs such as fertilizers, tools and seeds) are made by men. This is true regardless of the name on the legal title.<sup>5</sup> The gender gap in property rights is the single most important factor in the gender gaps in economic and social status, and in female empowerment.<sup>6</sup>

### **Women's Exclusion from Property Systems in the Developing World**

A major generator of present inequitable property ownership is the continued existence of inheritance systems from which women are excluded. In many agricultural societies, women do have usufruct land rights, but these rights become precarious in the

event of a husband's death or divorce. For example, in Cameroon succession is patrilineal and women do not inherit land. If a woman's husband dies, she gains control of the land only if she has male children. In fact the wife is not so much inheriting the land as being given charge over it until her sons come of age.<sup>7</sup> In patrilineal systems women have no claim to household property, and thus no access to farm inputs and services or agricultural practices. Matrilineal systems, in which land is passed through daughters, do not usually protect women's land rights any more than patrilineal systems. In matrilineal systems of inheritance, despite women's nominal ownership and inheritance rights, men are the heads of households and have control over managing property.<sup>8</sup> For agricultural households, land is often the most valuable asset, and the ownership and control of this asset leans heavily toward men, in large part because of the existing inheritance systems.

Women lack control over how property is utilized, how the income generated from property is spent, and the disposal of property, whether through sale or bequest. Even in matrilineal systems or in households where the woman is the technical property-owner, the husband and the natal family have more control over property than the female owner.<sup>9</sup> In a study done in Ghana, differing yields of cocoa on property held by men and women was determined to be a result of the difference in access to familial resources or credit and investment opportunities, as well as women's additional work requirements within the household.<sup>10</sup> Property is a male-dominated realm in the developing world, in which men make decisions regarding property and women are expected to comply.

### **Equitable Legal Systems are not Enforced**

Although there are many ways in which women can technically gain access to property, this access is almost always incomplete. For example, land titling, once considered a strong and unbiased way of securing property in order to reap the benefits made available by a formal property system, has now been recognized as a potential threat to equitable distribution of land. Since titling has occurred in many countries with a strong gender bias, systems that were once loosely unfair are now entrenched, especially in many parts of Africa where titling is a relatively recent phenomenon.<sup>11</sup> Although women can gain access to land through inheritance, marriage and informal networks as well as the law, none of these guarantees effective control over or security in property.<sup>12</sup> Various methods of access to land each have their own problems, especially for women. In Mozambique, for

example, land can be acquired per the 1997 Land Law through registration and titling, purchase or through the working and clearing of available land. However, titling is slow and cumbersome, purchase requires capital which women often don't have, and the clearing and working of land requires intense physical labor and a large investment of time. These factors inhibit women from gaining access to land, despite ostensibly equal opportunities to do so. Nevertheless, women still acquire land rights through informal bartering.<sup>13</sup> Gender divisions in property do not render rural women helpless, but they do put them at a great disadvantage socially, politically and economically.

Even when regulatory systems are put in place to protect women's property rights, they are either riddled with gaping loopholes or are so poorly enforced that they are ineffective. The 1974 land reforms in Cameroon created a system that on the surface appears to give equal rights to women, but invisible barriers to take advantage of these rights exist because of women's generally lower literacy and economic status, which make titling and registration significantly more difficult for women. The law also allows uninhabited land to be given to "cultivators" and "developers." Unfortunately, these terms seem to apply only to the cultivation of cash crops grown by men and not the food crops grown by women.<sup>14</sup> Even when legal barriers to women's property rights are technically removed, existing social barriers are insurmountable.

### **Women's Inheritance Rights**

Inheritance is an area in which women are especially vulnerable to discriminatory social norms, regardless of legal verbiage. Moveable assets are difficult for women to hold onto in the event of a husband's death, and immovable assets (land and housing) are almost universally returned to the husband's natal family after death.<sup>15</sup> The phenomenon of "property grabbing," the process in which the family of a deceased husband seize all possessions of the widow and her orphaned children, is common in sub-Saharan Africa.<sup>16</sup> In a study done by the International Justice Mission (IJM) in Uganda, 30 percent of orphans and widows had been victims of property grabbing. Most of these – 71 percent – live in extreme poverty on less than US\$1 per day, making the loss of land extremely difficult to bear.<sup>17</sup> Although land grabbing has been illegalized in many places, women often do not claim their legal inheritance rights for fear of social ostracism, counterclaims

by relatives or of physical harm.<sup>18</sup> Social obstructions to equitable allocation of property are often just as harmful to women as legal ones, if not more so.

Women's rights to land in developing countries are evolving, albeit slowly. A study in Ghana concluded with six goals for women's enhanced access to property. These included the rights to cultivate, rent, pawn, bequeath, gift or sell.<sup>19</sup> These are the most immediately necessary requirements for women's land rights so that they can begin taking advantage of the opportunities that increased access to property provides. The future of women's property rights is critically intertwined with the progress of development.

### **How Women's Disenfranchisement Hurts Development**

The connections between property and development are numerous, especially with regard to women's rights. Women's limited access to property has been linked to various other development problems, including lack of education, hunger, poverty and health problems.<sup>20</sup> These problems are especially compounded because of the close relationship between women's and children's welfare. Results implicate that finances held by women go to a larger proportion of household expenditures, especially those concerning children, than finances controlled by men.<sup>21</sup> Thus increasing women's welfare would have multiplicative beneficial effects because of the subsequent increase in children's welfare.

Property rights are included among those outlined in the international human rights system: under these definitions women have the rights to be free from discrimination, the right to adequate housing, to be financially independent and to earn a living, and the right to own, manage and dispose of property.<sup>22</sup> All of these human rights are violated when women are denied equal access to property rights.

### **Women's Limited Access to Agricultural Income**

An additional connection between property control and development is the obvious connection between agriculture and income for such a large part of the world. Women are not technically responsible for the land they till (even though they do a large part of the work), and so are not allowed to control the income earned from the sale of crops grown on that land. Women are sometimes allowed to keep the income from the "secondary" crops that they grow; whatever is left over after they feed their families.<sup>23</sup> Since women do so

much of the agricultural work in developing countries, and because they have been shown to allocate a larger portion of their incomes to benefit their families, a larger share for them in income generated from agriculture would advance development. This could be achieved more easily if women's property rights were adequately protected.

Women's access to property would further advance development through the increased economic transaction that holding, selling, buying or renting adds to the economy. An increased number of owners in the market for property would mean an increased number of transactions in the property market. The increased access to credit that property ownership entails may also increase women's labor force participation through increased entrepreneurial opportunities. Some hypothesize that adding women to the labor market would lead to greater increases in economic activity than adding the same number of men. A recent paper published by the Copenhagen Consensus theorized that under economic terms, if women start with less capital than men, the returns to capital from work would be higher than that of men's and would thus lead to faster economic growth.<sup>24</sup>

The fact that women usually do not own the property on which they work may also be a hindrance to productivity. Agnes R. Quisumbing investigates this in her study of tree-planting in Ghana. She concludes that under communal tenure regimes common in Africa, the incentive to invest in land is increased as land security increases.<sup>25</sup> This is because proportionately strong land rights are granted to land "developers," who are identified by the planting of trees. In cases where the tree-planting density was lower in areas owned by women than those held by men, it was usually because that land had been gifted to women as insurance from their husbands.<sup>26</sup> Men recognizing the risks that their wives and children faced would give land to their wives in order to better secure their families' futures. This type of behavior is dubbed "strategic planting." Disregarding strategic planting, ensuring women's property rights could bolster economic development by providing incentives for women (the primary agricultural producers in developing countries) to increase yields.

### **Women's Diminished Access to Capital**

Probably the most significant way in which encouraging women's heightened access to property is its effect on credit opportunities. As De Soto and others have theorized, effective legal property systems are the key to capital formation and economic prosperity. Women in Kerala, India reported that they suffered from lack of access to



banking and credit, and many of them had been refused loans because they couldn't come up with collateral. Women who can't receive loans through the formal sector are forced to resort to informal lending at high interest rates or pawning gold and other assets.<sup>27</sup> Neither of these methods for obtaining credit is realistic for entrepreneurship; these are ways of getting money in a pinch. Thus women are excluded from the world of business.

Throughout the developing world, female-headed businesses are relatively capital-poor in comparison with those run by men. In agricultural business, women farmers have poorer access to machinery, fertilizer, and extension information. Increasing women's access to credit through increased property ownership would not only improve their business opportunities, but has also been shown to enhance their bargaining power within the household.<sup>28</sup> Property rights, and especially those controlled by women, have been repeatedly shown to advance development goals. However, their implementation has been slow and weak.

## **Underlying Causes of Discrimination in Property Systems**

### **Traditional Devaluation of Women's Work**

Traditional social norms, when translated into formal law, have compounded women's inferior status and rights. In the past, women's limited agricultural role and perceptions of women's roles led to constraints on what women were allowed to do and thus to their contribution to agricultural production.<sup>29</sup> These constraints are consistently being challenged as women play a larger role in farm work, but the traditional views remain entrenched, creating an uneven society in which women's legal rights to control property are disproportionately small in comparison with the contribution of women to production. Women's work is considered reproductive work and does not deserve access to agricultural or veterinary services.<sup>30</sup> Despite the social changes that are taking place in household structures as women contribute more to the production of food, legal code is often outdated and supports the traditional inheritance and ownership schemes. When land reform was undertaken in Ethiopia, the cultural taboo against women engaging in farm work was codified, and gender divisions of labor were reinforced.<sup>31</sup> When land registration occurs, women are often not included as men are seen as the traditional heads of households.<sup>32</sup> In Rwanda, for example, it has been assumed that women are under the care

of men, and so they have no need of property rights. They also could not engage in community work, wage labor or enter contracts without the permission of their husbands or fathers.<sup>33</sup> These traditional assumptions about the role of women are constantly being eroded by changing household structures, but where they have been codified into law the change becomes complicated.

Marriage law, (both customary and legal), especially in sub-Saharan Africa, has important implications for women's land ownership rights. The continuing practice of wife inheritance, increasing numbers of couples cohabitating without getting married and the tradition of polygamy are all detrimental to women's property and inheritance rights.<sup>34</sup> Polygamous marriages are especially problematic for solving issues of inheritance in case of widowhood, as men in polygamous marriages often register only one wife, leaving others extremely vulnerable.<sup>35</sup>

### **Legal Perpetuation of Women's Inferior Status**

There are many barriers to change, including inadequate laws and feeble enforcement, women's lack of awareness about the laws protecting them or about how to seek help in case of violation, and the prevalence of traditional norms which often contradict statutory law and civil rights.<sup>36</sup> It must be taken into account that even in situations where social and legal law are increasingly addressing women's rights, female heads of households start with a tremendous disadvantage. Accumulated capital, necessary for the purchase or rental of property and investment, belongs mainly to men, and so women have trouble entering the property market. This prevents them from accumulating more capital, which in turn prevents them from purchasing land, constituting a vicious cycle.

Dualism in legal systems also results in confusion about women's land rights. Both formal and informal systems can be consulted to determine lines of descent and inheritance.<sup>37</sup> In Mozambique, there is a problem of dualism in land tenure: some are allowed to continue indigenous practices while others subscribe to law.<sup>38</sup> This type of situation is not unique. Many African countries wrote or rewrote the legal codes that are in existence today in the 1970s. The laws often had special exceptions for certain ethnic or religious groups, in order to protect cultural practices. However, these exceptions have

created situations in which women's property rights are not legally protected, leaving many women vulnerable.

Religious and ethnic customs are still practiced, regardless of whether or not they are sanctioned by law. Governments often practice duality in the law by which certain ethnic or religious groups are exempt from regulations that would (theoretically) otherwise make the distribution of land more equitable in favor of women.<sup>39</sup> In Mozambique, customary law takes precedence over religious law (the population is predominantly Muslim). This is one of many examples in which, since customary law is not codified, women's legal rights are ambiguous and no real grounds for protection of property exist.<sup>40</sup> In both Africa and Asia, legal loopholes compromise nondiscrimination in property disputes, or religious and customary law are more closely followed than statutory law.<sup>41</sup> Although religious law is often more fair to women than customary law in matters of daughters' rights to inheritance, Islamic law does not provide for women's land rights in cases of widowhood or divorce. Hindu law also denies inheritance rights to widows and daughters and discriminates in the provision of land rights to divorced wives; fathers are considered to be the defunct heads of households and legal guardians of their children. The divergence between statutory law and traditional or religious law is often detrimental to women's legal property rights.

## **Problems with Current Methods of Addressing Women's Property Rights**

### **The Pressing Need for more Research**

The importance of continuing research on the issues of women's property rights cannot be underestimated. The full repercussions of all actions must be scrutinized in order to avoid negative externalities or unintended consequences. Property is an incredibly important issue because of the ties it carries to other areas of development, but these ties also make it an extraordinarily complex topic. William Easterly recommends randomized controlled trials (RCTs) as an effective way to overcome the lack of evaluation that plagues aid distributors.<sup>42</sup> The strategy for addressing women's ownership must take into account current research, and must be carefully evaluated and flexible enough to change according to evaluation.

## Poor Enforcement and Legal Dualism

Even when laws that favor women's inheritance and ownership are put into place, knowledge of these laws often does not reach the farthest corners of rural areas, which is where they are most needed. Low levels of education and female empowerment make it difficult for women to become informed of their rights under statutory law or their options in case of violation of those rights.<sup>43</sup> The dualistic nature of legal systems, especially in African countries, creates problems for establishing a clear line of legality with regards to property rights, especially for women. Some scholars argue for less sensitivity about customary law in Africa, saying that this sensitivity can hurt individual land rights, undermines democracy, that it empowers local cadres and creates institutions that do not easily change.<sup>44</sup> They maintain that customary law is dynamic and ever-changing, and not some sacred relic of the past that needs to be codified and protected. This, the argument states, will lead to a misguided perpetuation of the "world of the customary."<sup>45</sup> As population increases lead to gains in the value of land and the incentives for titling subsequently increase, dualistic legal systems create rising amounts of conflict and confusion regarding inheritance and property ownership.<sup>46</sup> Dualistic legal systems, especially prevalent in Africa, were created to protect minority cultures, but have often ended up hurting women.

Enforcement mechanisms for laws protecting women's property rights are severely lacking at best. Even when proper laws are in place, they often make no real difference in the lives of women because traditional customs are followed without regard for or even knowledge of the law. It is believed that securing women's legal property rights will increase women's access to productive resources within the household, but this is not always true. The significant difference between law and life is due to lack of effective enforcement. Many governments in developing countries are weak and lack the funds or mechanisms to enforce the laws they pass, especially in rural areas that are distant from the seat of government. Furthermore, governments often are reluctant to adopt international norms into their legal systems because they are viewed as incompliant with national interests.<sup>47</sup> In order for the laws to be effectively enforced, the government must be able to penetrate the most distant agricultural areas, which is where the laws are least likely to be accepted or followed. There also needs to be an independent judiciary which is capable of

enforcement.<sup>48</sup> This is far from the reality in many if not most developing countries. Although legal reform is an important and necessary step in the alleviation of discrimination against women in property issues, the law alone is insufficient to bring about change, especially in countries where the government is incapable of reaching into the most remote areas to implement change.

Some legal reform has even backfired, entrenching traditional inheritance or ownership systems and diminishing the usufruct rights to land that women held under customary law. Land titling programs, while often initiated in attempts to overcome inequitable distribution, can often mistakenly lead to the formalization and legalization of these systems.<sup>49</sup> The victims in the formalization of inequitable property rights systems are usually women. For example, in Ethiopia beginning in the 1970s, “land to the tiller” reforms were undertaken which lasted until the early 1990s. However, the officials in charge of the program favored customary inheritance and gave female heads of households smaller parcels of land.<sup>50</sup> Women may even be more vulnerable under formalized systems of inequitable rights because the customary usufruct rights can now be legally overruled.<sup>51</sup> This happened, for example, after the land titling in South Africa.<sup>52</sup> It is crucial to be wary of easy solutions that may hurt women by making the current situation worse and more deeply ingrained.

### **Ineffective Legal Ownership Systems**

There are some areas, too, especially land-rich areas in parts of sub-Saharan Africa, where title and registration are seen as unnecessary and are often unused and neglected. In these places it might be a waste of time to individually title all landowners (a huge undertaking), since it is likely that titles will be disregarded. For example after land registration in Kenya very few people maintained up-to-date records of land tenure simply because the costs of doing so were not worth the added security.<sup>53</sup> The value of land or property in these relatively land-abundant areas must be sufficiently high in order for the increased costs of transaction resulting from legal titling to be considered worthwhile.<sup>54</sup> In these places, women’s access to land should still be protected, but titling may not be the best way to achieve this protection.

As women gain awareness of their legal rights, the demand for advocacy and advisory services to help settle disputes will surely grow. The most recent report from the

USAID Women in Development (WID) on this subject identified three actions to increase legal support for women who want to bring property claims to court: making services and information readily accessible to women, establishing the legal infrastructure, and using new methods of making sure that both are reached by the women who most need them.<sup>55</sup> It is important to provide women with accessible and helpful legal services as they become aware of their rights and attempt to protect them. A shortage of help in this area could be disastrous as it may discourage women from seeking aid in the future.

There are several organizations across the developing world that address issues of women's property rights. As this area of international aid grows, it is important to maintain high levels of communication and cooperation between aid organizations. These organizations can work together on promoting legal reform and implementing specific programs to help enforcement. Men should also be included in the process of protecting women's access to property, as most politicians and other decision-makers in developing countries are men.<sup>56</sup> No potential allies should be disregarded in the struggle for securing women's property rights, as it is an issue that concerns everybody.

## **Promising New Approaches to Confronting the Issue**

### **Working Locally**

Legal reform and advocacy is an area in which smaller NGOs can have a considerable impact, perhaps more so than large organizations. Since educating individuals is such an important component in the process of protecting individual rights, participation at the local level is necessary to instigate change. Securing rights for women is essential to democratization, and yet the political will for confronting this issue is weak. Women's property and inheritance rights can only be guaranteed when general attitudes toward women change, and this change must include even the most isolated communities. This type of change is most often generated at the local, rather than the national level. The link between gender issues and national development is one that cannot be ignored. Support for small NGOs that provide education and legal advocacy to women in rural areas will help to ensure that no one is excluded from the movement for women's property rights.

## **Increasing Education**

Education is one of the most important tools for securing women's rights to land and inheritance. An IJM study in Uganda shows the connection between education and the protection of women and children from property grabbing.<sup>57</sup> In Cameroon, there is a need for civic education as well as education for those responsible for land titling and registration. One way of promoting this knowledge in rural communities would be to find and emphasize traditional or religious tenets that honor women's authority or rights. Legal reform that accounts for these facts will be more effective.<sup>58</sup>

### **Case Study: The IJM in Uganda, Zambia and Honduras**

The International Justice Mission (IJM) is an NGO that provides access to lawyers, AIDS treatment, and job training among other things. They have recently begun providing community workshops on property rights. Participants get an education on Uganda's inheritance laws and they learn how to create wills. The IJM has been working in Uganda since 2002 where they provide legal advocacy for individuals as well as training for the community and for religious groups. Religious leaders are encouraged to use the funeral of the deceased as an opportunity to make sure the widow's and daughters' land rights are protected.

In 2005 in Zambia the IJM won 60 court appeals for the inheritance rights of its widowed and orphaned clients. Without the advocacy of lawyers from the IJM, these women would most likely have ended up landless.

IJM's founder Gary Haugen believes that legal empowerment is the most important tool for development. His goal is to accomplish this through professionalization of police and court officials and through providing legal advocacy for the poor.

(Source: International Justice Mission, 2008: [www.ijm.org](http://www.ijm.org))

Information about women's ownership rights does not always have to be transferred through stale workshops. Creative methods of distributing information are more effective because they are better remembered, understood and applied. This can include folk theatre productions illustrating the importance of women's property rights, traditional songs whose words have been changed to encompass the message of women's inheritance

rights, mock trials or funerals and personal testimonies by public speakers. There is much untapped potential for this type of knowledge transfer.<sup>59</sup> Furthermore, complete overhaul of traditional systems is not necessary for change. For example, polygamous marriages can be accommodated into more fair systems for women if the law requires that a husband be able to prove that he can provide for all of his wives and children in the event of his death. Community events can be used as a platform for promoting women's rights. Most religious and cultural traditions emphasize equity and fair treatment as well as respect for human dignity. Stressing these aspects of custom can support positive changes in the lives of women.<sup>60</sup>

Media programs can also be a useful tool for education. The Women's Media Center (WMC) in Cambodia puts on television announcements and performances as well as radio broadcasts in order to better inform women of their rights. In a survey of 80 individuals, 100% were aware of the WMC broadcasts, and 60% of respondents reported that watching the broadcasts had led to further discussion of the topics encompassed therein.<sup>61</sup> Media programs are a clever way to get people's attention, but many of the poorest rural households do not have access to media resources, and so this must be a supplementary, rather than a primary method of educating the public about women's rights to own and inherit property.

It is important that as women become more educated about their land rights, legal and advisory services increase concurrently so that women will have opportunity to use their new knowledge in protecting their rights. However, it is also imperative that as women increasingly become aware of their rights, the supply of lawyers and legal services is not depleted. Further funding for organizations such as the IJM is an important challenge for the future.<sup>62</sup>

Another way in which women are gaining buying, renting and decision-making power is through increasing economic opportunity. Any activity that increases financial independence for women will indirectly increase their bargaining power and thus their security in property rights. A direct link between women's property rights and their overall economic status has been proven.



## **Increasing Women's Political Freedom**

Ending the cycle of poverty and property insecurity requires adequate legal services, gender-sensitive legal reform and budgeting, and increased access for women to investment and technical inputs for production. One way of increasing the chances for this type of legal change is ensuring that women have a place in political decision-making, perhaps by providing support to women who run for office. Increasing women's involvement in politics and political autonomy through women's groups is another way to make sure women's rights are protected. Women in government are much more likely to be conscious of property issues. Realizing the low status of rural women, many measures have been introduced in India to involve them effectively in socio-economic development. One such measure is the empowerment of rural women through the Panchayati Raj Institutions (PRIs) by reserving one-third of the seats in accordance with the 73<sup>rd</sup> Amendment to the Constitution.<sup>63</sup> Similarly, the Sri Lankan government has become aware of problems resulting from multiplicitous legal systems, and has taken steps to reconcile contradictory legal provisions. In this way the government hopes to eliminate inequitable aspects of Sri Lankan law and provide women with equal opportunities to benefit from property ownership.<sup>64</sup> Legal reform is a necessary first step in ensuring gender equality in property rights. The cost of nominally implementing this type of legal reform is purely political or social. In many countries the appropriate laws already exist, and have only to be implemented and enforced. Unfortunately the cost of implementation and enforcement is often financial as well as political. The effectiveness of legal reform is contingent upon the government's ability to uphold the statutory system, and also upon the leadership of other groups in society.<sup>65</sup> Legal reform also requires the education of both legal and traditional authorities as well as individuals on the ground, especially in rural areas where statutory law might come into conflict with customary law.<sup>66</sup> But legal reform has to take into consideration the real situation in rural areas. Emulating western property systems will be ineffective if the new law does not provide incentives to comply or is too alien from existing social and political norms.<sup>67</sup>

## Technical Training

Another obstacle to women's property empowerment is the absence of technical education about agriculture specifically geared toward women. Some suggested solutions to this include initiating women's networks that primarily look at women's agricultural issues, promoting gender sensitization in farming, and creating national training programs for women farmers.<sup>68</sup> Encouraging the development or expansion of independent women farmers' organizations could help female farmers to share agricultural knowledge, capital, and markets for their goods.<sup>69</sup>

Non-governmental organizations have lots of potential in advocating women's property rights because of the vastness of the area in which this program will need to be implemented and also the range of necessary steps to tackle this issue. For one organization to single-handedly take on this task would most likely be disastrous. Poverty is alleviated by what William Easterly refers to as "searchers," who find solutions through trial and error and closely monitor the results of their work, adjusting as necessary to maximize success.<sup>70</sup> Small, not-for-profit NGOs have an advantage in this area because of their familiarity with local situations and their frequent ability to bypass bureaucratic entanglements. Locally-based projects often have beneficial externalities: they force the engagement of local community leaders and officials which increases project sustainability, and the result in greater and more inclusive results.<sup>71</sup> The government can easily support these efforts, Women in Development has already been funding a Small Grants Program specifically designated for this cause. When aid is passed directly through governments, much is lost in patronage and bureaucracy.<sup>72</sup> Thus there is much to gain by giving aid directly to NGOs. But we must be wary of "donor fragmentation."<sup>73</sup> NGOs focused on the same issues must communicate with one another. The Small Grants Program also facilitates coordination between NGOs with a common purpose, as they meet once a year to discuss methods and progress.

### **Case Study: Women in Development's Small-Grants Program**

USAID's Women in Development branch has started a Small Grants Program specifically geared toward NGOs that work with women's property rights in developing countries. "NGOs involved in the NGO Small Grants Program have made enormous strides in promoting and securing women's property and inheritance rights. Taken together, their accomplishments include: a dozen new pieces of legislation drafted; nearly 900 cases on women's property and inheritance rights supported with legal assistance; complementary funding provided by 12 donors; 75 TV and radio programs broadcast; 1000 workshops conducted; and nearly 49,000 women and 16,000 men trained in how to redress property and inheritance concerns."

(Source: Steinzor 20)

There are many potentially beneficial programs already in practice to help advocate for the cause of women's property rights, and many more opportunities to invest further. No single approach is sufficient on its own to overcome the barriers to women's property ownership; a combination of tactics will be necessary to address this issue.

### **Changing Social Norms**

Social norms are also changing. Male owners are increasingly giving land to their wives and children. In western Ghana, for example, family land is gifted by men during their lifetimes to their wives and children to secure their future land rights. Incidence of this has recently increased, and the reason given for these gifts is usually as payment or gratitude for wives' help in cultivating the land.<sup>74</sup> Will-writing is another way of reducing the potential vulnerability of wives and children in the event of the husband's death. However, in a study in Uganda 92% of those interviewed had not written a will, and most of those said the thought had never occurred to them.<sup>75</sup> One possible way to overcome the sometimes negative consequences of land titling is to ensure co-ownership for co-inhabitants. Co-ownership of marital property ensures that women have full legal access to the income that can be generated by property ownership.<sup>76</sup> Civil marriage usually provides some legal protection as well, as marriage clauses often protect women's inheritance rights. Gender-sensitive legal reform that protects the rights of occupants as well as owners and law that ensures uniform inheritance would greatly buffer women's land security.<sup>77</sup> The South African government has been innovative in its land reform, initiating the Communal

Property Association Act in 1996 by which individuals can acquire land if they are members in a communal property association.<sup>78</sup>

An interesting evolution of land rights that is taking place spontaneously is the acquisition of decision-making powers through “sweat-equity:” as women take on larger roles in agriculture, their influence necessarily increases as they become relatively more knowledgeable about farming techniques and requirements.

## **Concluding Remarks: Challenges and Opportunities**

In the current economic and political climate, a change in how we distribute and monitor development aid is inevitably underway. A closer look at efficiency, transparency and accountability of aid organizations will be necessary in order to remedy the past failures of development aid. With a new approach should also come a reevaluation of what project areas need to be prioritized.

Women’s property rights are one of the most important issues for developing countries today. Although the problem of securing property and inheritance rights is a complex one, there are many approaches to addressing the current problems with property law and enforcement as well as people’s awareness. New information is emerging that will greatly bolster new attempts to confront the gendered inequity of land distribution and control in the developing world.

## **OPTIONS**

- **Increase funding for small grants to NGOs that specifically address property rights. This can be done through the USAID’s WID Small Grants Program, or through some other mechanism.**

Large multilateral institutions or programs are often ineffective in matters of property rights, because the situation differs so much between areas and because these organization are often unfamiliar with local customs and laws. NGOs can be instrumental in effectively using aid to make sure that individuals are benefiting, and they can easily use different approaches in different areas, whereas this is difficult for larger institutions. NGOs are also more capable of measuring their own success, and adjusting their approaches to enhance this success.

If USAID is to increase aid for non-governmental organizations, there are several implications. In order to address liability issues, USAID would also have to bolster its monitoring mechanisms and have some system of measuring and rewarding NGO success. The Women in Development's Small Grants Program is currently a relatively small project, but its results are promising and its expansion would be an effective way of increasing US funding of NGOs that address the issue of women's property and inheritance rights.

- **Fund further research on the connections between women's property and inheritance rights and development, and for the evaluation of NGO effectiveness.**

It is absolutely necessary to get away from the endorsement of programs with no feedback mechanisms. These are usually ineffective and use unnecessary amounts of resources while accomplishing very little. Increasingly monitoring NGO effectiveness and working together with organizations such as the Poverty Action Lab at MIT that already evaluate the success of aid intervention will ensure the effectiveness of aid.

Further research is also required on the connections between property ownership and development, especially for women. Bolstering the arguments made above with additional research will draw attention to the significance of this topic and may help to inspire a greater focus on this area.

However, research on its own will not end the inequity of property ownership systems. This research will be useless unless it is utilized to change the current situation.

- **Work with willing governments to increase on-the-ground enforcement of women's property and inheritance rights through funding, advising and assistive training programs. Expand on this even more by working with these governments to undertake comprehensive re-registration and will-writing programs that recognize co-ownership of shared property and reinforce women's rights to own and inherit property.**

As we have seen, legal reform is completely useless unless it comprehensively addresses issues of inequity and is gender-sensitive to ensure that women are not left out of a legal property system. The most effective ways of reforming property systems to include women are recognizing co-ownership or legally recognizing inhabitance rights as well as

ownership rights. Ensuring that enforcement mechanisms are strong is crucial to implementing effective legal reform.

This option entails high costs, but with the benefit of being guaranteed to produce effective change. Another issue with this option is that of compliance: it will be impossible to force governments to undertake programs of this magnitude, and so only those states who willingly and actively cooperate can benefit from a program of this caliber.

- **Endorse microcredit programs that specifically address rather than avoid the issue of women's property rights. This would include programs that provide loans to women for the purpose of renting, buying, or investing in property.**

A major problem with the phenomenon of microfinance is that it provides collateral-free loans to women who don't have collateral, which helps them in the short run but does nothing to address the underlying problem of inequitable ownership. If this method could be used effectively to help women overcome their limited access to property, it would be much more beneficial in the long run.

Microcredit is a rapidly-growing approach to providing fairly-priced loans to those who would otherwise be unable to benefit from credit. However, microcredit loans can never total more than a few thousand dollars because of the high risk involved with providing a collateral-free loan. So as long as microcredit avoids rather than addresses the issue of women's property rights, there will be no opportunity for anything more than small, personal-level entrepreneurship for women.

However, if microcredit loans could be provided for the purpose of obtaining collateral (especially land) with which to secure larger loans in the future, it could have great potential for being a mechanism of change.

## **RECOMMENDATION**

In addressing the issue of women's property rights, we believe the most effective approach would draw from each of the options mentioned above. Because of a limit on the supply of funding, not all of the aforementioned options can not be implemented in their entirety. Thus an approach strategically encompassing parts of each of these four options would be best.

Increasing the size of the Women in Development Small Grants Program would be a good move, as it already has the infrastructure to distribute funds and monitor the success of the NGOs it administers to. The Small Grants Program currently channels funds to NGOs working in only four countries; expanding this is necessary so that its benefits can reach more of the world's poorest. Since this program already specifically targets the protection of women's property and inheritance rights in developing countries, the necessary infrastructure for funding these operations is already in place. Further more, since this project of Women in Development reports to USAID, it already closely monitors the recipients of its grants, requiring feedback and quantitative proof of success.

Perhaps using a portion of its increased funding, the Small Grants Program can provide specifically to microfinance institutions that provide loans specifically for the purchase of or investment in property for women. This would help overcome the dilemma of accidentally perpetuating inequitable property systems through microcredit. The second option, of increasing research on both the connections between women's property rights and development and on the effectiveness of NGOs working in this area, can also be done through the Small Grants Program, which already monitors the success of the NGOs to which it grants funding. However, we would recommend that more in-depth studies, such as the randomized control trials advocated by William Easterly, be done by a separate institution with more expertise in this area, such as the Abdul Latif Jameel Poverty Action Lab at MIT, which already does scientific evaluations of aid intervention.

The third option is probably the most promising for creating lasting effects, but also the most complicated. As a step toward accomplishing this, we recommend first opening some kind of international forum for the discussion of women's property rights and development, inviting the governments of developing countries to join. This will help raise awareness of the issue, and can be a platform for gauging the willingness of developing countries. It is absolutely imperative that this type of summit include representatives from the poor female recipients of aid as well as from governments and organizations. Bringing together the knowledge of the poor and the resources of the rich is a fundamental tenet of bottom-up development, and it is this unique characteristic that makes the bottom-up approach so promising. Further action, such as sending out teams of personnel to help train law enforcement or working on legal reform, will have to be decided after an initial

evaluation of willingness and feasibility based on the conclusions reached through such a dialogue.



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## Chapter 7

### PROMOTING EFFECTIVE CONTRACT ENFORCEMENT

*Kang Hur*

#### **ISSUE**

Entrepreneurship is a catalyst and engine of economic development in poor countries. Many international organizations, including the World Bank and United States Agency for International Development (USAID), aim to create an enabling environment for private enterprise development and growth in developing countries. Contract enforcement is an important mechanism that considerably improves the business environment for private enterprises. When a contract is properly enforced, it enables people to participate in the market by providing them the necessary protections to run their businesses safely. Facilitating effective contract enforcement will not only give entrepreneurs legal recourse but also help to protect and expand their business. Effective contract laws give people the confidence to start businesses and provide opportunities for them to expand their scale and scope of business by working with people who they have never done business with. This ultimately creates a business-friendly environment where the world's poor can create networks of business cooperation within their communities in order to counteract and reduce the effects of unemployment and poverty.

One of the core problems with legal systems in developing countries or transitioning economies is that they are inefficient and not user-friendly. In fact, many entrepreneurs still face greater regulatory burdens than entrepreneurs in developed countries and have fewer protections in terms of legal rights, property rights, and contract enforcement. Thus, bottom-up development schemes are necessary to create contract enforcement mechanisms for entrepreneurs that would likely work, foster and expand the scope and scale of private firms beyond kinship and local areas. Bottom-up development schemes need to not only address the ability to fund business, but also interact with businesses in a stable environment.

## **BACKGROUND**

### **Introduction**

Economic development is closely linked to entrepreneurship. Institutions and individuals promoting economic development now see entrepreneurship as a development strategy intervention that can accelerate the economic development. Furthermore, institutions and individuals seem to agree on the urgent need to promote enterprises: development agencies see entrepreneurship as an enormous source of new jobs for unemployed people; politicians see it as the key strategy to prevent rural unrest; farmers see it as an instrument for improving farm earnings; and women see it as an employment possibility that provides autonomy, independence and a reduced need for social support. To all these groups, however, entrepreneurship stands as a vehicle to improve the quality of life for individuals, families and communities and to sustain a healthy economy and environment.

While entrepreneurship is crucial for economic development in developing countries, a country that lacks the necessary legal system such as specialized commercial courts that deal with business disputes or appropriate contract laws will make businesses much riskier when the two parties are strangers to one another. Lack of legal systems is not only an impediment to entrepreneurship but also complicates access to credit, use of courts and access to other public services. The legal systems in most developing countries or transition economies are highly inefficient, costly to use, potentially corrupted and lack legal recourse.<sup>1</sup>

Thus, effective legal systems are a prerequisite for business development and growth. They can be a tool to diminish the risk of doing business with an unknown partner. When the law is properly enforced, business partners are obligated to do what they have agreed or said that they will do: promptly paying the fee, delivering the goods or providing the necessary labor or service. This ultimately provides both business parties with more accurate information about their respective partners and greater confidence.

Sound legal systems are not only crucial for business development and growth but also closely linked with poverty reduction. Being poor and marginalized means being deprived of choices, opportunities, access to basic resources and a voice in decision-making.<sup>2</sup> Ineffective legal systems contribute to this deprivation because the poor and



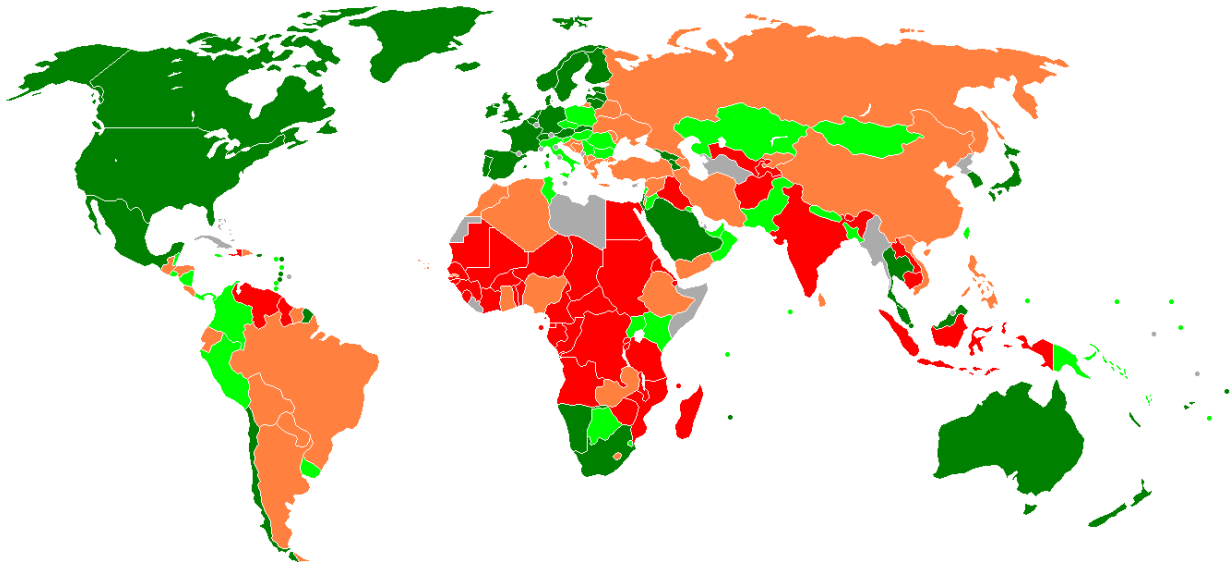
marginalized are most likely to be victims of fraud or violation of contract. Illegality is likely to have a greater impact on the poor or disadvantaged people's lives, as it is harder for them to obtain redress.<sup>3</sup> As a result, they may fall into further poverty. Therefore, having access to proper legal systems will provide remedies that will maximize the impact and protection for the poor and disadvantaged by clarifying agreements and enforcing contracts. Integrating fair and effective rule of law is one of the best ways to reduce the risks associated with conflict, disputes, and mistrust.<sup>4</sup> Having efficient legal systems emphasizing reliable contract enforcement will foster businesses development and growth in developing countries, which can be a very constructive bottom-up development scheme for poverty reduction.

## **The Correlation between Enforcing Contracts and Doing Business**

Among many different types of laws, contract enforcement is one of the most important requirements to create an effective business environment in developing countries and transition economies.<sup>5</sup> It has been known that next to criminal law, there is no body of law more important to a developing country than contract law, and that the effectiveness of contract enforcement is the single most important determinant of economic performance.<sup>6</sup> In addition, it has been known that the effectiveness of enforcement of contract law is the central difference between developed economies and developing economies. Without an adequate, well-defined body of contract law and the means to enforce contracts, a modern economy becomes meaningless.<sup>7</sup>

A good contract enforcement mechanism can foster business development and growth by giving confidence to entrepreneurs and providing necessary protection. Many countries with poor contract enforcement have poor business environments. Figure 1 and figure 2 (see below graph and chart) show the correlation between the ease of doing business and the efficiency of contract enforcement. Countries in colored green have simpler procedures and stronger protections for legal rights. Due to the strong legal systems, it is easy to do business in these countries. In contrast, countries in colored red have long procedures and weak protections for legal rights. Many of them face the same problem - inefficient contract enforcement mechanisms that make entrepreneurship difficult.

**Figure1: Ease of Doing Business Index<sup>8</sup> (as of 2007)**



**Figure 2: Enforcing Contracts Index by Region<sup>9</sup>: (April 2007 – June 2008)**

<u>Region or Economy</u>	<u>Procedures (number)</u>	<u>Duration (days)</u>	<u>Cost (% of claim)</u>
East Asia & Pacific	37.2	551	48.4
Eastern Europe & Central Asia	36.4	425.2	23.4
Latin America & Caribbean	39.7	710.1	31.3
Middle East & North Africa	43.7	688.8	23.7
OECD	30.8	462.7	18.9
South Asia	43.5	1,052.90	27.2
Sub-Saharan Africa	39.4	659.7	48.9

Countries that score high on the ease of enforcing contracts keep the enforcement of judgments faster by having strict procedural time limits and specialized commercial courts.<sup>10</sup> A strict procedural time limit is limiting the time to solve one case within a certain period of time. For instance in Hong Kong, the enforcements of judgments speed by allowing the process to start based on the essentials of the court decision and limiting

the days to resolve the days (It takes approximately 211 days to resolve a commercial disputes in Hong Kong). The ten countries with the fastest average time to enforce a contract tend to have specialized commercial courts or specialized courts sections within existing courts and limits on the number and length of adjournments once a case has started.<sup>11</sup> In contrast, the ten economies with slowest average time to enforce a contract have exactly the opposite condition, lacking specialized commercial courts that deal with contract disputes and having long procedures, which makes them difficult to do business.

The existence of a strong contract law is also closely associated with business growth, while a weak or nonexistent of contract law is an impediment to business development. Since 1994, the World Bank, the Inter-American Development Bank (IDB), and the Asian Development Bank (ADB) have initiated and implemented more than \$500 million in loans for judicial reform, particularly to improve contract laws in 26 developing countries or transition economies.<sup>12</sup> Moreover, the US Agency for International Development (USAID) has spent approximately \$200 million in the past decade on similar projects and other private sectors to modernize the judicial system in developing countries that lack proper contract laws.

According to a World Bank report, Argentina and Brazil show that firms doing business in provinces with better-performing commercial courts with efficient contract law enjoy greater access to credit.<sup>13</sup> New work in Mexico shows that larger, more efficient firms are found in states with better legal systems. Better legal systems with good contract laws reduce the risks firms encounter; and consequently increase the firms' willingness to invest more. In contrast, weak legal systems with lack of contract laws have negative effect on business growth. Firms in Brazil, Peru, and the Philippines report that they would be willing to increase investment if they had more confidence in their nation's legal systems and contract enforcement. Firms in Albania, Bulgaria, Croatia, Ecuador, Moldova, Peru, Poland, Romania, Russia, Slovakia, Ukraine, and Vietnam say they would be reluctant to switch suppliers, even if offered a lower price, for fear they could not turn to the courts to enforce the agreement.<sup>14</sup> One of the common explanations for avoiding courts to enforce contracts is that people in poor countries turn to informal contract institutions when seeking justice.<sup>15</sup> In the absence of efficient contract enforcement, firms

undertake fewer investments and business transactions. They prefer to involve only a small group of people who know each other from previous dealings.

Contract enforcement mechanisms are largely divided into two categories: formal and informal contract enforcement. Formal contract enforcement is practiced mainly in developed countries based on a strong legal system; while informal contract enforcement is mostly practiced in underdeveloped countries due to inefficient formal contract enforcement mechanism.

## **Formal Contract Enforcement**

In modern economies, business development requires a clear and predictable formal contract law that adequately enforces obligations of the parties involved, and provides remedies when one party is in breach. It is necessary to create and enforce contracts under a clear and consistent formal legal framework. In modern formal commercial legal systems, there are two components to enforcing contracts.<sup>16</sup> First, there must be laws establishing the rules for the creation, interpretation, and performance of contracts. These rules in a formal system can either be set forth in statutory enactments or, in common law systems, can be found in published decisions of judges. Second, a working system of commercial law enforcement must have a means of adjudicating and enforcing contractual rights. Fundamentally, for a contract to be valid and subject to enforcement contracts in a formal commercial legal system, the following conditions must be met<sup>17</sup>:

- (1) All parties to the contract must indicate that they agree to its terms, as demonstrated through an offer and an acceptance.
- (2) The contract does not serve an illegal purpose, or a purpose plainly interferes with public policy.
- (3) In common law countries, with limited expectations, promises made in a contract must be made in exchange for consideration that is payment, some action, or another promise.
- (4) The contract may be made only by parties with the capacity to reach understanding.

(5) In most instance concerning business affairs, particularly in civil law countries, the contract must be in writing. In common law countries, although certain oral contract can be legal and enforceable, contracts establishing obligations lasting longer than one year must generally be in writing to be enforceable.

One of the major obstacles of business development in developing countries is outdated, ineffective legal systems with no adequate contract laws. Outdated legal systems are not only the impediments to meet the challenges of supporting economic and social transformation, but are a bottleneck in national reconstruction. Thus, the importance of having formal contract enforcement mechanisms is perceived by many developing countries as a way to foster their business development and growth. As a result, they are reforming their legal and institutional system under the auspices of the World Bank, USAID or other international organizations.

## **Legal and Institutional Reform: A Successful Case**

### **Case Study 1: Rwanda Commercial Law Reform Project**

Rwanda's commercial law reform project was initiated by the government of Rwanda and the World Bank in 2000 dealing with competitiveness and legal environment. Commercial law reform was needed to encourage both foreign and domestic investment to include the small-scale business sector of Rwanda's economy. It was also recognized that the scope and type of assistance should be shaped by Rwanda's internal needs and circumstances rather than simply be the product of non-Rwanda legal consultants. The project was conducted in this way so that the Rwandans determine what Rwanda needed to become competitive from the perspective of a commercial legal environment conducive to business development and growth.

In mid-2005, the Ministry of Justice (MoJ) appointed six Rwandan legal and financial experts to a business law reform cell. The objectives of the business law reform cell were:

- (1) Identify legislative and regulatory constraints affecting private sector development
- (2) Diagnose the institutional framework for commercial transactions
- (3) Propose ways to integrate international best practices into the reform process
- (4) Produce a guideline and road map for the business law reform

Under the auspices of international legal consultants, several commercial laws relevant to the enforcement of contracts were: Laws Establishing Commercial Courts; Laws on Arbitration; Mediation and Conciliation; and Laws on Contracts.

(Source: BizCLIR 2009)

The Rwanda commercial law reform project is considered well suited to deal with all aspects of contract formation and enforcement in a modern economy. Although Rwanda's legal reform was initiated by the government, the reform mechanism was based on a bottom-up approach. Its legal reform was based on internal needs and circumstances, and was carried out by a domestic legal community. Rwanda's legal reform case shows the importance of legal reform and how proper legal reform underpins business

development. Since its commercial legal reform, the country did not look back. While the reform is far from complete, results are already being seen. Rwanda has attracted major foreign investments and improvements in the business and investment climate have been achieved by updating legal and regulatory framework.<sup>18</sup> Rwanda has also improved the efficiency of legal institutional structures and built human resource capacity to enable effective and speedy enforcement of contractual obligations and resolutions of disputes.<sup>19</sup>

### **Legal and Institutional Reform: A Failed Case**

#### **Case Study 2: Afghanistan's Legal Reform**

Afghanistan's old contract law was not suitable for the modern economy. It institutionalized a very high-risk involved with entering into a contract. Thus, in 2003 and 2004, the Afghanistan Transitional Commercial Law Project (ATCLP) was initiated under the auspices of the Center for International Management Education and the American Bar Association-Asia Law Initiative to reform its contract laws.

In the process, drafters consulted officials within the Ministries of Commerce, Finance, and Justice, and the Judicial Reform Commission. However, many local lawyers, judges, businesses, law professors, and other critical constituencies have not been consulted about the reformed contents or even informed about it to any significance. Furthermore, the law was not constructed, in conjunction with a meaningful plan for implementation. As a result, in the Afghan marketplace, there continues to be only nominal use of contracts, and those companies that do use them have little appetite for taking disputes to courts.

(Source: BizCLIR 2009)

In Afghanistan, the impact of the new law on contracts is very weak. The development of the new law appears to have involved only minimal engagement of the Afghan legal community, which is the significant difference between the Rwandan and Afghan legal reform.

The important lesson by looking at the Rwanda's successful case and the Afghanistan's failure case is that Rwanda's reform emphasized the importance to involve both the top leadership and representatives of all those likely involved with and affected by

the process. On the other hand, Afghanistan's legal reform show the fact that in order for a legal reform to work effectively, the scope and type of reformation should be determined by the country's internal needs and circumstances. Also, reforms should be carried out by the domestic legal community rather than implemented by foreign legal consultants.

## **Informal Contract Enforcement**

A number of pieces of empirical evidences show that there is aversion on the part of the business community in developing countries or transition economies to formal legal mechanisms to enforce contractual terms or resolve contractual disputes particularly.<sup>20</sup> In developing countries, informal contract enforcement is used because social pressure and reputation are more widely trusted than formal contract laws as community members carrying out mutually beneficial agreements.

For these countries strict judicial enforcement of contract rights is not a precondition for business development and growth. In these countries, the legal institutions for resolving commercial disputes and facilitating contract enforcement have little role. For instance, China has performed almost consistent 9 to 10 percent economic growth rate for more than two decades. However, China has a poor legal framework that is often not suitable for modern market systems and business climate.<sup>21</sup> Commercial courts primarily dealing with contract enforcement in China are generally known for the lack of both professional competence and independence from political interference, and also suffer from local and departmental protectionism in adjudication and enforcement of judgments.<sup>22</sup> Yet its economic growth continues. The reason why China is able to succeed in economic development without formal contract enforcement method is that it has informal contract mechanisms instead.

According to the World Bank, two-thirds of 50 developing countries and transition countries, ranging from very poor countries in Africa and South Asia to middle income states in Latin America and East Asia replied that they had reached a solution without resorting to the courts when settling disputes and enforcing contracts.<sup>23</sup> The reasons why formal contract enforcement is not practiced among developing countries are:

- (1) Long Delays: prohibitive costs of using the system; lack of available and affordable legal representation that is reliable and has integrity; abuse of



authority and powers resulting in unlawful searches, seizures, detention and imprisonment.

- (2) Severe limitations in existing remedies provided either by law or in practice. Most legal systems fail to provide remedies that are preventive, timely, un-discriminatory and adequate.
- (3) Inadequacies in existing laws fail to protect poor, disadvantaged, women, and people with low literacy.
- (4) Expensive legal procedures that most people in poor countries cannot afford.

Also there are generally two methods of substitutes for formal contract enforcement that are widely used in developing countries: unilateral and bilateral. Unilateral measure is a method based on expenditure on advertising, the development of a trademark or brand-name, or the ownership or long-term lease of a facility. Each of these unilateral measures is a form of investment in a firm's reputation for providing quality goods or services and the failure to live up to promise would render its investment less valuable.<sup>24</sup> Bilateral measure is based on bilateral mechanism. Contracts enforcement based on bilateralism can be also perceived as "self-enforcing." Contracts are self-enforcing when the threat of termination is sufficient to deter breach. The terms are manipulated to increase the loss to one side from termination and thus reduce the chances one side will breach it. For example, when a manufacturer forbids the retailers or distributors to which it sells to cut the price on the goods it sells them. They must maintain the agreed upon resale price. Such a practice increases the retailer or distributor's profits and gives it an incentive to continue dealing with the manufacturer.<sup>25</sup> These mechanisms are not only found in developing countries but in developed countries as well. Informal contract enforcement does not necessarily mean it is illegal or impediment to entrepreneurship. It is an inexpensive and speedy way of enforcing contracts.

### **A Substitute for Formal Contract Enforcement**

In developed countries, there are several business community organizations like the Better Business Bureau (BBB) that use informal contract enforcement mechanisms to foster business growth and development. These organizations' mechanisms are based on three key components: feedback systems, community forum, and effective dispute

resolution programs. These tools are believed to bring positive effects on doing transaction with strangers and provide an alternative to an expensive legal pursuit. First, a feedback system is one of the most significant systems to enhance users' trust in business transactions. The core function of a feedback system is to give both the seller and the buyer testimonials about their partner's activities during a transaction.<sup>26</sup> After the transaction is completed by both seller and buyer, they are given a chance to evaluate the other. The feedback will be recorded and can be seen by future users. This feedback system acts as a tool to foster trust between people by acting as both an incentive to do the right transaction and as a mark of distinction for those who conduct transactions with respect, honesty, and fairness.<sup>27</sup> For example, a seller can take advantage from feedback: they can choose which users they want to have business with based on the feedback history. Therefore, the advantage of having this feedback system is that it gives sellers more confidence to sell their products with less risk, and buyers to use the history of sellers' feedback description to ensure that the other person has good record.

Second, community forum is another tool that is used to promote business environment where people can actively interact with each other and share information. Community forum is based on social networking concepts. This forum is a place where people can ask questions and exchange information about products, business ideas, or buyer and seller's reputations. Users can also find people who have similar interests in particular items, brand, and products.<sup>28</sup> Effective dispute resolution programs are based on conciliation, mediation, and arbitration. They are all user-friendly, inexpensive and help to speedily resolve hundreds of thousands of complaints. By working with both parties to a transaction, they can restore consumers' trust in the marketplace and promote more effective business practices.<sup>29</sup>

These organizations have several purposes. (1) It creates an account for those who register and the members are required to abide by the rules of the association. (2) It acts as an intermediary helping people to find the appropriate business partners, (3) and operates as a tool to foster accountability in business transaction and enforcing contracts. For example, when two parties decide to do business, they are required to give a feedback rating and to write an evaluation on their counterparts' activities. The feedback and evaluation is a tool to promote trust between people by acting as an incentive to do the

right thing. (4) A voluntary association promotes accessibility to legitimate markets. For instance, feedbacks and evaluations on other members are recorded and can be seen by other people, in this way people can decide the appropriate business partners. (5) It creates a forum community, which is based on social networking. A forum community is a place where people can actively interact with other people and exchange information about their business interest, ideas, or new markets. (6) A voluntary association coordinates with local business people to develop dispute resolution programs designed to meet the specific marketplace needs and various businesses.

In Vietnam, private firms widely use grass-roots contract enforcement mechanisms that are similar to the BBB and other business organizations in developed countries. Vietnam is currently a transitional country from a planned economy to a market economy that became a part of the modern economic system. Yet, Vietnam has no commercial legal system that is not compatible with modern market systems and proper contract law to regulate transactions or resolve disputes between private agents.<sup>30</sup> Paradoxically, its private business sector is growing at a fast phase and has been an economic driving force in Vietnam's economic growth.<sup>31</sup>

### **Case Study 3: Alternative Informal Contract Mechanism**

More than 90 percent of the managers of private businesses in Hanoi and Hochi Minh said the courts are no use of to them in resolving business disputes and enforcing contracts. These private-owned firms use bottom-up substitutes for contract law. The manager's strategies for contract enforcement include relying on reputation and gossip to select partners, trying to avoid disputes by checking their customers' financial backgrounds and personalities with others who have done business with them, and meeting each other regularly in teahouse and bars to exchange information and discuss market opportunities.

(Source: Trebilock and Leng, 2006)

These Vietnamese private firms found their own way of effectively enforcing contract to facilitate their business. The contract enforcement method presented by the BBB and Vietnamese private firms show us that business development can be established

without formal legal systems. Alternative informal contract enforcement mechanisms have the potential to provide speedy, affordable and meaningful remedies to poor and disadvantaged people. They can be used as an effective tool to enable bottom-up development schemes for business development and growth in poor countries where people do not have access to legal systems with contract enforcement.

## **Concluding Remarks: Challenges and Opportunities**

The existence of an efficient and well-organized legal framework with proper contract enforcement is a prerequisite for not only economic development, but also the basis of creating business-friendly environment and poverty reduction. An effective contract enforcement system facilitates business transaction, prevents poor or disadvantaged people from fraud, and provides legal recourse and remedies. There are two ways to ensure that contract enforcement works properly.

Firstly, in order to attain an effective commercial legal reform under the auspices of international legal consultants, internal legal communities and entrepreneurs must be involved. The Rwandan and Afghan commercial legal reform cases have proven this. The key difference between Rwandan and Afghan commercial legal reform is the involvement of domestic legal communities. Afghan commercial legal reform was initiated by international legal consultants without any involvement of the Afghan legal community. As a result, Afghan commercial legal reform did not work and the failure was due to the un-involvement of the domestic legal community. Rwandan commercial legal reform was carried out by its legal communities and the scope and type of assistance from international legal consultants was completely determined based on internal needs and circumstances. These two cases show that commercial legal reforms establish concrete contract laws to foster business development. However, domestic involvement of the legal community is crucial for legal reform to work. Outside legal consultants should function as a supporter rather than initiator.

A second approach to fostering effective contract enforcement is through alternative informal contract enforcement methods that have shown promise as an effective bottom-up development scheme. Alternative contract enforcement serves as a solution before formal institutional legal reform takes effect. The method used by the BBB is an

effective contract enforcement mechanism available to those transition economies that have neither effective formal contract law and enforcement institutions, nor where social trust and efficient commercial laws are in existence.

Both legal reforms and alternative contract enforcement mechanisms would create a business-friendly environment and would expand the scope and scale of entrepreneurship in developing countries. However, they need to be geared towards the entrepreneurs who are the actual users of contract laws and find out what works for them.

## **OPTIONS**

- **Create Voluntary Associations with Feedback Loops, Community Forum, and Effective Dispute Resolution Programs:**

The first option involves creating a voluntary association based on a feedback system, community forum, and effective dispute resolution programs. Voluntary associations are institutions that enable entrepreneurs to expand their scale and scope of business by connecting them with business partners beyond local areas or kinship. A voluntary association uses methods of contract enforcement similar to those of the BBB or other business communities in developed countries. It acts as an intermediary helping people to find the appropriate business partners, and operates as a tool that fosters accountability in business transactions and enforcing contracts. A voluntary association promotes accessibility to legitimate markets, and creates a community forum, which is based on social networking. A community forum is a place where people can actively interact with other people and exchange information about their business interest, ideas, or new markets. The forum facilitates coordination amongst local business people allowing them develop dispute resolution mechanisms designed to meet the specific marketplace needs and various businesses. When a complaint is received, both parties are contacted and made aware of the dispute. The defendant has an option to engage the voluntary association's assistance in the settlement process.

The creation of voluntary associations will provide practical alternatives for developing countries or transition economies where contract enforcement systems are still inefficient, costly to use, and inaccessible. By establishing a voluntary association, people can determine what they will need to become competitive in marketplaces and what type of contract law is conducive to their business development and growth. Most importantly, a

voluntary association provides inexpensive dispute resolutions which considerably reduce the transaction costs of doing business. It also empowers people to operate their businesses with accountability, accessibility, and proper ethics. The challenge of this option, however, is that a large number of participants are crucial for success. People can be uninterested with this system because it also takes time for people to accept any system; thus, there is the possibility that people will not participate in the system. Proper advertisements about the benefit of the system and education on how to use the system properly are critical to successfully gain widespread acceptance of this system.

- **Provide Aid and Legal Consultations to Reform the Legal System of a Country:**

The second option is to provide US aid and any other necessary legal consultations to legal communities in developing countries that wish to reform their legal systems. The legal reform must then be carried out by the domestic legal community rather than implemented by foreign legal consultants. The scope and type of assistance from international legal consultants should be determined by the country's internal needs and circumstances. The reason businesses in developing countries use informal contract enforcement mechanisms today is because the formal legal procedures are inefficient, costly to use, and inadequate. Most importantly, entrepreneurs in poor countries often do not have access to a legal system or legal recourse. Additionally, courts do not have the necessary capacity to deal with business litigations and often lack specialized procedures that can deal with commercial disputes. As a result, commercial disputes are processed very slowly and are costly to use. Also a number of developing countries with commercial courts struggle due to a lack of legal representation and avenues to pursue recourse. Thus, it is crucial to provide government aid and the necessary legal consultation to create legal institutions that can produce more lawyers and judges, and build commercial courts that only deal with business disputes or contract enforcement.

It is important to have efficient markets with clear and predictable formal laws that can adequately enforce obligations of the parties involved and provides remedies. Thus, providing funds and legal consultations to reform legal systems of states are key for business development and growth. In addition, having proper formal legal frameworks that are compatible with current market systems can attract foreign investment. The

complications with this option, however, are that there have been some cases where legal reforms have not worked. The main reasons for these failures were that the reformation was initiated by foreign legal consultants without any cooperation from local lawyers, judges, and businesses as seen in the Afghan legal reform example. Afghan legal communities have not been consulted about the reforms or their contents. Moreover, the law was not constructed in conjunction with a larger meaningful plan for implementation. Therefore, in order for legal systems to work properly, the reformation must be based on the country's specific needs and circumstances.

- **Employ a Wide Variety of Researchers to Learn More about the Internal Legal Systems in Different Developing Countries:**

The third option is to employ a wide variety of researchers such as legal consultants, economists, anthropologists to learn more about the internal legal systems and how cultural and societal factors affect contract enforcement in different developing countries. Every country has a different way of doing business with their own way of enforcing contracts. In Vietnam, an informal contract mechanism is more suited to the country because it is culturally and ethnically homogenous where reliance on informal social norms is more effective. On the other hand, legal reform would be a more effective way of enforcing contracts in Rwanda. The strength of this option is that it is an effective way of understanding grass-roots contract enforcement. While government agencies and legal consultants know and understand the basic principles of contract enforcement are, they tend to still have a top-down view of things and are looking for the best practice. However, there are likely no single identifiable "best practices." Thus, diverse mechanisms of enforcing contracts and institutions in poor countries need to be studied and comprehended. The problem that arises with this option is that it is very expensive and time consuming. The undertaking would take years in order to understand the local contract enforcement mechanisms of each different country.

## **RECOMMENDATION**

Generating economic growth in developing countries while reducing poverty through entrepreneurship is of special interest to the US because of the economic and

social stability it provides. Creating suitable contract enforcement mechanisms can be an effective tool to achieve this objective. Facilitating the creation of voluntary associations based on feedback loops, community forums, and dispute resolution programs would realize this critical US goal. The participation and assistance of the government and legal communities and representatives of a country are required because the government should do no harm and not create barriers for this system to work properly. When these conditions are met, a voluntary associations would truly capture bottom-up development with minimal use of US aid to effectively promote the growth of businesses. The voluntary associations would enable people to choose their own business partners based on trust and accountability. In addition, voluntary associations provide speedy, affordable, and meaningful remedies to poor and disadvantaged people because they are designed to meet specific internal needs and accommodate local circumstances. They can be used as an effective tool to enable bottom-up development schemes for the growth of entrepreneurship and reduction of business transaction costs in poor countries where people do not have access to legal systems with efficient contract enforcement.



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## CHAPTER 8

### REVISITING PRIMARY EDUCATION IN POOR COUNTRIES

*Chayut Setboonsarng*

#### **ISSUE**

Despite continuous international efforts at improving basic education, many countries still suffer from extremely poor education services. Globally, 75.2 million children remain out of school and some nations suffer from literacy rates as low as 23%. Repetition rates, and standardized tests, show that access to schools alone is not enough to raise attendance and literacy rates, but that the quality of education a student receives and teacher competency must also be addressed.

The two prevailing problems regarding basic education are **access** and **quality**: issues of access ranges include affordability, environment, etc. Schools situated in violent areas may cause parents to be reluctant in sending their children into dangerous situations. While some households that suffer from poverty may opt to have their children work instead of attend class. However, even if the conditions of access are remedied, they are meaningless unless schools can also provide a quality education. Moreover, students cannot be blamed entirely for their shortcomings, since negative factors such as weak curriculum, low teacher commitment, and poor facilities may contribute to poor student performance. Without proper textbooks, and adequate learning environments even the most sedulous student may not succeed.

Bottom-up approaches to development programs, which directly involve the local community, families and students, are integral in order to substantially change the quality of and access to education. Policies that advocate an increase in financial aid and simply build schools lack accountability and feedback systems. Such programs do not solve the fundamental and chronic problems of failed education projects. New bottom-up schemes will have an immediate impact that can be measured, evaluated, and replicated in many countries. This approach stresses the harmonization of local and donor efforts in carrying out development projects.

## **BACKGROUND**

### **Introduction**

Education is the cornerstone of development: literacy rates have direct economic consequences, enable political participation, foster the entrepreneurial spirit, and pave the path to sustainable development. In 1962, education aid entered the network of World Bank financing operations; since then, the international donor community, private aid agencies, NGOs, and governments have participated in financing education development around the world. However, after decades of commitment, children in poor countries still face the same problem of inadequate education and the same issues of failed basic education remain prevalent.

### **The International Donor Community**

External contributions to education aid can be classified into two categories - loans and grants. External aid is defined as flows of resource at concessional rates of interest and on liberal terms of payments. Typically, external assistance originates in rich countries and flows into developing countries either directly or through international organizations or non-profit sources. Some multinational sources include the United Nations Educational, Scientific and Cultural Organization (UNESCO) regular budget, the United Nations Development Fund (UNDP), the World Bank, and the Asian Development Bank. While non-profit sector are charitable establishments such as the Ford Foundation, Rockefeller Foundation, and Carnegie Corporation, faith and community-based organizations, and universities.

One major characteristic of education aid is that it focused on higher education. In 1975, about half the teachers, experts, and advisers from Organization for Economic Co-operation and Development (OECD) donor countries assisted general secondary, vocational, industrial, and technical educations. In 1980, the World Bank estimated that 80% of education aid was allocated to secondary and higher education and foreign assistance had not reached primary schools, and out-of school children. The two main reasons for this were that elementary education was regarded as a quagmire that was best dealt with by local governments. Secondly, donors agencies, and leaders believed that the greatest need was to strengthen human capital and provide expertise in major fields. An

example of this was education aid in India, which bolstered the Indian institutes of technology, management, and agriculture universities.<sup>1</sup>

The first few decades of international effort in improving education appears to have been lacking. However, by the late 1980s, academic and international organizations began to suggest new approaches to education aid policy that focused on primary education along with reduced intervention from donor agencies. For example, the World Bank endorsed assistance for basic education and movement towards increased internal efficiency. Scholars called for a reduction in direct or indirect authority of donor agencies on policy in planning and executing policies in the receipt country. It was argued that external aid should not become a threat to local sovereignty educational policies.<sup>2</sup> In 1990, 155 nations convened at the World Conference on Education for All (EFA). The conference brought donors and developing nations together under a common agenda to reorient their goals towards primary education. Donors also began to question the effectiveness of sector-wide approaches (SWAp).

Sector-wide assistance is aid given directly to governments for an education development program. The control of how funds are spent often varies among donor and receiving states depending on individual agreements. A major drawback of this model is that it is highly selective, since few countries can produce sector plans that are approved by donors. Furthermore, in many of these cases, there is no system of accountability to ensure that the aid money is not embezzled or used ineffectively. A disconnect between donor agencies and local community is also a source of problem since donors do not actually understand the most urgent problems that families face. Despite the appearance of increased commitment from developing countries, aggregate levels of aid did not increase and aid effectiveness has hindered education development from 1990 and onwards.

## **The Current State of Education**

Globally, only one third of pre-primary age students are enrolled in pre-primary education.<sup>3 4</sup> The three regions with the lowest net enrollment rates are Sub-Saharan Africa, North Africa, and South Asia. As for primary education, of the world total, 86.4 percent of primary age students are enrolled in primary school<sup>5</sup>, while the region with the lowest enrollment rate is Sub-Saharan Africa. Another important statistic is the number of out-of-school children. Again, Sub-Saharan Africa and South Asia have the highest numbers. Although since 2001, there have been some improvement in enrolling children, the situation remains dire.<sup>6</sup>

Some of the main issues in basic education in developing countries include the opportunity cost of schooling. When deciding to enroll their children in school, parents face a trade-off between household consumption and their children's expected future income, which are the direct and indirect costs of the children's forgone labor at home or in wages. Opportunity cost, in this case, refers to the cash earnings or non-monetary contributions that a household sacrifices to keep a child in school. The gravity of opportunity cost has been underplayed. Even when schools are accessible and affordable, families have to see a net advantage to themselves if they are to forgo participation in domestic and economic activities.<sup>7</sup> In weak states that cannot enforce compulsory education laws - parents become the children's gatekeepers and control the children's access to education resources that are made available by the state. For example, in Mali children spend time taking care of their siblings and working on family fields at a very early age.<sup>8</sup> In Zambia, parents withdrew their children from school during important seasonal events of harvesting and fishing.<sup>9</sup> A factor that is directly linked to the problem of opportunity cost is poverty. Children of the poor are least apt to attend school, furthermore, they may also be malnourished, which lowers achievement even further.

Other social factors also prevent education from reaching particular groups. Discriminatory attitudes towards the education of girls are potentially the cause of the gap between net enrollment rates between boys and girls. In some tribes in Africa, girls that reach puberty are taught the wisdom and knowledge of her society. These instructions are considered directly relevant for a girl, preparing her for womanhood. However, conflict occurs when there are apparent differences in what she is taught at home, and at school.



This leads to parents opposing a girls' continued education. These behaviors are related to tribal traditions, cultures and taboos that can dictate various stages of development, which are in friction with the demands of schooling.<sup>10</sup>

A considerable amount of research and analysis has been done regarding the state of education. Key regions with the most urgent problems have been identified, and the major problems associated with poor quality and access to education has also been recognized. The international community has responded with a series of campaigns, the most notable and contemporary one being the Fast Track Initiative.

### **Education for All: Fast Track Initiative**

During the Millennium Summit in 2000, world leaders ratified the United Nations Millennium Declaration<sup>11</sup>, which contained eight Millennium Development Goals (MDG) one of which was to achieve universal primary education (UPE) by 2015. Currently, the most publicized and robust effort in education development is the Fast Track Initiative (FTI) headed by the World Bank. Launched in 2002, the FTI is a global partnership aimed at helping low-income countries to achieve UPE and EFA. Through the FTI platform, poor countries and their donor partners designed and committed to an education plan. Funding was mobilized through four channels, the Catalytic Fund (CF)<sup>12</sup>, domestic resources, multilateral donors and private donors. The World Bank describes the main principles of FTI as country ownership, local-level empowerment, mutual accountability and donor harmonization.<sup>13</sup> Currently FTI and the Catalytic Fund are at the forefront of education development. One problem that developing countries previously faced when dealing with donor agencies was the unpredictability of aid and the flow of money into their education budget. Once the donation had been received, officials still had to deal with state bureaucracies. FTI and CF ensure the predictability of aid into the education sector. Predictability of foreign aid allows government officials to better plan out education reforms as budgetary information is readily available. The agreement between the government and FTI also guarantees transparency and a reduction of red tape. By not having to constantly seek bureaucratic approval; policy makers are able to quickly implement the necessary changes in their education systems. Another important component of the Fast Track Initiative is self-evaluation. Annual reports are available to

the public and show the progress and shortcomings of the FTI. Evaluation forces donor agencies, local government and community to consistently cooperate in improving aid effectiveness. An ongoing external evaluation of FTI aims to analyze and evaluate the effectiveness of the FTI partnership and its programs. All aspects of the FTI partnership are being assessed, with final results expected by September 2009. The most recent evaluation, the 2008 Annual Report, shows that the FTI Framework uses the sector-wide approach (SWAp) and a program-based method.

### **Case Study: Mali Fast Track Initiative<sup>14</sup>**

During the 2007–08 academic year, Plan Mali initiated the “fast track” reading program called the Systematic Method for Reading Success program, which was collaboratively developed with Malian government specialists and consisted of a series of stages to introduce children to all of the phonemes of the Bamanankan language. The program used a teaching technique that combined creative use of illustrations for words that children had not learned, allowed children to “read” from the first day of instruction.

- Teachers received two weeks of training in use of the approach, in addition to supervision.
- The program was taught in the local language Bamanankan to 1,267 students in 25 community schools (ages 6 to 8).
- From a baseline of 0, after four months of instruction, 89.7 percent of students in the schools could read fluently at grade level with good comprehension.
- Compared to 41.1 percent of the students in national curriculum (or bilingual) schools after a full year of instruction.

An expansion of the program is under way in four maternal languages. A similar program has also been developed in Niger where 390 students in 15 community schools received four months of reading instruction in Zarma.

- From a baseline of 2 percent, 21 percent could read and comprehend fluently on the post test.
- Compared to another test in French with a full year of instruction in government schools, where only 14 percent of students in the first cycle could comprehend what they read.

The relative success of Mali's reading program is one of the many cases in which FTI sponsored programs have taken incremental steps in bringing universal primary education to developing countries. However, this accounts for a very small portion of the country's problem. Mali still currently has a youth literacy rate of 32 percent, primary school enrollment of 74 percent and with an attendance rate of 45 percent. Its worst problem is the 1,112,659 out of school children, which ranks Mali 8<sup>th</sup> highest in the world.<sup>15</sup> An approach that is aimed at encapsulating the entire education sector, in terms of aid effectiveness, is the SWAp. Under FTI guidelines, donors and governments are expected to work closely. Unlike the SWAp of the 1990s, corruption and bureaucracies are no longer issues.

#### **Case Study: Rwanda Fast Track Initiative<sup>16</sup>**

In 2003, the Government of Rwanda adopted its first Education Sector Strategic Plan (ESSP), which consolidated policies into a single comprehensive sector strategy. The government stated a clear preference for budget support over other aid modalities. Donors responded to the re-introduction of the sector-wide approach (SWAp), which bundles both government and external resources in support of the ESSP. Under the FTI Compact, the SWAp provided:

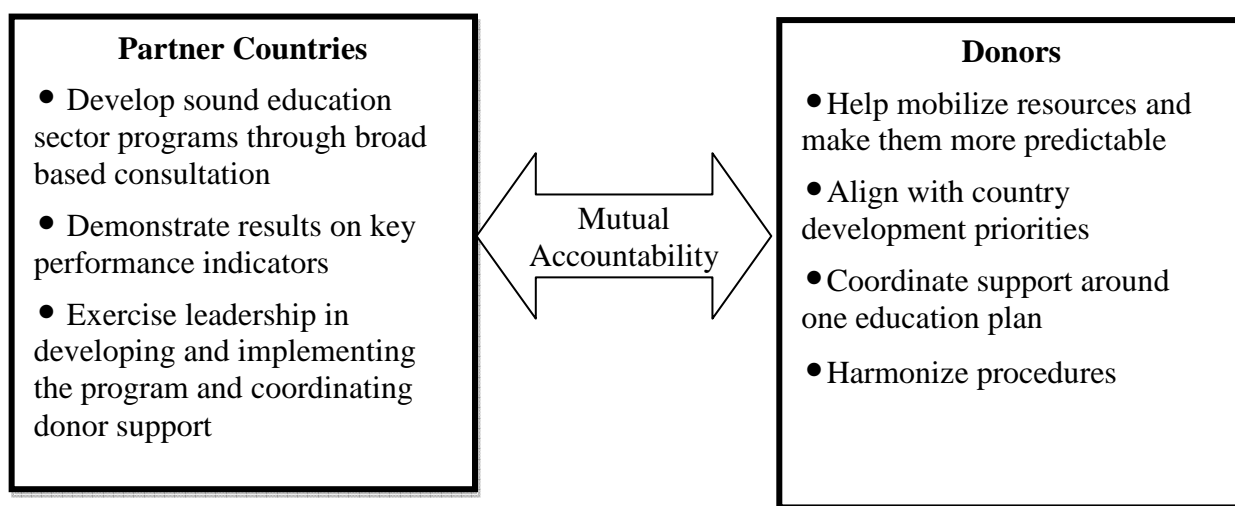
- More effective support to national priorities.
- Increases country ownership and stewardship.
- More partnership between the government and local donors.
- Promotes the delivery of aid in more efficient ways.
- Donors collaboration on joint country reviews and missions
- Increased analytical work jointly, thereby freeing government capacities for more urgent tasks.

By and large, this positive impact has been confirmed in the findings of FTI's 2008 pilot survey on aid effectiveness in the education sector.

One remaining challenge is to prevent Rwanda's education sector from falling victim to its own success. The number of donors who support the education sector has

been growing in recent years. The need to address funding shortages and to attract more donors has to be balanced with the increased requirements in coordination, and alignment. The government is taking a more proactive stance to encourage donors to adopt an improved division of labor.

Rwanda has become the model sector after the implementation of this new policy. Its success underpins the importance of bottom-up development and dialogue and collaboration between local governments and donors have increased the effectiveness of foreign aid. It shows that, if properly carried out, SWAp has the potential to make substantive changes. The relationship between partner countries and donors within the FTI Compact is one of mutual accountability:



(Source: [www.worldbank.org/education/efa](http://www.worldbank.org/education/efa))

The FTI has three degrees of separation from the donors and the immediate stakeholders (families, local communities). FTI administrators communicate with national governments through Local Donor Representatives, who are country-level staff of agencies subscribing to the FTI compact. They are the primary interlocutors with governments on operational issues in the FTI process. They are responsible for assessing the scope, volume and timing of developmental assistance needs and make financial decisions according to policies and regulations of each donor within a framework of commitment to maximize harmonization.<sup>17</sup> Lastly, the Coordinating Agency is designated among the local donor representatives, who have decisive role during the development and endorsement of the

education sector plan.<sup>18</sup> It is unclear how influential donor representatives or coordinating agencies are in allocating funds and what sort of expertise they offer local governments.

The World Bank's Education for All Fast Track Initiative has its merits. The Catalytic Fund, donor-nation harmonization, SWAp, and incremental program-based methods are all beneficial to education development. However, so far the outcome of FTI has not been as promising as expected. Many countries remain off track, with only seven years before the 2015 deadline.

## **Governmental Roles**

### **United States:**

The most prominent US organization responsible for non-military foreign aid is the United States Agency for International Development (USAID). Established in 1961, USAID immediately engaged in education aid, albeit at low levels. In the 1980s, a series of reports regarding the wrongful use of foreign aid generated a deep suspicion, and began a downward trend in American foreign aid. During these administrations aid was primarily used to advertise American investment, free market economy, national interests, and expand the American sphere of influence against the Communist bloc. The end of the Cold War led to cuts in aid spending. From the early 1990s to 2001, the importance of overseas development assistance was stressed and some of the restrictions placed on foreign aid were overturned. Presently, USAID is committed to EFA-FTI and provides resources for this global initiative.<sup>19</sup> The current US position on foreign education aid includes the United States' commitment to improve data collection and using gathered information to identify weak areas and barriers to achieving EFA-FTI goals. Statistics such as dropout rates, repetition, student flow rates, and test results are used to develop strategic plans for schools and departments to achieve their goals. USAID supports a decentralized teacher training program and training for elementary school supervisors. These USAID investments are among the only two donor initiatives that are relevant to classroom teachers.<sup>20</sup>

USAID has a total of 150 accounts and a foreign aid budget of \$39.5 billion. Currently, the President's International Education Initiative is allocated with \$94 million to provide an additional 4 million students with access to quality basic education through

2012. These figures show the level of US commitment to education aid. However, for a developed country the United States' public school system also has its problems. Some of the policies that certain cities have implemented may also be useful in the context of developing countries.

### **Case Study: Incentive Program, Opportunity NYC**

This student incentive program is a conditional cash transfer (CCT) welfare program that targets the most rudimentary level of education, the students. Opportunity NYC is the brainchild of Harvard economist Roland G. Fryer, Joel I. Klein, chancellor of the New York City public school system and Michael Bloomberg. Opportunity NYC is an experimental program that gives financial incentives to students for earning good grades and performing well on standardized tests. Some of the incentives include:

- Students can earn between \$25-\$50 per month for maintaining an attendance level of 95%,
- parents are given \$25 twice a year for attending parent-teacher conferences
- Some schools give \$2 for each book a child reads.

(Source: Opportunity NYC incentive schedule)

Since people respond directly to incentives, in the case of poorer households, cash incentives become all the more important. This scheme can potentially solve the problem of opportunity costs in education. In addition, CCTs can help alleviate the financial burden tied to the conditions that perpetuate poverty. The program currently includes cash rewards for families that maintain health insurance, full-employment, dental care, and regular health screenings. CCTs provide money directly to poor families and establish a social contract with the beneficiaries. Some critics suggest that there can be backlash against the notion that money would motivate students, at the moment this is still uncertain.

The results for this pay-for-performance scheme in NYC are still unclear. However, Mexico's *Oportunidades* program, which captures a quarter of the Mexican population, has been credited with decreasing poverty. In addition to education, the 2002 Mexican program includes health, nutrition and matrimony components. While the *Oportunidades* platform does give cash incentives for education, it also provides direct cash aid to help

improve the quality and diversity of nutrition. The effectiveness of annual cash transfers to villages aimed at improving service coverage and usage of basic health and education service is currently being tested by the MIT Poverty Action Labs in Indonesia:<sup>21</sup> Villages will be given an annual block grant, proportional to the number of households in the village, which they can use to improve the coverage of specified health and education services in their community. In subsequent years, the size of the block grant will depend in part on past performance relative to other villages in the same subdistrict, providing an incentive for villages to use the funds efficiently. The evaluation will compare this incentivized transfer program to two alternatives: a non-incentivized cash transfer model, which will be an identical program but in which villages will receive the same amount of grants in the second year regardless of village performance, and set of controls.

In both New York City and Indonesia, the conditional cash transfer schemes is being tested. A similar experiment tries to solve a problem in many developing countries face: teacher absenteeism, which contributes to the low quality of education. An experiment with 500 Indian public schools was carried out with teachers. Teachers were provided a cash incentive based on the average improvement in their students' test scores. The result of the study suggested that a performance-based bonus has a positive impact on test scores and in turn, the quality of education. The differences in the scores of experimental school students and the control group were statistically significant. The incentive program was also cost effective when compared with the status quo.<sup>22</sup> A similar experiment was performed in Kenya, which also resulted in higher test scores but it was not due to improved teacher attendance. Furthermore, there were no changes found in homework, assignments or pedagogy. It was assumed that teachers conducted review sessions for exams outside class hours. The year after, test scores returned to previous levels, suggesting that teachers concentrated in improving exam scores rather than long-term learning. Lastly, test scores were highest in subjects that relied on memorization such as, geography, history and religion.<sup>23</sup>

It appears that the outcome of the incentive programs and CCTs are variable. Households, students, and teachers in different parts of the world with different socioeconomic backgrounds react differently to cash incentives. Therefore, even though cash incentives may improve the quality of education in one country, it may be a perverse

incentive in another setting. There has been no conclusive evidence in NYC's student incentive program. One advantage of the incentive programs is that it is versatile and can address several problems at once. It could improve the quality of education by giving assistance to households that have financial constraints to education thereby improving the access to education and also encourage students to perform well in school.

### **Privatization and Education Vouchers**

Private education and the voucher system were initially proposed by Milton Friedman in 1955. Friedman believed that the government was responsible for ensuring access to universal education, but operation was not a role of the state. Instead, Friedman envisioned a system of state-funded vouchers that would be given to parents and allow families to choose the institutions they believed were best for their children. Once a radical idea, implementation of the voucher system has spread to several states in the US with varied results. Supporters of the voucher system claim that the privatization of the education sector will improve the quality of schools because schools come into direct competition with each other since families will not send their children to schools with a poor image. Critics of this system have argued that the increase in demand of private education will force private institutions to be more selective and admit students based on academic performance. These students would then end up in public schools and hinder the competitiveness of public schools – perhaps ending universal education. In 2001, the “No Child Left Behind Act” included the voucher system, however results and support for it has been mixed.

A notable case in which the voucher system was adopted by a developing country is Chile in 1980.<sup>24</sup> The Chilean expectations of the voucher system included:

- Rapid expansion of non-religious and profit maximizing schools.
- Market competition would eliminate inefficient schools.
- Students were expected to gravitate toward quality institutions.

However, Chile's experienced many negative consequences:

- The vouchers system pitted private schools against municipal institutions for government funding resulting in a split in the education sector.



- Although low income students were provided choices of schools they lacked adequate information to make the best choice.
- Students also did not have the appropriate means to travel to urban schools.
- Unrestricted school choice has also intensified social stratification due to the selective admissions of certain private schools, creating a concentration of students in public schools

The problem with the Chile case is implementation. This large-scale, nationwide reform was performed with little research and was tied to a political agenda of dismantling the public education system. The political climate provided benefits for investors who ran purely profit-seeking institutions with little regard for negative consequences. Teachers suffered wage declines, deunionization, and deregulation which accompanied the voucher reform. The main growth in private subsidized schools was in the for-profit sector, and not based on voucher plan's failure to produce gains in student achievement.

## **Non-governmental Organizations**

NGOs have always played a large role in foreign aid and development. Successful education-based NGOs have several common characteristics, namely bottom-up schemes, gradual degrees of change, an intimate relationship with the local community, and a steady source of finance.

### **The DREAM Project**

The Dominican Republic Education and Mentoring Project is an NGO that was established in 2003 by a private Dominican mountain bike tourism firm. Its founder, Iguana Mama, eventually sold the business to undertake the DREAM Project. This NGO is involved in many of schools in the community. The organization's philosophy reads, "[w]e stay and we work with them until we have the trust of the community. They know us and we know them. We treat the children in our schools as children; we give them dignity because we believe in them and try to give them the same opportunities as our own children."<sup>25</sup> It has gained international recognition and received volunteers from major universities such as, Dartmouth College, Harvard University, Cornell University and Columbia University, the World Education Corps (WEC), Middlebury College and Oxford University. In its five years of existence, it has worked closely with the local community, serving 2,000 students in ten schools. It has built ten new schools and community centers, constructed seventeen classrooms, six libraries, six bathrooms, three equipped computer laboratories, one science laboratory, one sports field and a 100-foot square foot pavilion. What sets the DREAM Project apart from international donors is that all of its accomplishments are directly in service of the local community because of its relationship with the villages.

The DREAM Project's largest obstacle is its capacity. It's funding and manpower is limited, and does not allow it do cover as much ground as an international consortium. There is also little that this NGO can do to reach families that live in poverty, and the 119,848 out of school children in the Dominican Republic.<sup>26</sup> It can only provide a supportive leg to pre-existing education infrastructure. The changes it makes may affect a small community, but on the grand scheme of things, their effort does not leave a substantial impact on the country.

### **Networking Thai Schools (NTS)**

This NGO began as a school club at the International School Bangkok in 2003. It is similar to the DREAM Project in that it engages with the local community through education. Members of NTS visit the public schools in their area and teach English lessons. Its efforts were generally well received by the school administration and students. Once the school and NTS establish firm ties, the school would no longer have to employ an English teacher as volunteers from NTS provide semi-permanent English lessons several days each week. The organization gradually grew and involved field trips and extra curricular activities. The NTS agenda also grew and began to include many other public schools, as the number of volunteers increased. NTS sought to give assistance further assistance outside of the classroom. For example, families often spoke of expensive bus fees for their students, which was required for students who lived a distance away from the school. NTS began a bicycle campaign which collected and refurbished old bicycles and purchased functional bikes, which were all given to students at each school. It also successfully helped lobby Thailand's Ministry of ICT to endorse the One Laptop per Child program (OLPC) in 2007.<sup>27 28</sup> When the schools in the area obtained new computer labs and laptop computers, volunteers taught students and instructors how to operate word processing programs and helped setup the routing system at each school. NTS technicians also provided maintenance and troubleshooting support for when these machines broke down.

NTS had an even smaller operation than the DREAM Project, however, it managed to reach a large number of schools and become closely attached to its community. However due to limitation of its size, it suffered the same problems as many NGOs did such as lack of funding and the inability to engage in extensive projects. Both, however, capture the spirit of bottom-up development and successfully carried out their goals with limited resources.

### **Pratham**

Pratham is an Indian NGO which began in the slums of Mumbai in 1994. Its founders believed the education deficit could only be solved by involving the people of Mumbai and the government to reach universal primary education. Later, a partnership between Pratham and UNICEF and a public trust was formed by the Commissioner of

Greater Mumbai. It was later taken under the wing of the Industrial Credit and Investment Corporation of India (ICICI) Bank, India's 2<sup>nd</sup> largest bank. Over this 9 year period Pratham has reached out to a million children in 21 states. An accelerated learning method, in which an unlettered child starts reading and computing basic mathematics in 3 weeks, has been in use since late 2002 and since then has taught over 160,000 children to become literate.

The most notable aspect of Pratham is its close linkages to the corporate sector and the government. It establishes a triangular relationship between the corporate sector, government and local community. Corporate donors help finance their operations while the government responds by opening schools, and sharing facilities. Lastly, community volunteers can help implement Pratham programs. The model is easy to replicate since administrative costs are kept low and immovable assets are not required unless a donor specifically requests and the need is clearly established.

Pratham works closely with the government thus it is able to obtain statistics nationwide, and find areas to improve. The most recent Annual status of education in India (ASER) has shown considerable progress. The rate of out of primary school children has decreased to 2.7%, while the number of children in Madhya Pradesh (largest state in India) and Chhattisgarh increased from 31% to 70% in 2008. These gains in education cannot be attributed solely to Pratham, but the improvement in India's education sector is synchronous with Pratham's success.

## **Concluding Remarks: Challenges and Opportunities**

This chapter has examined how international organizations, national governments, and NGOs deal with the problems in the education sector of development. The two main trajectories taken are the sector-wide approaches (SWAp) and experimental approach. SWAps are programs like Chile's voucher program or Mexico's *Oportunidades* that aim to optimize an entire field with one key change. If successful, these approaches can quickly resolve problems or it can backfire and yield negative consequences. The experimental approach used by Poverty Action Labs, NGOs, and New York City's Opportunity program begin with an idea that is slowly tested in a control environment. If successful the same scheme can be implemented in regions with similar characteristics. For example, CCTs for

teachers appear to be more effective than they were in Kenya. This outcome can then be reported to EFA-FTI and CCTs will be carried out in the Indian education system, while new ideas can be formulated for the issues that Kenya face.

The combined efforts of these organizations have ranged from rudimentary methods to encompassing policies. Some have been effective while others were failed ambitions. International bodies and governments are still continuously working to improve the current state of education in order to meet the Millennium Goal by 2015. Despite their efforts, many countries remain off-track and suffer from severe education services. CCTs and Pratham are promising ideas in the movement for universal education. The voucher system, given proper research and execution may also yield positive results. If the correct path is taken and donors consistently finance the proper approach, universal education by 2015 is attainable.

## **OPTIONS**

- **Increase funding for Conditional Cash Transfers (CCT)**

Conditional cash transfers are currently being carried out by some local governments, and NGOs, but have not yet been implemented by EFA-FTI programs. Funds should be channeled to support CCTs in order to help improve the access and quality of education. Furthermore, there should be increased financial support for the usage of CCT through EFA-FTI programs. Conditional cash transfers are incentive programs that are extended to households, and teachers. In certain cases, CCTs should be offered to low income families in exchange for the enrollment of their children in public schools. One problem that low income families face is the opportunity cost of sending children to school. CCTs alleviate some of the financial problems that these families face. At the same time it could increase enrollment rates and decrease the number of out of school children. However, different regions or countries will yield varying results. Households that will directly benefit from cash transfers are likely to positively react to CCTs, however in areas where culture and tradition are the problems that the education sector faces, CCTs may not be as useful. Furthermore, if the problem lies in poor quality of education, this kind of cash transfer may fail to improve the situation.

Instead CCTs should be offered to teachers that are able to cultivate a learning environment in their classrooms. Schools that suffer from teacher absenteeism or unenthusiastic teachers typically have faculties that are paid low wages. A cash reward can be extended to teachers who are able to raise standardized tests scores of their students. Parents and students should also be involved in evaluating the effectiveness of their teachers. CCTs to faculty members can also be based on the grades parents give them, which could potentially improve the teaching quality. There are also drawbacks to this CCT scheme as some teachers may “teach an exam” rather than fundamental course material and although exam scores may improve, students are not receiving a higher quality of education. Ongoing research conducted on CCTs has yielded mixed results. In certain cases students and teachers have responded to cash transfers and education has improved, while other times it has not.

- **Endorse an education voucher system**

In many countries where the existing education system is extremely weak, even negligible gain is an improvement. In these cases, there may be viable reasons to consider opening the trade doors to for-profit school management providers.<sup>29</sup> This process can begin on higher secondary education, with extra-curricular activities and training, but primary education is the ultimate desideratum. This option is aims to provide a private supply of a publicly undersupplied service; funds should be used to support education voucher systems in poor countries. Since private schools are known to have a higher standards than public institutions, by providing households with education vouchers that can be used at any school, low income families will also have access the same high quality education as medium to high income households. This will bypass the financial constraints of the household and will increase enrollment rates. Low income students will now be able to attend private institutions while their families do not have to bare the financial burden. The voucher system has been used in the United States, Sweden, and Chile with mixed results.

Some problems that arise in the voucher system are private schools becoming more selective in the admission of their students, imperfect information in low income families, access to education, and the politics behind the voucher system in each country. Poor

families that are given vouchers may not know where the best schools are and thus do not fully benefit from their vouchers. This option also fails to address a fundamental problem in the education sector of access. The basic action of traveling to a voucher school may be impossible to road conditions or distance thus leaving the students facing the same problem of access and quality. Lastly, in each country the voucher system is typically carried out by the government and because there is a potential for profit to be made, lobbyists or corruption can reduce the effectiveness of the system. The problems that the voucher system faces are easily solved, for example, it can be monitored by an independent commission to ensure transparency, information pamphlets can given to families to increase their knowledge of schools and transportation subsidies could be attached to certain families that cannot afford a means of transport. Despite these suggestions, new unique problems are expected to arise in each region. The voucher system can be favorable if the area it is used in is carefully selected and researched before implementation.

- **Finance and Implement the Pratham model**

The Pratham NGO in Mumbai has had successful history. The improvement in India's education sector cannot be solely attributed to Pratham, however, the increased cooperation between local communities, the private sector, and the government is largely what Pratham seeks to establish in the places it operates. On the surface Pratham is like any other NGO that seeks to improve the lives of the disadvantaged. Its initial operation in the slums of Mumbai tackles the education by working with local communities. However, Pratham distinguishes itself from other NGOs by increasing cooperation between all the actors and agencies involved in the education sector. It harmonizes the efforts of international organizations and governments, and local communities while private firms that want to show their corporate social responsibility are kept within the loop to help finance operations. A proliferation of NGOs similar to Pratham would be beneficial to the education sectors of poor countries as not only would it help with improve basic education, but NGOs understand clearly the more pressing problems of the community. If the NGO is able to link government, donors, and private sector together with a single cause, they can better allocate their resources. The Pratham model is able to overcome a major obstacle of many NGOs, which is its capacity. Large NGOs are known to have funding lost in their

bureaucracies, while smaller NGOs, although proficient in handling resources, simply do not have the capacity to make substantial changes. Pratham itself is a large NGO that uses little overhead costs, fixed assets and has high mobility. It has reached 21 states in India and has improved the state of education from the basic reading programs, to a longstanding partnership with the Indian government.

The Pratham model elsewhere, however, will not be precisely as it is in Mumbai. An NGO in Sub-Saharan Africa may not be as active as Pratham, which is run by Indians who are passionate about their cause. In a region where assistance is much more urgent an African run NGO may not work as well.

## **RECOMMENDATIONS**

This chapter recommends two phases to the implementation of conditional cash transfers. Firstly, the experimental phase will test out the CCT in selected schools in regions across a country. A lump sum should be provided and regulated by EFA-FTI and government officials to a handful of primary schools in order to ensure proper usage. The type of incentive program should also be selective. In regions that have a low enrollment rates, and high numbers of out-of-school children, the household incentive program should be tested. Places with low test scores, teacher absences, and overall poor quality of education should run a teacher and student system e.g. NYC Opportunities. The experiment process should be carried out for at least two years to review standardized test scores, enrollment and dropout rates, and overall accesses and quality of education. This scientific approach to development can be used in other policies in order to gain information on the most effective programs in each area.

The second phase of this policy recommendation is a sector-wide approach (SWAp). Schools that experienced improved enrollment rates, test scores, etc. will receive continued CCTs, while schools within the same region that service households with similar socioeconomic statuses will receive the same cash transfers. If the nation responds well to CCTs it will be applied to the entire education sector, with the expectation that it will ameliorate the nation's entire sector.

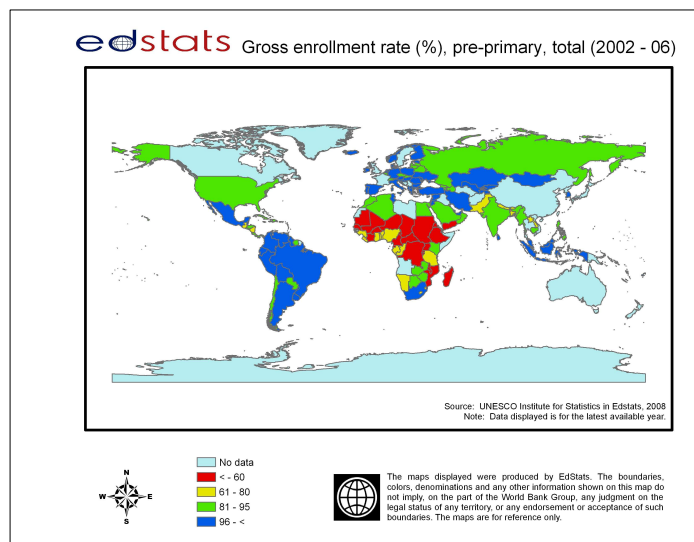
There is, however, no universal cure for global education development. Each region and country is unique in its own way and a certain policy may be successful in one context,



but only partially effective in another. If Option B and C underwent the experimental phase and produced positive results they should be incorporated into the SWAp. Education vouchers and Pratham have a high potential for success, but their outcomes cannot be immediately observed like that of CCTs. It may take several years for the effects of the voucher system to be apparent or Pratham-type NGOs to establish a presence in a community.

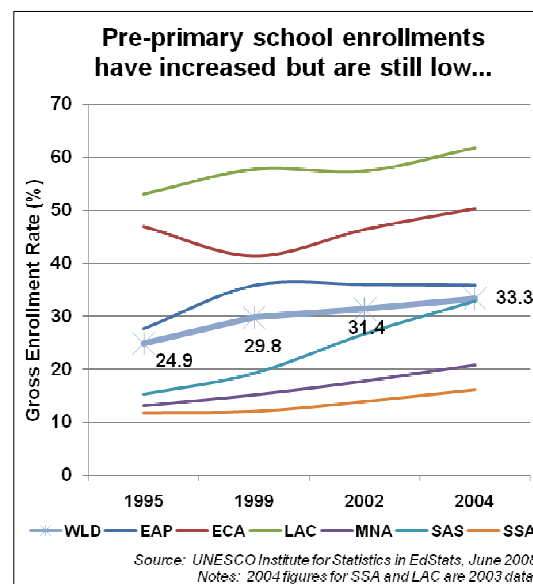
# Appendices

## Appendix A

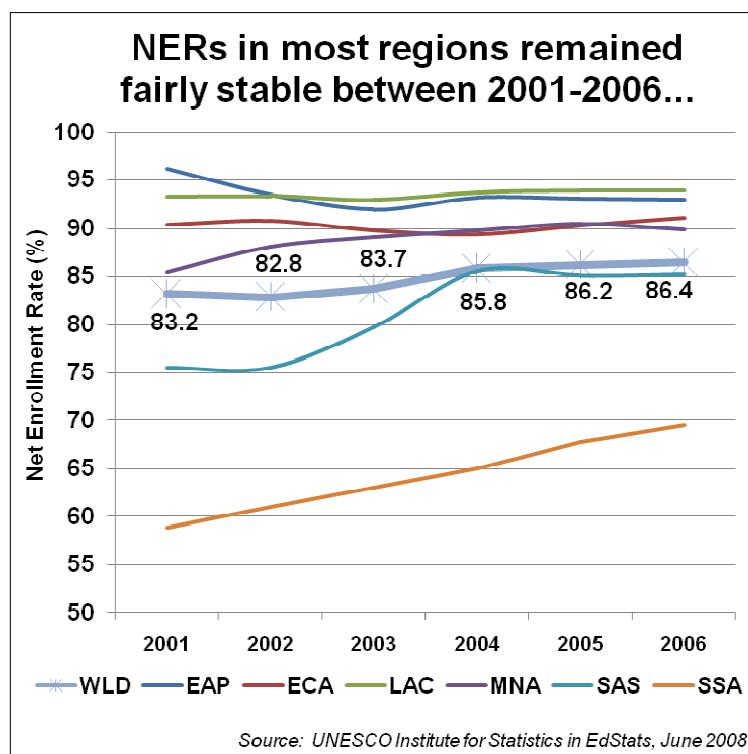


## Appendix B

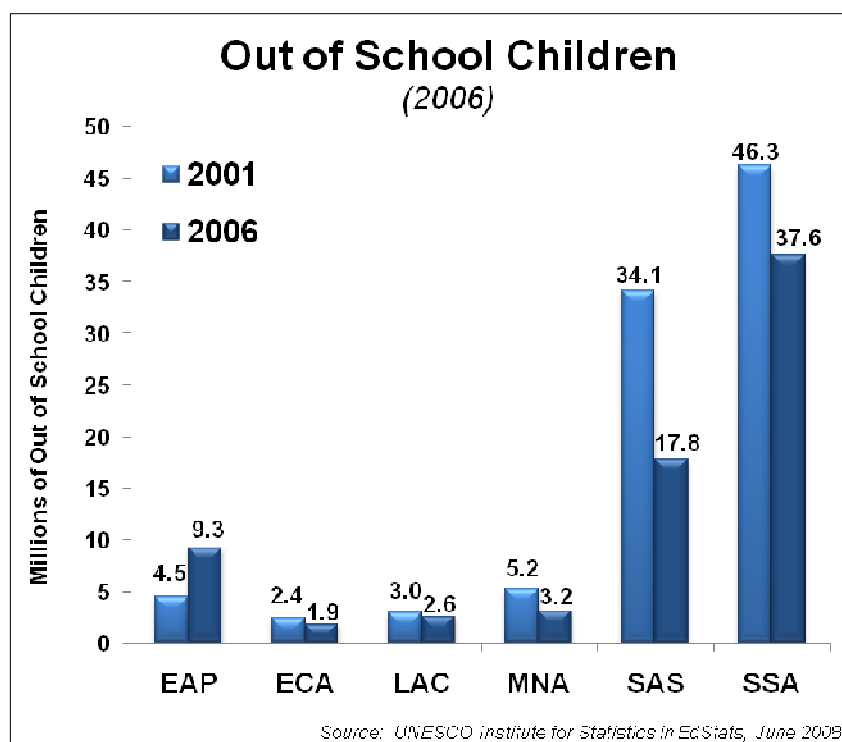
Acronym	Name
EAP	East Asia and Pacific
ECA	Europe and Central Asia
LAC	Latin American and the Caribbean
MNA	Middle East and North Africa
SAS	South Asia
SSA	Sub-Saharan Africa
WLD	World (Global Aggregate)
GER	Gross Enrollment Rate
NER	Net Enrollment Rate
OOS	Out of School



## Appendix C



## Appendix D



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- <sup>2</sup> Jandhyala B.G. Tilak, "Foreign Aid for Education," *International Review of Education* 34.3 (1988): 313-335.
- <sup>3</sup> Appendix A
- <sup>4</sup> Appendix B
- <sup>5</sup> Appendix C
- <sup>6</sup> Appendix D
- <sup>7</sup> C.B. Lloyd & A.K. Blanc, "Children Schooling in Sub-Saharan Africa," *Population Development Review*, 22:(1996)
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- <sup>9</sup> F. Dall, "Confronting the Basic Education Crisis: The Ambian Dilemma," (Cambridge Bridge Project, Harvard University 1989)
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- <sup>11</sup> United Nations, 55/2. *United Nations Millennium Declaration*, 8th plenary meeting., September 8, 2000
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<sup>25</sup> “Our History, Our Philosophy, Our Accomplishments,” *The DREAM Project*, <http://www.dominicandream.org/what-is-the-dream-project/history.html> (Accessed Feb. 14, 2009)

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## **Chapter 9**

# **MAKING TECHNICAL AND VOCATIONAL EDUCATION RELEVANT**

*Jessmin Lau*

### **ISSUE**

Education is crucial in alleviating poverty and stimulating economic development but while financing and implementation of basic education programs have accelerated, alternative forms of education have been largely ignored. This has to drastically change if we truly desire to increase access to education for all. Education, in particular technical training and vocational education (TVET), is the key to achieving sustainable, bottom-up development by imparting the knowledge and skills necessary for people to take advantage of their opportunities, available resources and realize their full potential. While basic education, primary and secondary, are crucial in improving literacy rates, alternative forms of education such as TVET must also be explored, in particular with regard to people in areas where traditional academic education is impractical or impossible.

TVET can enable people of developing countries to learn the skills necessary for productive work and employment using levels of technology suitable for their communities and environment. It has the potential to instill the attitudes, skills and values necessary in preparation for joining the workforce. It can also serve as an additional avenue for non-traditional students such as older workers who lack the basic skills for employment, entrepreneurs of small businesses and child laborers who are unable to attend school with regularity.

The crux of the problems currently faced by many TVET programs is that most of them offer skills and training that are highly impractical and unsuited to the conditions of the country. Many of these training programs are geared towards high-technology, high-profile industries which sometimes do not even exist in developing countries. As a result, graduates of these training programs have no viable opportunity for work. In order to analyze accurately what skills are most relevant to the conditions of each country, the

people of the local communities have to be consulted and their local knowledge tapped, to ensure the success of TVET programs.

## **BACKGROUND**

### **Introduction**

A basic, general academic education aimed at increasing literacy and numeracy is essential and beneficial to developing a productive society capable of taking advantage of the opportunities offered through aid development and pulling themselves out of poverty. However, the current state of education with its recurring problems of high drop-out rates, absenteeism and an overall lack of access to a huge proportion of people in developing countries, illustrate the need for an alternative measure of education to plug in the gaps and fulfill the needs that a more general, basic education is unable to address.

TVET is a branch of education which focuses on the acquisition of practical skills, attitudes, understanding and knowledge relating to occupational work.<sup>1</sup> It is also known as “workforce development” under the USAID policies. As can be seen, TVET seeks to exert a direct effect on the economic productivity of a society. It is a means of preparing for effective participation in the world of work and there is no stronger, more direct correlation than that of a workforce’s productivity and poverty alleviation. Used effectively, as in the case of East Asia in the 1960s, TVET programs are fully capable of enhancing economic competitiveness and reducing poverty by equipping a society’s pool of labor with essential skills for employment.

Given the extent of widespread, debilitating poverty in the world, faster, more efficient and comprehensive methods of poverty reduction have to be devised and implemented to reach those that currently do not have access to educational options and poverty assistance. TVET can fulfill these major twin goals of bottom-up development by equipping people in developing countries with certain attitudes, skills and values necessary for productive work or in preparation of joining the workforce and ideally, provide opportunities for employment in a wide range of job categories.



## **The Current State of TVET Programs**

Currently, UNEVOC-UNESCO is the largest and most cohesive global institution focusing on TVET programs in the world. UNEVOC is the International Project on Technical and Vocational Education of the United Nations Educational, Scientific and Cultural Organization (UNESCO). It was launched in 1992 following a resolution of UNESCO's General Conference in 1991. The objective of this project is to strengthen the development and improvement of TVET in UNESCO Member States.<sup>2</sup> As a small subsidiary of the United Nations (10 full-time staff), the organization's main objective is to work closely with governments of member states to improve and integrate TVET as part of the global "Education for All" campaign. Its work in developing countries largely focuses on the public sector and involves the cooperation of the local governments.

As the only global authority on TVET programs, UNEVOC has published the only broad overview of participation in TVET programs in the world.<sup>3</sup> However, data is still far from detailed. The study itself acknowledges that there are a myriad of problems associated with gathering information for TVET programs, primarily:

- Problems with defining TVET programs. TVET often cuts across many disciplines such as formal education, training courses linked to labor markets, microfinance projects, healthcare measures and so on. There is no consistency in drawing the boundaries of TVET programs thus many countries provide data that is inaccurate and not standardized.
- In many cases, there is simply a complete void of data even in countries which claim to be working on developing TVET programs.
- Misrepresentation of TVET as being less relevant than other forms of education.

As a result, there is no single source of accurate and up-to-date information and only a general idea of the extent of TVET programs can be grasped from statistics. Table 1 shows a broad overview of TVET programs offered in the 143 member states.

**Table 1: TVET programs offered by level (number and percentage of countries)**

		No	Yes	Data not available	Total
Vocational enrolment at lower secondary (ISCED 2)	N	125	49	33	207
	%	60.4%	23.7%	15.9%	100.0%
Vocational enrolment at upper secondary (ISCED 3)	N	29	136	42	207
	%	14.0%	65.7%	20.3%	100.0%
Vocational enrolment at post-secondary non-tertiary (ISCED 4)	N	79	80	48	207
	%	38.2%	38.6%	23.2%	100.0%
Enrolment at tertiary ISCED 5B	N	43	104	60	207
	%	20.8%	50.2%	29.0%	100.0%

Source: UNESCO Institute for Statistics database, 2005.

ISCED stands for International Standard Classification of Education and is a method employed by UNEVOC in classifying TVET programs by the level of education they are typically offered at. It can be seen from the table that there is an overwhelming number of countries in which data is not even available for assessment. However, a general trend can be detected: TVET programs are typically offered at the tertiary level of education which many countries feel is a right age for diversification of curriculum and courses in preparation for joining the workforce. Unfortunately, it is extremely unlikely that the students in developing countries will have access to tertiary education options when enrolment rates for primary education are already inadequately low.

Another common indicator for measuring the scale and scope of developmental programs is the amount of funding allocated. Again, information is drastically lacking but for a general overview, Table 2 shows the percentage of TVET expenditures in total education expenditures of the only countries in Africa with information in this area.

**Table 2: Percentage of technical and vocational education expenditures in total education expenditures**

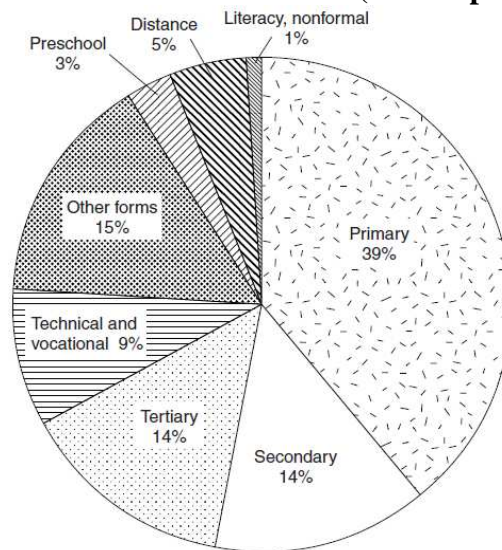
Country	%	Year	Country	%	Year
Benin	3.3	1995	Guinea	7.5	1993
Botswana	5.5	1991	Lesotho	3.3	1994
Chad	2.0	1994	Malawi	1.1	1992
Congo	4.9	1980	Mali	9.1	1995
Côte d'Ivoire	4.8	1994	Mauritania	2.3	1995
Eritrea	1.6	1994	Mozambique	6.2	1990
Ethiopia	0.9	1993	Namibia	2.0	1995
Gabon	12.7	1992	Senegal	2.7	1990
Ghana	4.9	1990	Togo	3.7	1994

Source: ILO, World Employment report 1998/1999 cited in Atchoarena and Delluc, 2002, pp. 45.

The data presented in this table is extremely outdated yet it was the only information regarding fund allocations cited in UNEVOC's latest 2006 statistical study. This implies that since the 1990s, TVET programs have almost entirely disappeared under the radar of education awareness in developing countries.

In recent years, technical training and vocational education has been increasingly excluded from mainstream educational development assistance. Since 1980, despite an increase in the World Bank's overall funding for the education sector, disbursements to TVET programs continued to decrease until, by 2002, the percentage had fallen to no more than 9% of the World Bank's gross education sector assistance.

**Table 3: Education Assistance (As of April 2002)**



Source: World Bank Development Report 2006

On the contrary, the percentage of primary education assistance grew at an inversely proportional rate. Investment in TVET declined sharply from 51% of overall investment in education in 1963-1976 to a paltry 25% in 1990.<sup>4</sup> Moreover, while basic education is usually well-defined and strictly delineated as academic knowledge acquisition, technical and vocational education is seldom so distinctly apparent. Indeed, an overwhelming majority of data sets from private and public developmental organizations do not even have a category for TVET despite the fact that some form of technical training or vocational education usually takes place within the confines of secondary or non-formal education. The World Bank's Education Statistics Public Expenditure Database only has one country listed with a proportion of investment in TVET, rather unsurprisingly, that proportion is a very inadequate 1.8% of Mozambique's public expenditure. Ultimately, the three most fundamental problems faced in effective implementation of TVET programs is the lack of information, awareness and financial support. Until resources and attention can be afforded to TVET programs, we will never realize the true potential of TVET programs as an alternative form of education.

Detractors of TVET programs claim that TVET does not appear to exert an impact on employment rates, wages and worse, in some cases, result in a decrease in academic achievements. However, there are so many other components that determine employability

such as the actual economic environment of each individual country and the availability of jobs that TVET can hardly be isolated as the sole determining factor. Most significantly, TVET has not even been tried out with proper procedure on an observable scale in the developing world.

There has been a general stagnation in net enrollment rates in primary education programs in various regions of the world despite a corresponding spike in funding from the World Bank and other nations<sup>5</sup>. This does not, in any way, indicate that funding from primary education ought to be redirected to technical training and vocational education. The two are complements that cannot work alone. However, it should serve as an example that even with 34% of total education funding and high awareness, primary education has not been a decisive success. On the other hand, TVET programs which are only allocated one-third the amount of finances reserved for primary education, have been largely written off without being given a chance to be tried out, implemented and studied in developing countries. In order to conduct more controlled experiments with TVET programs and determine the right ones to push through, more investment that is commensurate with the potential benefits that TVET programs can yield has to be allocated to this sector of education.

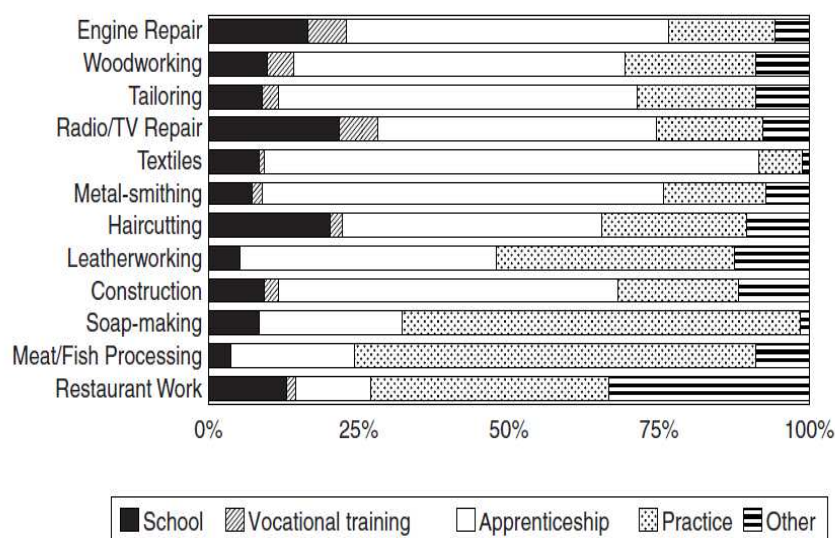
## **Relevance and Benefits of TVET Programs**

TVET has been considered as a second rate educational alternative for a long time. However, current TVET programs cover an increasingly wide range of skills with openings in vocations that were unknown ten years ago. This training helps young people and adults to face the new challenges of globalization, giving them the opportunity to acquire new skills and adapt to key vocations in a modern society. TVET is also able to serve as a complement to the acceleration of basic education programs. Given the urgency attached to developing the education sector under the Millennium Development Goals, TVET should be highlighted as an effective, indispensable counterpart. The “Education for All: Fast Track Initiative,” mentioned in the previous chapter, seeks to improve the access and quality of basic education programs in the developing countries. As a logical progression, as primary education enrolment increases, the access and quality of post-primary education options will have to increase proportionately to accommodate the

number of graduates. Particularly in developing countries where the education system is not well-developed and there are very few, if any, tertiary education options, TVET is a viable option for allowing graduates of primary education to immediately move on into the working world. This will enable more immediate economic development in developing countries, on a sustainable and practical scale than can be achieved by pushing through with tertiary education systems.

Primary education is extremely important as a foundation for skills acquisition, however, that alone will not result in competitive competency skills for the labor market. Graph 1 is a direct, clear illustration of the usefulness and relevance of vocational training and apprenticeships in managing microbusinesses.

**Table 4: Most useful mode of skills formation according to persons running microbusinesses in Dakar, Ibadan, Lome, and Niamey (Sample of 1751 persons)**



Source: Fluitman pg.2

Although this sample is clearly not indicative of all participants of TVET programs, it certainly shows that apprenticeships are a very useful component of TVET. Given the increasing awareness of micro finance as a crucial tool in alleviating poverty, TVET is a necessary aspect in ensuring that individuals who obtain the credit to start their own businesses have the ability and skills to generate profit and ensure stability in their ventures. Fortunately, apprenticeship programs are very practical and well-suited to the often rural, agricultural or underdeveloped economies in developing countries.

The complementary benefits of TVET for many existing critical development programs are undeniable. If incorporated into mainstream education and microfinance programs, TVET will enable them to become more effective and inclusive in reaching out to the greatest number of people.

### **Existing TVET Programs: What Works and What Does Not**

The lack of information in the field of TVET should already be a common theme in this chapter. Not surprisingly, there is a similar void of data in the evaluation of existing TVET programs. Many programs advertize success in terms of enrolment rates and expenditures but these measures of success are not relevant and do not directly translate to actual benefits for the people in developing countries. This is an evaluation of some of the more notable existing TVET programs.

#### **CASE STUDY 1 - UGANDA YOUTH DEVELOPMENT LINK (UYDEL)<sup>6</sup>**

##### **A SUCCESS STORY: UGANDA YOUTH DEVELOPMENT LINK**

The Uganda Youth Development Link is a non-profit agency funded by UNESCO. The project put in place in Uganda aimed to impart livelihood skills to the marginalized street and slum youth in the poorest regions of Uganda. Careful selection of individuals who genuinely wanted to pick up a skill was conducted with individual interviews, surveys and weeks of data collection in the area. Artisans, craftsmen and other professionals were then recruited from the local community and connected with participants of the program who wanted to learn a specific skill or trade. Many of the local professionals agreed to train these youth without any form of payment because they saw the program as helping their own community. Upon completion of the program, which can range from a few days to a month or more, the apprentices were evaluated by their mentors and frequently offered a job.

Here is an anecdote from a participant of the program:

"William (not real name) was born in 1987 and both parents died in 1997. He dropped out of school after senior three because he could not raise school fees to continue with his education. He started using drugs due to peer pressure. He came to UYDEL for help because he had become addicted to drugs. At the center, he was counseled and advised to take on vocational skills training to get an alternative to spending time and earning a living. He chose to do motor mechanics at Toyota Genuine garage in Wandegaya. Since then, he stopped using drugs and has been retained to work at the same garage."

(Source: UYDEL, pg. 38)

William is a classic example of many of the beneficiaries of the UYDEL program. These youth are frequently the ones most in need of aid and education so that they can break out of a vicious cycle of drug abuse, prostitution and poverty.

UYDEL demonstrates many crucial elements of a successful TVET program:

- Appropriate, precise identification of the people who are most suitable, in need and actually desire the acquisition of skills
- Adequate funding to provide certain essential tools such as sewing machines or hair trimming shears
- On-the-ground networks between mentors, trainees and potential employers

UYDEL managed to cut costs to a bare minimum by utilizing the resources and human capital from the immediate area itself instead of importing materials or teachers from outside Uganda. Despite popular misconception, poor, developing countries do have the means of helping themselves. Artisans, craftsmen, tailors and mechanics were recruited locally from Uganda and persuaded to impart their skills of the trade to these disenfranchised youth. Frequently, they were willing to take on students without any payment and if the trainees performed well, they were often employed by the same tutors or offered contacts to other potential employers. These linkages and the opportunity for employment are one of the most crucial aspects of successful TVET implementation.

The success story of UYDEL's project which involves identifying and providing TVET courses to 200 children from the poorest, most impoverished parts of Uganda serves to illustrate the benefits of bottom-up development in technical training and vocational education when it is implemented in response to the needs of the community.

## **Case Study 2 - Adult Learning Network in Western Cape, South Africa<sup>7</sup>**



### **ROOM FOR IMPROVEMENT: THE ADULT LEARNING NETWORK**

The Adult Learning Network is an adult basic education program which includes skill-training programs, HIV and AIDS education and awareness in rural environments. Training courses implemented including farming techniques, business development, hairdressing and most recently, in 2008, bookkeeping. The project primarily targeted HIV-infected women and youth but was also of benefit to the wider rural community. South Africa is one of the worst affected by HIV and AIDS in the world, with an adult prevalence rate of about 19% and nearly 6 million people living with HIV (UNESCO, 2007). Particularly in the Western Cape region, where this program was implemented, the Stellenbosch area in the Western Cape Province is characterized by seasonal work, meaning that farm workers and their families are either unemployed during the off-season or unable to attend school during the peak seasons.

In situations like those depicted in South Africa where many people in rural villages do not have the luxury or opportunity of attending regular classes, standardized basic educational curriculums are difficult to adapt to local conditions, TVET programs are a viable alternative to teach the local community productive skills for employment and also to raise awareness for health concerns, reducing their vulnerability to HIV and AIDS.

The Adult Learning Network managed to reduce initial capital outlay by collaborating with local communities. One key partnership was forged between the Klapmuts Feeding and Development Project which was a community-based and community-led initiative aimed at developing farming skills and food gardens in the community. Through collaboration with already-existing small-scale communities, the project provided the legal structure, funding, expertise and technology to make greater impact.

Despite the achievements of this program in alleviating poverty and providing alternatives to seasonal work, one of the notable failures was the lack of in-depth data collection in matching trainees to the available courses. People were instead grouped according to literacy levels or gender instead of their actual preferences and some participants noted regret at not being able to learn particular skills that they had wanted initially. The program also did not establish the crucial linkages between employers and

participants of the program so that besides self-employment, the trainees largely returned to their old seasonal jobs. This is a common phenomenon across many TVET programs in developing countries. Initial success is measured through net enrolment rates but there is no method of following up with participants after graduation from these programs.

### **Case Study 3 - Pinelands Creative Workshop, Bridgetown, Barbados<sup>8</sup>**

#### **A SUCCESS STORY: PINELANDS CREATIVE WORKSHOP**

Bridgetown, Barbados has one of the worst socio-economic problems in the world. Substance abuse, violence, HIV infections, academic failures, delinquency, unemployment and many other problems are rampant in this city. The Pinelands Creative Workshop was implemented to specifically combat youth vulnerability to crime, violence and the chosen method was TVET programs targeted to provide an additional route out of the vicious cycle of crime and poverty. Training courses such as computer training, marketing, basic accounting, legal orientation was introduced. At the end of a 6-week program, a “Job Fair” was held where local businesses and partners were encouraged to attend and conduct interviews with participants for potential employment opportunities.

This was one of the more successful TVET programs which assessed the needs and interests of community members before embarking upon actual implementation. This resulted in a successful program which empowered women and youth who had fallen through social and economic cracks. In order to seriously affect and change living conditions, the program sought to create wealth through business, employment and the development of marketable skills as alternative way of raising income instead of resorting to crime.

One of the most unique characteristics of this program in comparison to the previous two case studies was the larger scope of programs offered. Training courses were extremely relevant and up-to-date, in response to the current labor market situation and demand for labor in both public and private sectors. Specific programs in areas where employment opportunities exist such as plumbing, electrical installation, mechanics and carpentry were also established so that participants could be connected to local mentors willing to give back to the community. The introduction of a “Job Fair” gave participants

of the program actual, realistic opportunities for employment which should be the guiding principle of all successful TVET programs.

### **The Role of the Government**

The government's primary role in TVET is in designing systems and establishing the legal framework while simultaneously collaborating with industry and the private training sector whereas it ought to keep direct implementation of training programs to a minimum. The problems with direct government intervention and top-down approaches in TVET programs are failures to accurately grasp labor demand, market conditions and industrial development trends. The formal sector in many developing countries only comprises 10-30% of the workforce and TVET policies that rely too much on the formal sector to generate employment demand are often less effective from a poverty reduction perspective.<sup>9</sup> In this case, determination of the skills desired by the current labor markets ought to be left up to the market mechanism or to small-scale, in-depth research teams who are better able to communicate with local communities.

However, this does not mean that the government plays a peripheral role. When proper, efficient governance exists in developing countries, TVET programs have attained the greatest success. In fact, many developed countries now have built their past successes on effective TVET systems.

### **THE FIRST OF ITS KIND: GERMANY'S DUAL-SYSTEM**

Germany was one of the first countries to practice TVET on a large scale. The government implemented a “Dual System Structure” that has been studied for application in developing countries. The larger part of the learning process takes place in production facilities or service enterprises in industry, commerce, home management and agriculture. The students are trainees in a company. They receive formal practical training in a company for three or four days per week and part-time theoretical training in a vocational school for one or two days per week. Responsibility for the training is shared by all those involved: employers, employees and governmental authorities cooperate at all levels. The theoretical technical education in the vocational schools is in the responsibility of the state while the practical training is in the responsibility of the company. Such cooperation is subject to legal regulations and has proved to be successful. State and companies share the costs of training.

Companies provide training voluntarily at their own expenses because they believe that it is the best way in which to provide for their own need for skilled staff. No company is obliged to provide training and no young person in Germany is obliged to undergo training. However, approximately 70% of all school leavers in Germany today embark on training under the dual system.<sup>10</sup>

The most important role of the German government in this scheme was the provision of legal framework and standardization through State Education Acts. Upon completion of the 2-year program, the trainees attain certificates and qualifications which open the path to employment within an occupationally structured labor market.<sup>11</sup> The success of the system can be seen in that it recruits almost three-quarters of the 16-19 year olds and thus contributes to holding the number of unskilled employees in the economy down. Unlike England or France, where graduates of vocational training systems form a marginal proportion, apprenticeships exist in all branches of the Germany economy including the professions and parts of civil service.

One of the most obvious advantages of the dual system is the practical training in the companies which takes place under actual conditions of using machines and facilities which reflect the current state of the art. On completion of their training, skilled workers

are able to enter a qualified position immediately. The purpose of technical training received at the vocational school is to promote and to supplement the training received by students in companies at a theoretical level and to improve and fill gaps in general education.

### **STANDARDIZATION IN UGANDA**

An example of how governance can play an integral role in the implementation of TVET programs in developing countries is Uganda. TVET institutions in Uganda traditionally follow a top-down approach and fall into the following categories: 1) the Uganda Technical (Two-Year) College providing diplomas at the tertiary-education level, 2) technical institutes and vocational training institutes at the upper secondary level and 3) technical schools, farm schools, vocational training centers and community polytechnics. One of the strengths of TVET programs in Uganda is the support of the government. Uganda's government has drawn up an Education Sector Strategic Plan (2004-2015) in which TVET is a focal policy concern. The government provides the necessary legal framework for TVET programs that legitimize and recognizes the value that TVET adds to the economy and society. There are craftsman certification examinations at the technical institutes and trade certification examinations at vocational training institutes. The Education Ministry has set its aim to achieve uniformity by 2011 by way of a system called the Uganda Vocational Qualification Framework.

However, Uganda is a unique example in which good governance has complemented public and private sector TVET programs. A large part of the burden of putting in place cost-effective and successful TVET programs still falls onto the private sector and non-profit organizations.

### **Concluding Remarks: Challenges and Opportunities**

This chapter has illustrated the extensive benefits and relevance of TVET programs in developing countries. The biggest problems facing this education sector are lack of funding and awareness. There have been some successful, controlled-environment TVET programs that lack the finances to expand. At the same time, a dismal lack of awareness of

the benefits of TVET programs in developing countries have led to a perception that it is a second-choice option compared to primary education. Furthermore, the concept of basic skills and desirable skills of employability changes and evolves quickly. In order to keep up with labor markets and industries, non-profit organizations, the private sector and the government have to work together to analyze carefully the conditions in each country to determine the best fit of TVET programs. Given the potential of TVET programs, it would be a pity to continue funding this education sector without developing clear guidelines for information-gathering and success evaluation. Most importantly, TVET programs have to take into account the social, political and economic conditions of the country. In the absence of industrial employment opportunities, self-employment upon completion of TVET programs should be encouraged and employed along with microfinance and entrepreneurship policies. This will develop the private sector of any country and form the foundation for future, self-motivated economic growth.

## **OPTIONS**

- **Provide Incentives: Voucher System**

Given the lack of adequate, relevant information in the TVET sector, the redistributive effects of a voucher system will produce the most noticeable benefits at the least cost. As mentioned before in the bulk of the chapter, cooperation between the government and private sector is invaluable for producing the best results. One way this can be accomplished is through a voucher system in which the government acts as the legal authority for voucher distribution. Faced with vouchers that represent real monetary value, the free market mechanism can be utilized to ensure that individuals who do not truly desire to undergo skill-based TVET learning will pass on their vouchers to others who genuinely wish to. Vouchers can also act as a payment mechanism and monetary incentive for local businesses and professionals to offer their services in training participants of TVET programs. This option is most effective in regions where we have very little information on the profile of individuals most likely to maximize the potential of TVET programs.

- **Provide Opportunities For Employment**

The practicality of TVET necessarily dictates that it has to be linked to the real working world and labor markets. TVET cannot exist in a vacuum, unconnected to political, economic and social conditions of the country, or it loses its effectiveness. All TVET institutions should actively develop connections between relevant industries and participants through on-site training, job prospects, job fairs or field trips. TVET institutions should also undertake regular interaction between the commercial industry and students by recruiting businesses, corporations or professionals that are relevant to the skills taught in the program. It is also advisable to integrate entrepreneurship training to encourage self-employment and the development of the private sector in developing countries.

- **Enact a Standardized System of Qualifications**

The government can play a decisive role in this aspect by putting in place a legal framework and a uniform system of qualifications for example setting up Training Advisory Boards to evaluate a particular skillset. This will give TVET programs the much-needed recognition to succeed particularly since any people still regard it as inferior to traditional academic education. Standardized qualifications with clear levels and progression paths have to be set up within private or public schools. An accreditation mechanism that can enable credible evaluation of certificates by both employers and further training institutions. Learning guides, curriculum and tutor standards need to be synchronized to meet the qualifications standard for certification.

## **RECOMMENDATIONS**

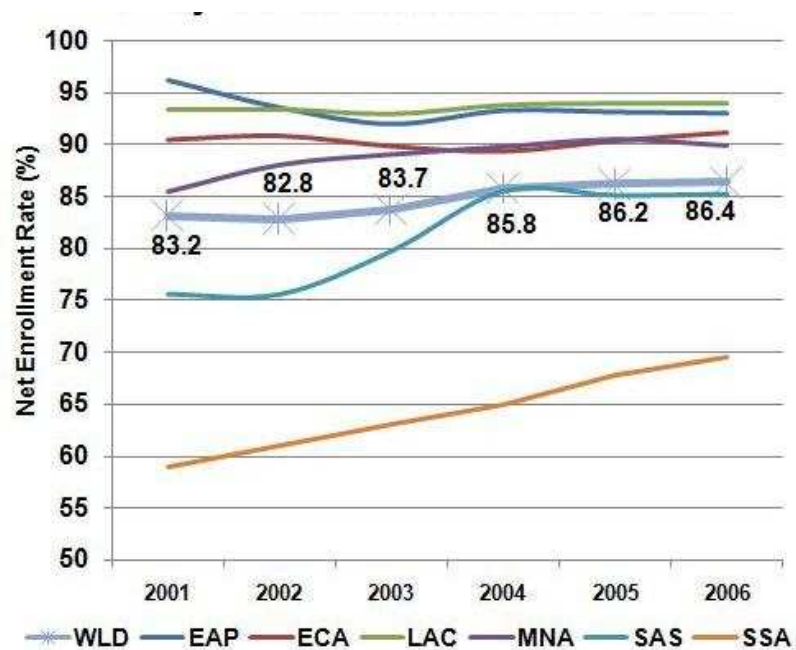
This paper recommends implementing an education voucher system as a stepping stone to further development of the TVET sector. In order to encourage people to pick up vocational skills of their choice and out of their own volition, incentives schemes such as education vouchers should be implemented. The redistributive nature of a voucher system will ensure that programs are offered only to those who genuinely need them and will

actually utilize the skills acquired. Instead of funding an assortment of TVET programs in one single region, some of this funding can instead be directed towards subsidizing the voucher system. When possible, collaboration with the government should be established so that the process of voucher distribution can be handled on a larger, more equitable scale. The voucher system should only be the first step towards developing the TVET sector. Given the case studies examined in the chapter, region-specific programs that make full use of local resources and human capital have had the most amount of success in alleviating poverty and ensuring sustainable, bottom-up development. The voucher system will facilitate processes of localization by providing incentives to both the supply-side and demand-side population in developing countries. The market mechanism and the right monetary incentive will initiate a process of self-correction by ensuring that only individuals who choose to undergo TVET courses will be connected to professionals who are able to train them.



## Appendix A

### Net Enrollment Rates in Primary Education of different regions



Source: UNESCO Institute for Statistics in EdStats, June 2008

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- <sup>1</sup> UNESCO and ILO Revised Recommendation
- <sup>2</sup> UNEVOC – International Centre for Technical and Vocational Education and Training website
- <sup>3</sup> UNEVOC Institute of Statistics, *Participation in Formal Training and Education Training Programm Worldwide: An Initial Statistical Study*, 2006.
- <sup>4</sup> Jones, pg. 182.
- <sup>5</sup> Appendix A
- <sup>6</sup> Uganda Youth Development Link. <http://unesdoc.unesco.org/images/0014/001495/149513E.pdf> (accessed February 9, 2009)
- <sup>7</sup> Adult Learning Network. *Another Way to Learn: Case Studies*, pg. 32-34.
- <sup>8</sup> Pinelands Creative Workshop. *Another Way to Learn: Case Studies*, pg. 78-79.
- <sup>9</sup> Bhuwanee, pg. 6.
- <sup>10</sup> TVET – your way to a better future. <http://www.tvet-pal.org/> (accessed February 23, 2009)
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## **Chapter 10**

### **FORMALIZING AND REGULATING MICROFINANCE**

*Ahmad Javid Aaf*

#### **ISSUE**

True bottom-up development means maintaining humility when offering foreign assistance. Providing tools instead of objectives to aid recipients will engender positive relations because they can ultimately use those tools to obtain their own goals of development. Nowhere are these fundamental characteristics of bottom-up development better encapsulated than in the drive to provide financial services to the poor. Grameen Bank, the first microcredit non-profit organization founded by Muhammad Yunus to address this issue in 1976, has received much deserved praise for pioneering this approach to poverty alleviation. Unfortunately, microcredit is still only available to a small percentage of the world's poor. As policy makers, it is important to understand the potential for and obstacles to spreading microfinance services. Employing microfinance as an integral part of foreign aid assistance is a straightforward policy decision that requires minimal intervention or new innovation because the technology and expertise are readily available. By creating environments that facilitate the growth and sustainability of microfinance wide-ranging positive outcomes can be obtained at relatively low costs. The formalization of microcredit offering NGOs into regulated microfinance institutions has provided a range of secure long-term financial services to previously underserved clients. Assisting the commercialization process of NGOs could exponentially increase microfinance reach by allowing private sector investments to drive the spread of microfinance, instead of NGOs with scarce donor funds. The NGOs and their resources would then be free to use their limited resources to penetrate into poorer and more marginalized markets. Realistically, the successful transition from NGO to a commercial financial intermediary that is subject to regulations is extremely costly and requires comprehensive understanding of local needs and overall finance. For this reason, policy makers must be sensitive to the needs of this burgeoning sector and provide assistance and oversight without taking ownership and maintain flexibility as regional micro-banking

sectors evolve. Creating incentives for existing banking institutions to downscale their services and endorsing NGO/non-profit accountability clubs can increase consumer confidence, encourage private investment, and cut funding costs, greatly improving the outreach of microfinance. There are numerous ways to connect poor people to the financial tools necessary for them to escape poverty; this chapter intends to outline the various approaches policy makers can use to exploit microfinance.

## **BACKGROUND**

### **Introduction: Why Finance**

The financial sector of any economy reflects the vibrancy and health of the overall economy. A financial sector is a set of structures that serve to facilitate transactions in order to reduce transaction costs that can limit economic potential. By providing trust the financial sector takes on intermediary responsibilities that would otherwise be placed on actors involved in transactions. As any economy grows, so must its financial institutions and their abilities to provide intermediary services for its participants; furthermore, the retardation of a financial sector can have prohibitive consequences for the overall growth of an economy. Indeed the nurturing of trusts, banks, and credit provisions can increase economic agents' abilities to participate in an economy and to weather financial hardships resulting from unexpected circumstances. Although it is absolutely necessary to have a functioning financial sector to achieve robust growth, it must be noted that finance alone can not cure economic stagnation.

The commodity provided by financial intermediaries is unique in its susceptibility to predation and its central role to politics and state provisions. The sector specializes in trust, which the public sector can help foster through the implementation of regulations and oversight, for this reason, financial intermediaries must grow alongside the rest of the economy under state supervision in order to ensure sustained growth. In the developed world a special relationship exists between banks and governments for this particular purpose. They have mutual goals and ideally work in tandem providing incentives and checks to create mutual benefits. As a nation's wealth increases so will the size of its financial sector as it adjusts to the needs of its larger base of high income client. Western financial institutions that cater to high income populations are ill equipped to

serve the financial needs of those in under-developed economies, creating a demand for institutions that can serve the needs of lower income individuals.

One of the most important services provided by financial intermediaries is credit. The establishment of credit allows businesses to expand, consumers to purchase expensive goods, and the unfortunate to absorb unexpected costs. The saturation and inclusiveness of credit to people in an economy, reflects the level of trust enjoyed by its participants. An important indicator of the efficiency and maturity of a financial sector is the amount of domestic credit provided by the financial sector as a percent of the countries total GDP (Gross Domestic Product). In 1999, before the credit bubble began to grow high income countries with sophisticated financial sectors extended around 150% of GDP in credit domestically.<sup>1</sup> Of course this takes a high level of organization, long-term strategizing, and stability to achieve such levels of efficiency and sophistication. It is also important to note that there are numerous paths to financial maturity and important variations between highly developed financial sectors of the first world.

<b>Domestic credit provided by banking sector (% of GDP)</b>		
<b>Countries</b>	<b>1990</b>	<b>1999</b>
South Africa	97,8	155
Malaysia	75,7	151,6
South Korea	65,7	96,6
Chile	73	72,5
Czech Republic	n/a	62,7
Brazil	89,8	51,8
Turkey	19,4	49,8
Poland	18,8	39,3
Argentina	32,4	35,6
Mexico	36,6	28,8
Gabon	20	22,5
Botswana	− 46,4	− 69,7
United States	110,9	164,2
Germany	105,4	145,2
Japan	266,8	144

*Source:* World Bank (2001:282–4).

(Source: Daniels, 2004)

## **The Beginnings**

The central role of the financial sector requires attention whenever economic growth is desired. In impoverished rural areas, the relationships between traditional money lenders and borrowers serve as the only form of financial service. The occasional and unreliable financial services provided by traditional lenders limits opportunities for growth due to high interest rates, limited access, and cultural restrictions. Traditional lenders charge excessive interest rates in environments with limited competition. Rural borrowers also suffer from lack of options limited by their remoteness and number of contacts. Some of the most cruel lending practices take place in rural villages where impoverished workers labor for long hours to pay back the lenders' fees only to be left with enough to purchase a handful of rice that provides them the nourishment to borrow again the next day. In these unregulated areas, the economically marginalized fall victim



to other forms of malicious exploitation and extortion as a result of their poverty. Cruel consequences for defaulting on loans and other unjust techniques are used by money lenders to perpetuate the cycle of poverty and maintain their own positions of power.

The champion of microfinance today, Muhammad Yunus, confronted this issue in 1976 in Jobra Village, Bangladesh. He spoke with local women to learn about their relationships with the *paikars* (local moneylender middlemen) and determined that there was a great demand for better financial intermediaries.<sup>2</sup> Of course there are some serious obstacles to providing loans to impoverished, illiterate, unorganized, and oppressed communities of people. Indeed, it is these numerous limitations that make lending to the poor prohibitively expensive and have created the current environment of perpetual indebtedness and poverty. Dr. Yunus recognized that in order to break free from this cycle something more than resource aid or literacy programs would need to be done. A systemic adjustment in financial services was necessary to liberate individuals from their exploitative lenders.

In theory, creating fruitful lender/borrower relationships to replace unfair ones should allow the poor to be more productive. Effective mobilization of increased savings or loans once favorable financial products are created should lead to growth. In order for that to happen, a method of providing loans that minimizes risks needed to be developed. The poor do not have the necessary collateral required to reduce risk and coinciding interest rates. To overcome this issue, microfinance providers use social collateral instead of regular collateral by lending to groups and relying on peer pressure to account for the missing incentives. In order to maximize the effectiveness and benefits of the cheaper loans, some non-profit organizations cater to women exclusively, because they are more likely to invest the money back into their families benefiting their children as well. By providing loans instead of hand outs, microfinance institutions also limit dependency and offer a sense of ownership. Charging interest on such small loans may seem trivial and counterproductive to poverty alleviation. Not only is the charging of interest important for creating confidence and a sense of independence for the borrower, it is also vital for the sustainability of the microfinance sector.

## **Striving for Sustainability**

The excitement around microfinance as a tool for alleviating poverty stems from its potential for sustainability. When most think of foreign aid or assistance, charity in the form of contributions come to mind. Many are pessimistic about the effectiveness of charity because of the seemingly endless giving and disappointing outcomes. Donor fatigue and dependency are frustrating realities that result in people's aversion to foreign aid and general awareness of the poor's suffering. Bottom-up development and microfinance in particular, emphasize the importance of sustainability. The notion that poverty alleviation could come at such a low cost has widespread appeal and garnered much attention to the field of microfinance. Therefore recent efforts of practitioners have been focused on the creation of self-sustaining non-predatory financial service systems for the economically and politically marginalized. In order to address this, one has to be familiar with the economic landscape of those in need of better financial intermediaries.

Countries with varying degrees of financial sophistication and political stability have realized the benefits of microfinance. Higher income countries with sophisticated financial sectors like South Africa and extensively marginalized areas such as Afghanistan both have shown latent demand for microfinance services. Of course there are a myriad of economic situations, all with their own culturally determined obstacles, and degrees of development, but for the purposes of this paper, distinctions will be made between areas that have the political institutions necessary to set and enforce regulations on existing financial intermediaries, and areas that for all intents and purposes operate without any officially recognized political oversight or rule of law. When attempting to bridge the supply gap of financial services one must remember that every economy is different and the services provided must consider the special needs of each one and cater to them accordingly. Different levels of poverty and specific cultural traits require a flexible approach.

## **Areas with Sufficient Governance**

With varying degrees of regulation and formalization, NGOs that offer microfinance services can turn into self-sustaining commercial entities that serve the financial needs of low to mid income communities. Regulations in the finance sector

increase trust which lowers transaction costs allowing more people access to the services. Market forces rely on certain protections and require a minimal level of trust to effectively spread services. Depending on a regions ability to enforce regulations and provide oversight market forces will either succeed or fail in providing the necessary services to those in need. Of course the conditions that allow or restrict commercial growth in a given region can be flexible and will require institutions and policy makers to be aware of the changing needs and environments in which they operate.

The role regulations play for the financial sector is two-fold, first they provide trust, generating consumer confidence and allowing the financial intermediaries to grow, and second they provide oversight, preventing financial institutions in pursuit of profit from becoming predatory and undermining economic growth. This is a fine balance that requires accountable governance and agencies that can maintain positive relations between the public and financial sectors. Given that microfinance institutions sometimes offer services in areas with little to no governance alternative methods must be used to account for the missing oversight and confidence.

## **Why Regulation is Important**

The current trend for NGOs offering microfinance services is to work towards profitability. This is problematic considering NGOs enjoy special tax exemptions because they are *non-profit* and therefore their efforts to achieve commercial viability create conflicts of interest. In some cases, NGO donors may insist that the organization increase profitability in hopes of creating a self-sustaining bank and in doing so force the NGO to increase interest rates and or loan sizes. Most often these increased interest rates are still lower than traditional lender rates, but combined with larger loans and strict repayment schedules they can create a sense of overbearing indebtedness for the borrower. There have been cases where microfinance institutions attempting to teach fiscal discipline and the importance of timely repayment of loans have resorted to arresting the unfortunate borrowers who defaulted on their microloans.<sup>3</sup> Other critiques of microfinance, point to the harsh social collateral requirements imposed on borrowers. It is argued that while it may seem like a suitable replacement for real collateral, the social costs for those borrowing may be underestimated. Many of the rural borrowers targeted by microfinance

organizations may have limited social contacts throughout their lives and therefore the significance of each one of those relationships is greater. If a person's routine social interactions are limited to a few people, alienating even a small number of them because of loan default can have vast repercussions on a person's freedom to participate in their community without shame.

Most practitioners today agree that if the situation is conducive to commercialization the microfinance institution should attempt to transform itself into a regulated financial intermediary subject to the region's laws and regulations. This is, of course, the epitome of sustainability. In order to free the institution from reliance on burdensome donor funding and to be able to offer a range of financial services such as savings, transformation must take place. Some of the obstacles that may arise in this process include poor management, lack of corporate governance, and inappropriate regulations. Regulations provide the necessary protection permitting the expansion of micro financial services. Below is an example of conducive regulations, but it should be noted that regulations can have the opposite effect as well.

#### **Case Study: Branchless Banking in Pakistan**

In order to facilitate the spread of banking services to isolated villagers in Pakistan, the Bank of Pakistan, passed regulation permitting financial institutions to partner with telecom and retail services to provide basic to advanced banking services. Microfinance institutions and Islamic banks are subject to these regulations which require branchless banking clients to register with the state which simultaneously expands the reach of the state and provides accountability reducing risk. Needless to say in the lawless tribal areas of Pakistan this becomes a great tool for not only providing relief and opportunity, but also for expanding the authority and legitimacy of the state. The political consequences include increased state centralization through the undermining of local warlords and increased inclusiveness of citizenship.

(Source: State Bank of Pakistan: 2008)

## Commercialization

Like any other sector, formalization of financial intermediaries has great benefits for the overall economy. Other than being taxed, many other opportunities transpire from the transformation of a non-profit lending organization to a commercial financial intermediary. The most alluring prospect for going commercial for a non-profit is access to cheap funding or capital through cheaper commercial loans and mobilizing deposits. Accepting deposits changes a microfinance institution greatly and increases liabilities to a degree that requires regulation. This still remains the cheapest way to attain the necessary capital. Most regions that already have a financial sector but not microfinance services require any deposit taking institution to comply with all the same regulations that traditional banks are subjected to. The positive aspects of commercialization, ability to provide a range of financial products and cheaper access to capital, both help to increase the total outreach of the institution. The negative side of this transformation process is called “mission drift.” This term adequately sums up the concerns mentioned earlier regarding the lack of depth in outreach. The World Bank and MicroFinance Network acknowledge that although transformation can cause institutions to offer larger loans to higher income clients, they do not do so at the expense of smaller loans.<sup>4</sup> Instead, these regulated entities provide a wider range of financial services for middle to low income clients. Of course once such financial entities are accountable solely to shareholders, ensuring their services are inclusive to the poor in the long-term may pose new problems. Regardless of the degree that a particular institution drifts from its original mission, the end result is usually positive for the growth of the overall economy in which the newly commercial entity is established. Furthermore, that entity is no longer reliant on scarce donor funding, liberating those resources to search and establish new institutions in poorer and more isolated regions.

Transformation from a non-profit organization to a regulated commercial financial intermediary is not the only way to provide financial services to the poor. Existing banks can downscale their services to lower income clients or commercial microfinance institutions can be created from scratch. Occasionally simple adjustments in usury laws and interest rate ceilings can be enough to encourage more lending to lower income clients. In the case of the Indian Bank ICICI a partnership between non-profit

microfinance organizations and the Bank proved to be successful.<sup>5</sup> Analyzing the strengths of the different institutions involved can offer insight on the best way to implement microfinance. NGOs have the ability to reach deep into impoverished areas where it is difficult for the state and formal banking sector to penetrate. The formal banking sector has limited incentives to take on the extra risk of serving poor people with minimal compensation. The state has every incentive to expand its reach of power, maintain a stable and prosperous society, and partner with its domestic financial sector to create trust and have the economy operate as efficiently as possible. It makes sense then from a development stand point that financial institutions should work closely with the state whenever possible to scale up services as quickly as possible. When there is limited state capacity to regulate and provide trust NGOs will have a difficult time formalizing or scaling up, and it is in these areas where their services are most needed. Working with locals to establish cooperatives and mutual trusts could engender various forms of informal governance that could theoretically become sustainable, but is unlikely without the support of a state. Regardless, considering NGO's comparative advantages it is vital that they focus their efforts in areas that lack the state institutions capable of providing incentives for their local banking system to penetrate their lower income markets.

## **The Governance Gap**

A significant proportion of those in need of financial services do not live in regulated areas that are under the auspices of state powers and as a result are neglected by the private sector. These populations would obviously be best served by NGOs. Self-governance can help NGOs minimize costs and work toward sustainability without falling victim to mission drift. Without the support of a state to offer assurance and regulation, NGOs can employ self-governance by establishing alliances or accountability clubs. These associations create standards and a recognizable brand exemplifying reliability and dependability which in turn fosters trust and lowers access to funding. Various forms of accountability clubs exist that perform a range of tasks. Some clubs set difficult standards as stipulations for membership and in turn may offer direct connections to funding or other assistance. Other clubs have lesser prerequisites for membership and commensurate benefits.<sup>6</sup> The private sector also exploits the benefits of accountability clubs, for instance

the Better Business Bureau offers a brand for its members that is easily recognizable by consumers. Some forms of collusion between service providers can increase efficiency, such as credit score reporting, but without checks interagency cooperation can tend to gravitate toward anti-competitive practices. Unfortunately for the poor that live outside of any state jurisdiction there are no regulatory mechanisms in place to provide a check on microfinance institutions. There is nothing that prevents NGOs from colluding with one another to limit competition, whether formal or informal to maintain a level of clientele necessary to renew funding. In Bangladesh for instance out of the 1250 NGOs receiving foreign assistance the top eleven receive 85% of the funding, and from those, the top three NGOs receive 72%.<sup>7</sup> Understandably NGOs have a special relationship with their clients and it is unpleasant to consider that such well intentioned people or organizations could be holding a community back from realizing its potential; still, the risk is there. Foreign assistance provides enormous sums of funding to microfinance institutions in Bangladesh and the competition is stiff. A level of state sponsored oversight preferably voluntary, non-binding, and made up of reputable experts could increase efficacy.

In the developed world, financial sectors are regulated by oversight agencies such as the Securities and Exchange Commission, whose sole purpose is “to protect investors, maintain fair orderly and efficient markets, and facilitate capital formation.”<sup>8</sup> While industry leaders work together to innovate and attract clientele they are constantly or should constantly be under the careful observation of the overseeing commission. They ensure that companies do not engage in activities that would unfairly bar others from entry into the sector or collude to increase profits at the expense of consumers and so forth. This is the vital missing link for microfinance institutions providing services outside of any state jurisdiction.

When accountability clubs or microfinance support networks take on the role of governance and providing trust they also run the risk of undermining domestic state institutions and their capacity to regulate. When the financial intermediaries of a people are controlled by foreign powers and as a result those alien powers are able to determine the growth and success of the overall economy in which they are based, the outcome begins to resemble colonialism. Certain microfinance providers require that a certain percentage of their borrowers are or become literate, others exclusively lend to groups of

women, and so on. Determining whether such practices are good for the people borrowing in the long run is not within the scope of this paper, but it should be noted that whenever such proactive development measures stipulate cultural changes for fiscal rewards the implications and approach is no longer bottom-up. It is important to be aware of the consequences when outsourcing the role of governance in finance from domestic institutions to international or foreign ones. Whenever possible, regulation and support should be provided by local governments and investors. Some states have added specific laws to address the unique needs of microfinance; others have worked with industry leaders to develop regulatory mechanisms and oversight agencies. As policymakers it is crucial to recognize when an accountability club that provides support for financial institutions in a particular area is impeding the growth and the ability of the state to govern itself. Similarly, the ability to exploit finance as a means of state-building is an important tool that should not be neglected in foreign relations activities. In fact if the US government is to take any role in foreign nation's finance sectors it should do so with complete awareness of its potential and implications.

## **Reaching a Balance**

Holding non-profits and their networks accountable is a difficult and cumbersome prospect. Evaluating whether they are actually creating economic growth or impeding state development or both is even more complex. However, at least in the field of microfinance certain truths can shed some light on the situation. In the poorest areas of the world, there may be limited demand for deposit services and need for regulation, so it is not prudent to subject NGOs operating in those areas to excessive oversight. Accordingly the NGOs operating in such depths of poverty should not focus on sustainability or profitability, but rather on the amount of families they can provide relief to. In such cases not only would the NGOs be critical for providing bottom-up forms of aid but they could also serve as distribution points for direct emergency relief efforts should they become necessary.

Obviously not all organizations are interested in helping the poorest of the poor; they hope to see economic growth and infrastructure development in mid to low income environments. This is a sensitive and obscure area that requires careful planning and



deliberation before providing assistance as the repercussions could have unexpected effects. There are tactful bottom-up approaches to provide assistance to such areas, but because of the larger volumes of money involved and the pressure to be profitable extra measures need to be taken to ensure no exploitation is occurring and that domestic development is not curtailed. The Bolivian BancoSol is a microfinance institution that coordinated with the state and local investors to commercialize and is now one of the most stable and well leveraged banks in the country.<sup>9</sup> Those operating in areas with limited state supervision, should be careful to respect local cultures, consider reaching out to state entities, include local investors, and strive to assist the state in developing regulatory mechanisms that allow formalization. Finally in areas with fairly sophisticated financial sectors that have large economic disparities within their population, minor policy adjustments can provide the needed incentive for their already existing financial sector to bridge the supply gap.

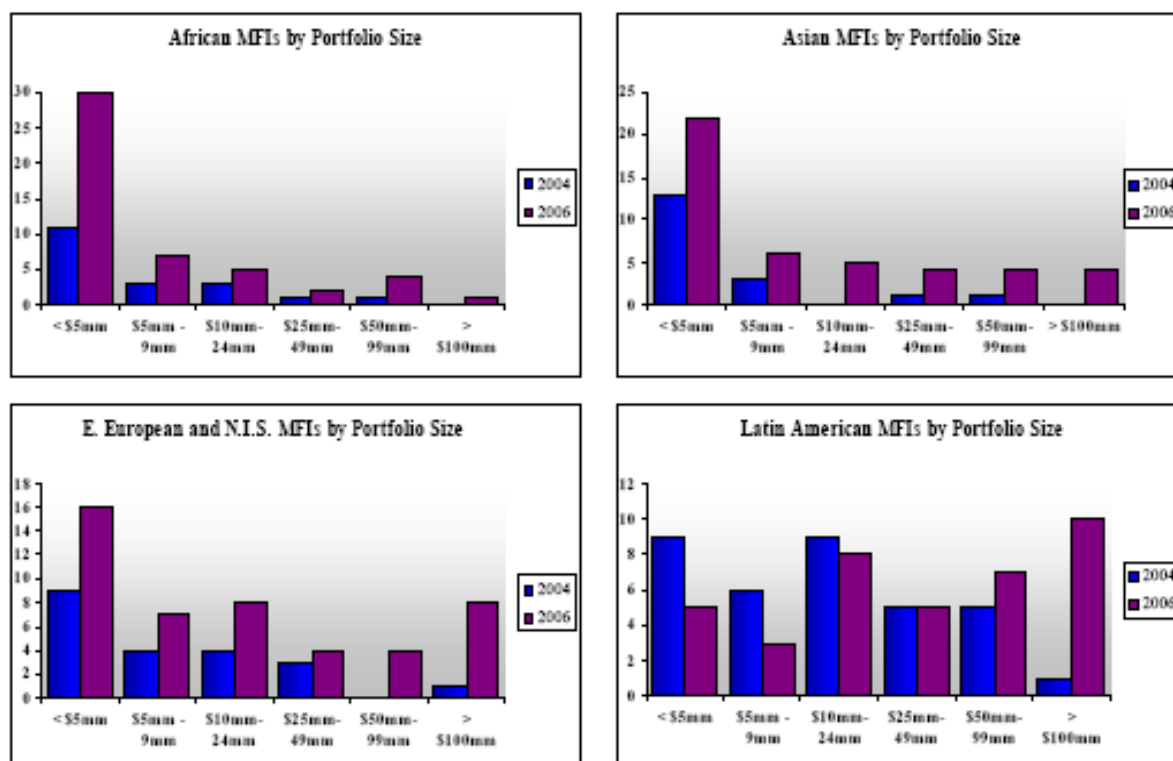
## **Recent Trends**

Today, the potential of microfinance is discussed in such diverse publications as the Forbes Magazine and the US Army's Counter-Insurgency Manual. The excellent repayment rates have attracted the attention of formal investors looking for returns. Former banking moguls are now operating various microfinance equity funds and consulting with practitioners about how to increase efficiency and scale up their projects. Investment in the microfinance sector has attracted both socially concerned investors and traditional profit driven investors, but as expected with any budding sector there are many uncertainties that still need to be addressed.

In the last two years 30 new microfinance investment funds were established for a total of 80 currently in operation.<sup>10</sup> Large Banks are also downscaling services which is increasing competition and leading to increased efficiency where applicable. The aggregate equity base of 397 microfinance institutions according to the MIX Market, a web-based microfinance information exchange platform built to attract investors and increase transparency, is roughly US \$5.2 billion.<sup>11</sup> The distribution of microfinance equity around the world is disproportionate in terms of geographical locations and amongst institutions. Larger MFI's enjoy a majority of the aggregate equity as expected, as do less impoverished regions such as Eastern Europe and Latin America.<sup>12</sup> The graphs below

show where the majority of growth between 2004 and 2006 took place, most notable is the increase in large scale MFIs beginning to operate in Eastern Europe and Latin America.

**FIGURE 6: NUMBER OF MICROFINANCE INSTITUTIONS  
REGIONAL CHANGE BY PORTFOLIO SIZE**



(Source: Council of Microfinance Equity Funds, 2006.)

## Concluding Remarks: Challenges and Opportunities

The main investors of microfinance today are still public commercial-investment institutions such as the World Bank's IFC, EBRD, and the German KfW, but private investments are growing rapidly.<sup>13</sup> The speculation about the sector with regard to the financial crises is that it will experience minor contractions throughout 2009 but will ultimately come out stronger than before as it attracts new investors from the traditional banking sector. Some also believe that the sector is somewhat immune to macro level economic downturns because it is largely disconnected from international capital flows. Nevertheless, there are adjustments that those in the sector will need to make in order to maintain their current level of service provisions, including securing public funding, improving cost management, and possibly even consolidating.<sup>14</sup>

As is evident in the graphs above the increase in private funds have provided adequate capital for large scale microfinance institutions in Eastern Europe and Latin America. Unfortunately, most microfinance services today reach people living around the poverty line, not those at the bottom of the pyramid. While this should be considered as substantial progress, there is still much to be done. Public funds and donor contributions are still needed to expand services to underserved regions and the very poor. NGOs' efforts, policy makers support, and first world contributions are still vital to the spread of financial services to those hoping to lift themselves out of extreme poverty. Creating industry wide standards, exploiting the current popularity of microfinance, developing proper oversight mechanisms, preventing investment bubbles, and ensuring that public funding is not used for unethical private gains are all challenges that the sector must face as it matures.

## **OPTIONS**

- **General Support for the Microfinance Sector:**

Through various means the US could pursue a general policy of supporting the microfinance sector. This approach would most likely be favored by those who prefer impartial forms of aid distribution. Promoting microfinance objectively could entail, but is not limited to, creating an equity fund, a set of standards, and unbiased access to all those who would want to apply for the capital and the resulting reputational benefits associated with it. Depending on the amount of capital available and the application requirements some additional consequences could result from this method including, standardization of an industry rating system and leadership that provides guidance for private investment. Various forms of sector wide support such as funding innovation and technical assistance would also be appropriate under this approach.

- **Selective Support for Microfinance Sectors:**

Another option would be to provide more selective support for microfinance entities. Assistance, under this approach, would be restricted to places and institutions that advance US foreign policy goals. Any allocation of resources or consultations to microfinance institutions, associated accountability clubs, central banks, or state regulatory

agencies would be based on domestic US concerns. For instance, assistance would only be provided if a region is of particular risk to the well being and safety of United States citizens such as the Northwest Frontier Province bordering Pakistan and Afghanistan or unstable areas of Mexico where drug cartels terrorize locals and seriously undermine the state. This option would effectively incorporate financial sector development to ongoing development and aid efforts.

- **Provide Oversight for the Sector:**

Providing oversight and some form of risk assessment mechanism i.e. credit rating, could be another role of US foreign aid assistance. With the recent credit crises partly resulting from botched credit risk ratings, the world has come to appreciate the importance of diligent oversight in these matters. The social orientation of microfinance goals along with non-profit tax exemptions and large amounts of capital flows within the industry make it uniquely susceptible to corruption. Additionally, the collapse of the traditional financial sector combined with the relatively unscathed and currently fashionable status of microfinance has some worried that the microfinance sector could fall victim to over-funding creating an investment bubble. Granted the amount of actual funds in microfinance are negligible compared to that of the traditional banking sector, the number of people affected by these loans as the industry becomes more efficient and increases outreach is considerable. Ensuring that the millions of people currently served by insufficiently regulated financial intermediaries are given fair access and treatment could have immeasurable positive outcomes for everyone involved.

## **RECOMMENDATION**

Provide oversight to engender confidence for burgeoning banking sectors. The development of today's sophisticated first world financial sectors greatly benefited from monitoring by banking associations, donors, investors, and local communities. Supporting this sector that transcends national boundaries requires the establishment of a board or commission similar to the Basel Committee, an international banking supervisory body made up of G-10 countries' central bank representatives, which can serve as a supervisory body and potentially even a central bank. This would be the most cost-effective approach

as it would not require direct investment in financial institutions. The potential and rewards of such an undertaking could be tremendous if successful. Providing leadership and assistance on regulatory matters for fledging financial sectors would ensure United States central role in emerging economies. This commission could bring together all of the broad-based stakeholders of microfinance in the US and abroad in order to standardize double bottom line evaluative criteria, minimize losses from currency fluctuations, and ensure local ownership and inclusion. This truly encapsulates bottom-up development because it is not directly investing money or allocating resources, but rather providing a service for banks and states that would like to realize the reputational benefits of trust associated with joining the commission. Direct investment in microfinance institutions of any region may lead some to believe that the US government is trying to profit from the growth of those economies. Creating oversight will instead encourage private investment to fill the gap while emphasizing the United States central role in promoting economic growth worldwide.

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## Chapter 11

### WOMEN AND EQUITABLE MICROCREDIT

*Sarah Belton*

#### **ISSUES**

Women are an untapped resource in many countries. They are a group that is frequently oppressed both economically and socially and as a result female capital can not contribute to development. Organizations and policies that realize this and specifically invest in the economic activities of women will make more of a difference in local poor populations. Basic services, such as education and health care, which are necessary to live healthy lives and raise healthy families, are rare commodities for impoverished women. Microfinancing and other bottom-up development schemes will not achieve the end goal of improving the standards of living in poor nations unless the common public goods of health and education services are provided to women. One key factor in the development of stable national economies is the inclusiveness of public goods and services. Not only do millions of women in poor communities and their children face challenges in accessing decent health services but women and girls also lack educational resources. These are just two out of many public goods that provide security and protection that poor women are not able to access. As a result women are relegated to domestic duties because they lack the ability to develop or exercise their potential to contribute to the public workforce.

Effective bottom-up development schemes are those that can successfully reach the entirety of the global poor. The cure to women's need for public goods will not occur overnight, but if we do not start working on it now the repercussions down the line will be more costly. Microfinance institutions are already in place, now it is only a matter of ensuring that the services these institutions provide include all women. At the same time microfinance institutions must address women's need for education and public health provisions.

## **BACKGROUND**

### **Introduction**

With poor access to the common public goods, education, healthcare, and economic freedom, that are necessary for equitable development, women are systemically excluded from poverty alleviation efforts.<sup>1</sup> Women today make up 70 percent of the world's poor in both developed and developing nations as a result of their inability to utilize economic opportunities.<sup>2</sup> In undeveloped states women have very limited contact with reliable or quality healthcare, thereby causing them to have higher infant and childbirth mortality rates as well as relative life expectancies that differ from biological norms. The “missing women phenomenon,” where the gender ratio is unbalanced in favor of men, of developing states is a direct result of the economic and social disadvantages that women face in the developing world.

When the value of women's work and their contribution to the workforce is recognized and rewarded, many are brought out of poverty. Countries that invest in female human capital experience fewer setbacks in development endeavors and economic growth. Countries that devalue or fail to make use of women's contributions have a more difficult task in developing their economies.

The most promising method for involving women and creating equitable conditions is microfinance, and particularly microcredit. Microcredit has been a very successful tool for poverty alleviation and economic development from the bottom up. If microcredit is more widespread and is supported by the necessary infrastructure of education and health care it will play a key role in the success of bottom-up development schemes. Microcredit and microfinance can be seen as tools to be utilized when attempting to liberate women and incorporate them into the workforce. Microfinance currently garners a great deal of attention within the development community, and for good reason. Such institutions are revolutionizing the way in which developed states invest and get involved with developing communities. Microfinance allows capital to directly reach into the poorest communities of the world, bypassing middle men and going straight to those who need it most. In its success in bringing capital to the poor the microfinance industry has failed to provide equal opportunities to both genders. Not all microfinance and microcredit organizations have provisions to ensure that their services reach women specifically. The viability of

microfinance as a development scheme would be bolstered if it focused on women's economic opportunities as well as on their access to common public goods. Two such goods that microcredit organizations should focus on are education and health care services. Both, if given priority alongside investment in female entrepreneurs, hold promise for improving the efficiency of microfinance institutions and also society's overall quality of life. The end goal of all development organizations should be to have a positive impact on the lives of their clients.

As the world's population continues to grow, so do the demands for both natural and economic resources. Living conditions of those in undeveloped countries, where the vast majority of population growth has and will continue to occur, will worsen as resources become scarce. In order to prevent global political and economic instability, something must be done to improve the quality of life of women. Women must be a priority because they are such an integral part of the family structure and their prosperity directly influences that of the family. Moreover, women are often more vulnerable to the effects of poverty and feel its effects much more acutely than their male counterparts. Due to this vulnerability and their lack of access to capital women invest more time and energy in child bearing and raising. This vulnerability is further exacerbated by their lack of education and adequate health services.

### **Microfinance: Targeting Women**

It has been established that economic growth cannot exclude women's opportunities if countries hope to develop in a way that is evenhanded to both genders. According to the IMF and numerous other sources, women are much more likely to save and invest their income in productive ways while men are often prone to activities that recycle or destroy wealth.<sup>3</sup> Women's participation in markets increases the opportunities for wealth creation. This wealth creation would be a result of women entering the workforce, earning more money for their families, and investing their earnings in creative and productive ways. Poor households benefit from the cautious and frugal economic behavior of women due to the fact that their habits are wealth creating.<sup>4</sup> In the past thirty years a new approach to economic development emerged in the form of microfinance. One particular type of microfinance, microcredit, has been particularly note-worthy

because it is a new bottom-up approach to development and also because it harnesses the economic talents of women.

Microfinance, as it applies to women, often takes the form of microcredit. This predominantly consists of small-scale loans that are distributed to those poor who lack the ability to borrow from traditional financial institutions.<sup>5</sup> This is noteworthy because in general women lack the collateral and social mobility necessary for borrowing money from conventional lenders. Small loans are targeted to entrepreneurs and have been particularly successful when issued to groups. Social ties of such groups raise a sense of obligation that reduces missed payments. No one wants to be singled out as having let down one's peers. This model for funding bottom-up development by targeting women was pioneered by Muhammad Yunus. His group, the Grameen Bank, recognizes women's importance to the poverty alleviation process as both recipients of it and as active agents promoting it."<sup>6</sup>

### **Grameen Bank and Women's Microcredit**

The Grameen Bank's philosophy is to target their microcredit loans towards women in order to improve their economic status. Grameen bank understands that women's economic empowerment, which is not to be confused with political or cultural empowerment, is the groundwork upon which better social and political conditions can be built.<sup>7</sup> Economic empowerment can be achieved by providing women with resources and capital that they can use to start their own businesses. With this help of organizations like Grameen, women in developing countries are given the freedom to make their own economic choices.

### **Case Study 1: Grameen Banking and Women's Village Banking**

The bank works with poor women in rural areas of Bangladesh where they are poorer than men and lack access to economic prospects. The bank's methods are sensitive to the unique culture of its clients and these methods have the potential to be a much more widely applied development strategy.

Grameen Bank does not solely work with microcredit, but it is its small low interest rate loans that have the largest effect on rural poor women entrepreneurs who make up 96 percent of their borrowers. Loans are issued in a unique way; they are given to groups of women and do not require contracts or physical collateral. These loans instead rely on trust and social collateral for repayment. Women share joint responsibility for repayment of the loans and the possibility of obtaining future loans depends upon the full repayment from the group. Their loans are dispensed for income-generating endeavors as well as for housing. Women are able to take the small amounts of income from these loans and make a profit and more importantly they are able to join the workforce. Through Grameen women develop knowledge and experience through entrepreneurship that they would otherwise not have.

(Source: Bernasek 2003)

In Bangladesh women suffer under poor living conditions and are also cut off legally and socially from economic resources. They are excluded from inheritances and seldom take land ownership in the rare cases where they are granted legal rights.<sup>8</sup> Instead women defer rights to male relatives in order to ensure their support for her family.<sup>9</sup> If women take ownership not only would they lose that familial support<sup>10</sup>, but they would also break the widespread taboo against women owning land. In such tight knit and isolated rural communities, status and well-being are tied to property and also to conforming to the rules of the group culture. This makes it all that much more difficult for women to create wealth since their wealth is not culturally valued.<sup>11</sup> As a result of their inability to own property due to both legal and social barriers women are cut off from traditional credit lenders who require collateral in order to obtain loans.<sup>12</sup> Grameen Bank has been very successful in changing this environment that has alienated women from

economic activity outside of the home. Grameen bank has targeted women because it sees credit as a human right to which none should be denied access.

What makes Grameen successful is the fact that their rates of repayment are so high. The bank helps women develop their own resources and at the same time it also sustains itself. Although Grameen started off small, the bank now serves 7.5 million borrowers in Bangladesh from approximately 83,000 villages. On average the bank receives \$1.3 million in debt repayment installments and its loan repayment rate is 98 percent.<sup>13</sup>

Muhammad Yunus and Grameen Bank took a chance on women and won. Yunus was correct in assuming that women are more likely to use the loans for productive purposes and repay them than men. The success of the bank's microcredit system is proof of that.<sup>14</sup> A study of microfinance by the World Bank in the early 1990s found that for clients of Grameen and other similar banks household consumption increased by nearly one fifth and five percent escaped poverty each year.<sup>15</sup> This is the result of women using loans more cautiously, but also because they tend to use their earning to improve the lives of their own families

Grameen Bank was able to successfully contact borrowers who needed their loans. Their methods of lending and their philosophy of lending to women in groups was one that has had a large impact on the lives of these women and their families. The success of such practices need not be confined to Bangladesh. If more lenders take a culturally sensitive philosophy that does not discriminate against poor women there is no reason why microcredit of this kind can not be implemented throughout the globe. Grameen's model of microfinance is such an important step forward in bottom-up development because it has pioneered a movement where the inclusion of women is their top priority. Unlike most microfinance institutions, those like Grameen that focus their efforts on women's development have a larger impact on the quality of life and overall development in poor nations.

### **The Importance of Women: Microfinance Efforts**

While Grameen Bank is successful, and implementations of its model are promising, microfinance has an even greater significance. Opportunities that Grameen provides women are vital foundations for development. Women's access to education and poor health care are dependant on stable economic growth.<sup>16</sup> So far top-down

development policies have left women behind which has resulted in overall poor performance of those policies. This is due to the fact that the strategy behind them did not consider the role that women's economic empowerment plays in development. This is in part attributed to the fact that top-down development schemes consist of interactions among those in power. Since women are systemically excluded from power both economically and socially, the chances are reduced that any top-down aid funds will reach poor women, let alone improve their situation. Such an approach often faces obstacles and experiences failure even when efforts are specifically made to minimize the barriers between aid and women in need around the world.

Microfinance enables women to work and start businesses outside of the home so that they may earn cash wages. Unlike housework, which contributes little to a family's economic well-being, entrepreneurship allows women to more efficiently use their time and energy.<sup>17</sup> As women earn more and have more control over "non-land assets" their involvement in market activities garners more acceptance from their husbands and the community.<sup>18</sup> The impact of this is great, increasing the respect towards women as market actors will reduce the barriers between women and access to education and healthcare services.<sup>19</sup>

Bottom-up development is characterized by community level programs that put the opportunities for the creation of wealth directly into the hands of the poor. In doing so even more is accomplished because their success affects not only themselves but their families and the communities as well.<sup>20</sup> There are many organizations that are working to provide common public goods aside from income in order to encourage overall development. The Foundation for International Community Assistance (FINCA), SKS Microfinance, and the Bill and Melinda Gates Foundation are some of the main organizations we will be discussing, although they are not the only institutions experimenting with ways for microfinance assistance to do even more for women in developing countries.

## **Education and Health Care: an Introduction**

It is true that microcredit programs have shown themselves as effective bottom-up organizations that economically empower women. Microcredit has shown that it has the potential to go a long way in economically empowering women as well as for creating growth for the poorest of the poor. But Grameen-style lending is not the limit of microcredit's potential. Current research and experimentation shows how microcredit lending to women combined with the provision of other important public goods improves women's living situations and also increases the success of microcredit programs. The two most significant cases are when education and health care or health insurance are combined with microcredit. Now we will examine situations where microfinance organizations have focused their attention on women and especially where they have invested in the provision of these public goods for women. In these cases women are given the economic opportunities that microcredit institutions have become known for. Women also gain access to much needed services and knowledge that improves both their economic agency as well as the overall quality of life for them and their families.

### **The Importance of Women's Education in Development**

Over the past few decades a wealth of evidence has amassed behind the assertion that women's empowerment through education, market participation, or health services carry with them financial and social benefits for all. Family nutrition, reproductive health, and childhood development all improve alongside female empowerment. While this is undoubtedly a positive effect of empowerment, women's group lending entrepreneurial businesses could be more powerful if not diverted.<sup>21</sup> Many of these women invest part of the profits and sometimes even part of their loans into improving the day to day lives of their families.<sup>22</sup> Poor women take up the task of providing goods that with gender equality would be much cheaper, or even free, to obtain. What they are doing is not wrong, but something wrong is happening. The fact that women have no choice but to use business income to sustain their families' needs is a sign that microfinance in its current form is not a sufficient tool for equitable and efficient development.

Expanding the reach of microfinance alone is not enough. While it is a proven effective way to economically empower women, in order to be equitable it must be enacted alongside other policies. It is clear that women know how to save, invest, and earn an



income. What is missing is a culture where women, and men, are educated on how to make more efficient use of the money they make and save. All over the world, and particularly in poor areas in Africa, even in the absence of formal banking people are able to save up vast amounts of money. Yet, that income has not made much of a difference in overall development for those countries. Deprived women around the world lack bargaining power and control over the quality of their lives. This is because income is a vital social tool that provides people with options and is also a source of economic power. Economic agency is the foundation upon which other freedoms are established, but this establishment has so far been elusive for most of the world's poor women.

Education and Health standards are key to solving this dilemma. For women in particular, their education does not address the need for women to have the self confidence and skills to participate in market activities.<sup>23</sup> Most girls do not have access or are not allowed to go to school. If those statistics do not change not only will it have an effect on the health and living standards of women, it will also stunt their economic development as well. Women will continue to face a glass ceiling of how to utilize their economic assets for the development of their countries unless schooling and health care are provided to them. Microfinance schemes, for all their good qualities, will not reach their full potential if health care and education are not implemented alongside them.<sup>24</sup>

## **Education**

### **Current Statistics**

Before delving into the potential of the cutting edge innovations in women's microcredit that are taking place, let us illustrate the situation of women's education around the world. The untapped potential of women as economic agents is a result of a global crisis in women's education. According to the Department for International Development nearly 60 million young girls worldwide do not go to school.<sup>25</sup> This is often due to family needs, where parents must work and the girls are needed to look after siblings and relatives. Also, their data shows that of an estimated 800 million illiterate worldwide, two thirds of them are women. For example in Mozambique, where, as of 2005, infant mortality rate ranks in the top ten highest in the world, there is an adult female literacy rate of only 30% while for men it is twice as high at 61%.<sup>26</sup> Figure 1 below shows

school enrollment rates, for men and women. The data, taken over the years of 2001-2002, covers the entire world. It shows education's effect on life expectancy at birth. The results show a positive relationship between education enrollment, especially through secondary school, and average life expectancy for both women and men.

**Figure 1**

**Gender inequalities persist**

On a global scale—especially in low human development countries—girls do less well in school enrollment than boys, and women's life expectancy relative to men's is lower than would be expected.

<b>Primary school enrollment</b>			
	<b>Male ratio</b>	<b>Female ratio</b>	<b>Ratio of females to males</b>
High human development	96	96	1.00
Medium human development	90	88	0.98
Low human development	63	55	0.86
<b>Secondary school enrollment</b>			
	<b>Male ratio</b>	<b>Female ratio</b>	<b>Ratio of females to males</b>
High human development	84	87	1.03
Medium human development	58	60	1.04
Low human development	21	15	0.73
<b>Life expectancy at birth (2002)</b>			
	<b>Male ratio</b>	<b>Female ratio</b>	<b>Ratio of females to males</b>
High human development	73.35	79.44	1.08
Medium human development	64.33	68.97	1.07
Low human development	44.69	46.52	1.04

Source: World Bank, *World Development Indicators*; United Nations, *Human Development Report* (2004); and IMF staff calculations.

Note: Data are from 2001–02 and cover the whole world.

(Source: Stotsky, 2007)

It is well accepted that just an extra year of education reduces the risk that a woman's children will die in infancy by 5–10 percent.<sup>27</sup> Increased women's education also reduces fertility rates in developing states and the resulting smaller families are much easier to sustain financially. In Brazil, literate women on average have less than half as many children as those who are illiterate.<sup>28</sup>

Overall it is quite clear that education goes a long way towards improving the quality of life for women and their families. Education that teaches literacy and health knowledge to women enables them to live healthier lives. Moreover, educating women about business will enable them to participate in entrepreneurial ventures with greater success and profit. This very possibility is being put to the test, with promising results.

### **Education and the Creation of Wealth**

According to the Council on Foreign Relations one year of primary education can translate to a 10-20% increase in a woman's potential wages later in life.<sup>29</sup> The benefits of secondary education are even higher.

While statistics like these shine light on the economic benefits of education because it prepares women to join the workforce, they do not tell the whole story. What are women to do with an education when there is little to no work to be had outside of the home that is not already taken up by men? One answer is entrepreneurship fueled by microfinance. Education will magnify the success of microfinance if it can help to stabilize repayments. This happens as the money that microfinance lenders provide is returned more regularly. The reason for this is that women are better equipped to function more smoothly in the face of such upheavals. Repayment is not as hindered by fluctuations in local and regional markets. In the end microcredit institutions gain stability as a result of the stability of their clients businesses, which is directly related to the education they receive. Microcredit organizations like Grameen give women a chance to participate in the economy and create wealth from the bottom up. Through simultaneous investment in microfinance and education, microcredit becomes a tool for women's economic empowerment. Microcredit is also a stepping stone for entrepreneurial businesses towards incorporating their activities into larger, national or global formal markets. Bottom-up development is for the most part informal, but eventually the wealth that women create within smaller communities will be able to contribute to the wealth of nations and overall development.

## Microfinance and Business Education

### **Case study 2: Business Education and Microcredit - FINCA**

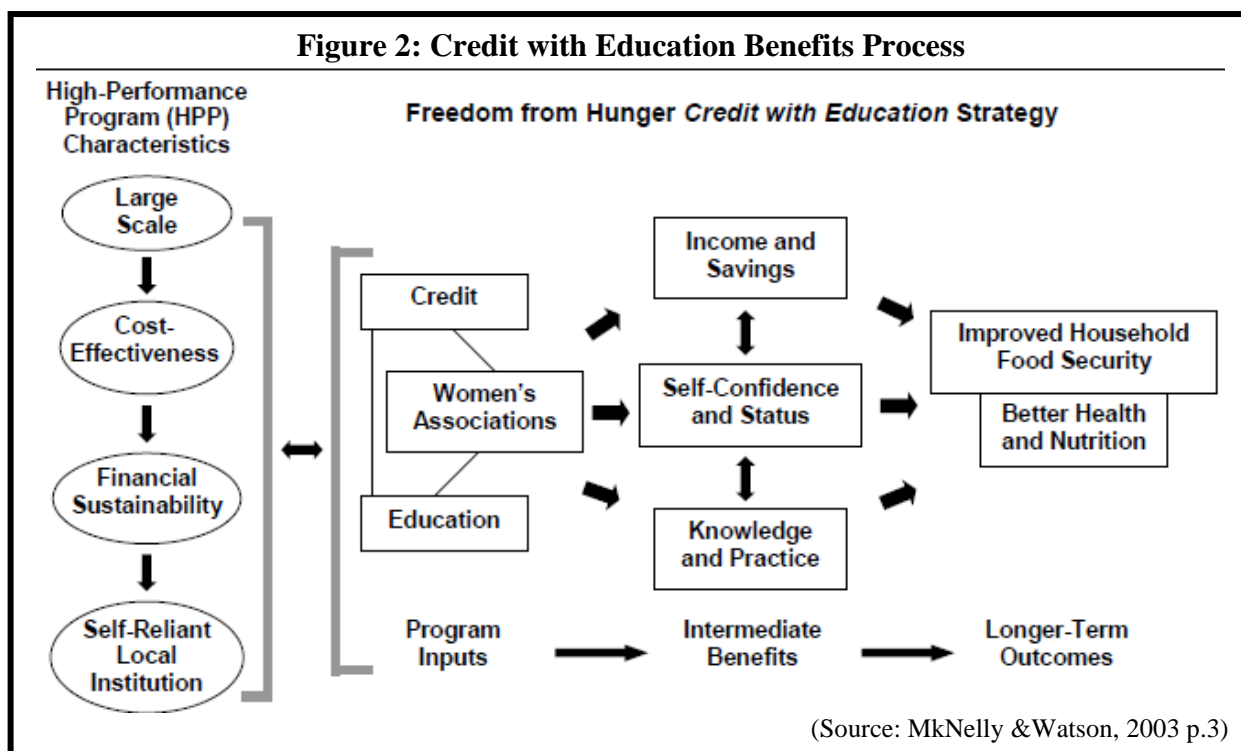
The Foundation for International Community Assistance (FINCA), a non-profit microfinance institution associated with FINCA International in the United States, has been operating in Peru since 1993. It focuses its loans on women with the goal of enabling them economically as well as improving their quality of life. Throughout 2002-2003 FINCA experimented with something different by incorporating simple business education into their loan system. Like Grameen, FINCA issues loans to groups of women who are required to meet regularly to both repay the loans and coordinate their business ventures. These meetings were where business lessons were facilitated for up to half an hour at a time.

The lessons consisted of teaching women the basics of what a business is, how business works, and the functions of the marketplace. This included teaching women about how to identify customers, competitors, and how to plan around these factors and promote their products and services. Also, women were educated on how to keep track of finances. This helped women to better calculate production costs in order to more profitably price their goods. Women were also taught how to separate business finances from home finances so that they could then budget for both much more clearly.

(Source: Karlan & Valdivia, 2006)

Education, although a reward in and of itself, also resulted in greater economic success within the lending groups that were part of the experiment. FINCA saw an increase, among the lending groups that received lessons, in the retention rate of clients.<sup>30</sup> This occurred because the women involved had a much easier time repaying their loans, not defaulting on them, and receiving new ones. These women saw more stable profits that were not subject to as many extreme highs and lows in their business cycles, because they immediately utilized their education and knew how to plan ahead and reinvest profits into

the business.<sup>31</sup> These female entrepreneurs experienced more stable profits and their overall profits increased as a result of the newly learnt methods.<sup>32</sup> Women's lending groups were able to translate the lessons into practices that improved their chances of succeeding in the long term.



The argument that women's education when implemented alongside credit is an important proponent in equitable development is relatively new. Figure 2 shows how such a provision effects not only women's entrepreneurial development but their overall living standards. Education provides practical benefits that when compounded with the economic profits of microcredit result in intermediate and long term outcomes that are well-rounded and stable. Women will have both the income and knowledge to be able to build healthy households for themselves and their families. Financial services of microcredit organizations are the tangible resources that, when combined with the intangible benefits of knowledge, can be used in a way that is both efficient and equitable for women.

The experiment does not end there, a similar process led by FINCA is underway in the Philippines, and it is very likely that results will be positive there as well. Nothing in FINCA's results points to this success as an isolated incident, and it is very feasible for such lessons to become a pivotal part of micro-lending practices. Income and education, independently, are both very potent resources. For women in developing states, who are systemically deprived of one or often both of these assets, gaining either enables women to exercise more freedom.<sup>33</sup> Yet, it is when the two are integrated into one program that women are able to truly capture their potential. A woman can finally exercise her economic agency with microcredit and business teachings. At the same time, she is also capable of providing for her family and her community.<sup>34</sup>

### **Benefits for Future Generations**

While the business lessons have proven to be beneficial for women in terms of economic empowerment, they have also shown potential for being a way to change the overall culture of education for women in developing states.<sup>35</sup> Those women who were a part of FINCA's experiment were able to understand the value of education after having seen the direct impact it had on their incomes.<sup>36</sup> As women were able to see how an education equipped them with better chances for success they in turn encouraged their daughters to educate themselves so that they might one day benefit as well. The resulting phenomenon was the increased amount of time that daughters of these women spent at school.<sup>37</sup>

Therefore, business education implemented alongside community based microcredit lending to women had positive results in the short term and in the long term as well.

Women play a vital role in the health and well being of the family. As women experience economic empowerment their success not only helps improve their businesses, it also enables them to provide more for their families in the short run, with improved capacities to provide nutrition and health care,<sup>38</sup> and in the long run with increased rates of education for their daughters.<sup>39</sup> Their daughters will in turn be able to participate in the economy as well, most likely with even more profitable outcomes.

## **Creation of a Formal Economy**

Business education, along with regular education services, frees microfinance institutions from worrying over high rates of defaulted loans. Repayment rates increase, and so does their retention rate of clients. On the other side of the equation, the education that women receive provides them with better tools for success and efficiency. When more women are able to compete successfully the market grows larger and businesses become more robust. The ultimate goal of development, be it top-down or bottom-up, is for a state to have an economy that produces wealth within a formal system of finance, property rights, and such.

Bottom-up development is intended to grow this system from the ground up by targeting the developmental needs of the world's poorest populations instead of just investing in governments and top-down NGOs. Microcredit lending programs that target women with loans and educational resources as well contribute to this growth. As women are economically empowered and knowledgeable of how to utilize their market potential small scale markets grow in size. Eventually they will finally reach a point where they are strong enough to create or strengthen the formal national economy of a state. All in all, inclusiveness of women provides more businesses equality within national economies. This has the potential to increase growth rates substantially, much more so than if women continue to stay marginalized. Microcredit for women must be supported in order for this outcome to be feasible. Furthermore, with simultaneous implementation of education the process of development is stabilized, and accelerated.

## **Health Care**

### **Current statistics**

Not only do women in developing and underdeveloped states have fewer opportunities for education, they also find themselves in a situation where health knowledge and resources are hard to come by. As a result of poor health systems and limited access to doctors and midwives, or health care of any quality level, women's lives are at risk during pregnancy. That combined with the high rates of pregnancy in uneducated women results in very high mortality rates for women in childbirth within the population of the global poor. In comparison with developed countries like the United

Kingdoms, where health care for women is both high quality and easily accessible, women in developing countries are more than 200 times more likely to die from complications during pregnancy and childbirth.<sup>40</sup> One woman dies, unnecessarily every minute from such complications.<sup>41</sup> Add to that the high rate of unsafe abortions that take place due to unwanted pregnancies and you have an environment where the odds are high against women's survival in order to raise their families.

Women in poor areas around the world face high health risks from pregnancies and are also at a greater risk for HIV infection. As of 2005 17.5 million women worldwide were living with HIV and they make up two thirds of those under the age of 24 who are living with the disease.<sup>42</sup> Women suffer much more from HIV related health problems due to the fact that they are economically and socially more vulnerable than men, which makes it difficult for them to cope with the disease. These factors combine and it is seen that one third of the burden of disease in the world among women of reproductive age, 15 to 49 years, results from sexual and reproductive illnesses. Of the overall health burden that puts pressure on the world's population, women's illnesses *one fifth* is due to women's health issues.

When societies take into consideration women's health concerns their ability to modernize and develop improves. Poverty reduction depends on a healthy population. Therefore when such a large proportion of the world's poor is constantly facing health risks development is suppressed.<sup>43</sup> Women's poor sexual and reproductive health keeps them in poverty. When women cannot escape poverty neither can the rest of the community.

### **Microfinance and health: Freeing up Income for Business**

Sudden health crises within a family have been shown to have a significant impact on women's ability to make their business prosper as well as repay their loans. In order to safeguard their investments, and their clients' health, many microfinance organizations are testing possible sustainable methods for providing health care and insurance.<sup>44</sup> In the past microfinance and lending to the world's poorest was seen as unfeasible and a bad investment. Over the past 30 years that assumption has been overturned, and now the assumption that the rural poor will abuse health insurance rights, with false claims and



such, will likely be overturned as well. In case study #3 one can see an example of how microfinance organizations are re-imagining and revolutionizing the way that poor women are able to access and benefit from common public goods like health insurance.

### **Case Study 3: SKS Microfinance & Health Insurance**

Group based lending firm SKS Microfinance is currently conducting trials where it incorporates the provision of formal health services into its programs. SKS microfinance operates within India and is one of the fastest growing lenders, to women, in the world. In much the same way that FINCA tested the effects of business education on the stability of microfinance and overall development, SKS is hoping to see how the availability of health insurance and health education affects women's quality of life and lending habits. As only 1% of households in India have formal health insurance, there is a lot of hope that the provision of health care combined with women's group based lending will ensure that businesses funded by microcredit are not as vulnerable to the shock of health problems and the costs they entail.

(Source: Centre for Micro Finance, 2007)

SKS is now joined by other endeavors of a similar nature. In 2006 the Bill and Melinda Gates Foundation launched the Microfinance and Health Protection initiative (MAHP) in order to research effective ways of providing reasonable health care packages to clients of microcredit programs. The most effective packages will be measured by how well they both serve the clients health needs and also on whether or not they increase the institutional bottom line.<sup>45</sup> Round one of the project is set to be complete at the end of 2009, at which point the most effective health providing schemes will be determined.

While the results of these different trials have not been reached, the principle behind them is similar to that of FINCA and other programs that incorporated business education into lending programs. Both approaches seek to improve the success of women's market activities by bolstering the public goods that women lack.

## **Concluding Remarks: Challenges and Opportunities**

The goal of providing development aid is to improve the quality of life as well as economic and social stability in developing states around the world. Women have so far been generally excluded from both markets and public goods such as education and health services. Microfinance has already shown that it is a feasible method for economically empowering women. We have argued that it has the potential to be an even greater force in women's development. Microfinance acts as a buffer between poor women and the worst downturns they face, but it has the potential to do so much more. Through incorporation of education and health services, such as insurance, microcredit will be better able to meet women's needs.

Women in developing states possess an immense untapped economic potential. With the help of village style banking women are able to tap into that potential. Yet, it is not until they are provided with the common public goods of education and health care that women are able to truly exercise their ability to produce wealth. Supplying such services as education and healthcare must be one of the top priorities of US development assistance. Only when women have such resources will development succeed.

## **OPTIONS**

- **Target USAID Funds Towards Provisions for Women's Public Goods:**

USAID should continue to utilize existing top-down networks and investment channels in order to fund development efforts. Additional regulations must be immediately enacted to ensure or enervate the investment of capital into organizations that prioritize their efforts in a way that caters to the developmental needs of women specifically. This could fall under the heading of improving women's economic opportunities, although the optimal solution would stipulate that institutions develop common public goods, particularly education and health care, as well.

**Strengths:** This option is attractive in that it would not require any significant overhaul of the political and bureaucratic infrastructure that is currently in place in order to see results. Much of the changes that must be made come in changing regulations so that capital may be allocated more effectively. There would be little to no start up period that would delay progress significantly.

**Weaknesses** This method, however, entails some risk as well. Additional regulations may be able to ensure efficient spending and accountability on the part of organizations based in the United States. Yet, they will not necessarily guarantee that once money crosses into hands outside of our borders that it will spent as it is intended. USAID only has so much leverage when it comes to dictating how sovereign states, or organizations that function outside of ours, allocate and utilize their funds.

- **Prioritize Microfinance as Main Recipient of USAID Funds:**

Focus funding of aid dollars to microfinance organizations, but do not prioritize preferential investment in institutions that cater to women. Microfinance itself is no longer a fledgling development scheme. With over three decades of history, it can now be assumed that it is a viable investment. Funding would help microfinance organizations to expand their effectiveness and reach. Their bottom-up approach, with more funding, will prove to be more successful if they have more resources at their disposal that they may connect with those who need them.

**Strengths:** One major benefit of this approach is that it will strengthen institutions that have proven successful at reaching and invigorating the economies of underdeveloped nations. Also, this option in its very structure is more immune to the drain that top-down bureaucratic methods are hindered by.

**Weaknesses:** As with most development approaches, both top-down and bottom-up, this option is vulnerable in that there are not standards for accountability that will help the government know if funding is truly being used responsibly.

- **Invest in Microfinance that Caters to Women and Public Goods Provision:**

**Strengths:** This choice is appealing due to the fact once it is implemented it is unique in that it will guarantee the provision of public goods for women. At the same time

women are given access to loans and financial services that help them to exercise their economic potential. What potentially sets this option apart from others is that it's simultaneous provision of public goods and financial services that are made directly available to poor women has both short term and long term benefits for development. Development will be less tumultuous and more equitable as well.

**Weaknesses** Once again, accountability is an issue for this option. There is also the additional risk that this option entails because it is still in the experimental stages, and therefore has not been proven viable in all situations and countries.

**For all three options:**

There are two approaches that can be undertaken with all of these options. The first is an experimental approach, where the policies and methods are implemented in a smaller scale. The benefit of this approach is that the unique cultural environments are taken into account and we can see how the methods work better in some places than others. The second approach is one of broad implementation. With broad implementation the same method is used in all areas of the world. This approach has the advantage of being able to reach more women at once.

For all options a weakness exists as a result of the absence of a system of regulation that would help measure the success of the ventures of development organizations. Without such a system the task of measuring the success of any of the options is difficult to complete. No matter which is undertaken, evaluation of these options must factor in the need for a framework by which the success of these models can be documented.

## **RECOMMENDATIONS**

Of the three options presented we believe that the third, investing in microfinance that caters to women and public goods provision, is the most effective choice. In such a climate of domestic economic instability the US government cannot afford the potential for losing money that comes with the first option. While continuing with top-down development methods may be the easiest option, as it would only require adjusting regulations, its flaws still exist. There is still little or no way to guarantee that investments will not be mishandled once they pass out of US hands. Prioritizing microfinance in

general is a possible option, however its weakness is that it can not guarantee that any investments will benefit poor women.

We believe that the best way to approach women's development with the third option is to use an experimental approach. That way USAID will be able to tell whether or not some methods work better than others in different areas. This approach combined with the creation of a system of regulation as discussed in the previous chapter is the one that the US should undertake. Not only is it less likely that US investments will be lost in transactions, it is also the only way to guarantee that women receive the resources they require if they are to have any hope of improving their quality of life.

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## Chapter 12

### THE PROMISE OF PERSON-TO-PERSON LENDING

*Johanna Madany*

#### **ISSUE**

In the time this chapter is read, a woman in Toronto will have helped a woman in Uganda open a store without technically donating any money or traveling outside of her own home. Online person-to-person (P2P) lending sites that have emerged in the last four years made this situation a reality. Through these sites entrepreneurs in developing nations suddenly have access to the capital needed to begin the business ventures they are fully capable of starting and managing but lack the credit to get off the ground. At the same time, these sites allow individuals and companies to contribute to development assistance without requiring the ability to donate huge amounts of money. One key component of these sites is that they allow the lenders to track exactly where their money has gone and how it has been used. This transparency is refreshing in a time when, as we have seen, much of the money intended for development is being lost in transactions along the complicated path to disbursement.

P2P lending sites demonstrate a small opening into what could emerge as the path of development in the future. By utilizing the inherent quality of the Internet in building connection between individuals around the world, P2P lending has provided a means by which transparency and efficiency can exist in effective development programs. The current novelty of P2P lending means that its sustainability and longevity remains untested and unproven. With such huge potential to revolutionize the way in which microfinance development projects are funded, P2P lending demands recognition and engagement while it still remains in its formative stages.

## **BACKGROUND**

### **Introduction**

One of the more noteworthy developments of the last five years in the world of microfinance and development in developing nations is the rise of online P2P lending sites. In connecting individuals all across the world with entrepreneurs in developing nations, these lending sites provide financing for small businesses and individual entrepreneurs who would otherwise have no access to loans necessary for beginning or expanding their businesses. P2P lending sites have provided a new form of funding making it possible for existing microfinance institutions (MFIs) to have sufficient funds to continue their projects.

In the short four years from the implementation of the first site, online P2P lending has made significant monetary contributions towards development. Between three of the sites, KIVA, MyC4, and MicroPlace, almost \$60 million has been channeled towards the microfinance industry in developing nations.<sup>1</sup> The importance of these lending sites goes beyond this quantifiable characteristic. Online lending sites have provided the necessary platform for connecting a whole new reservoir of funding with entrepreneurs, empowering them to work towards economic development in their own regions.

P2P lending demonstrates the shift that is occurring away from development projects existing only in the form of donor funded aid programs or charities. The P2P lending sites allow for the resources of local innovation and entrepreneurship, instead of foreign donations and outside agendas, to fuel the economic development process. The hope and goal is that by providing the money in the form of loans, the funding for these programs will be more sustainable. By sending loans as directly as possible to the individuals in need, the development process should become more efficient and effective.

### **Conception of Person-to-Person Lending**

The concept of P2P lending developed at a time when the microfinance industry was in need of new ways to access funds and capital. As many MFIs were started in the early 1990s, they had expanded enough by the 2000s to require access to greater sums of money.<sup>2</sup> The options that arose first would provide the MFIs with debt funding but were only accessible to individuals with large sums of money, private donors or foundations, or commercial institutions with an interest in social responsibility.<sup>3</sup> P2P lending filled this

void by allowing individuals, along with businesses and institutions, to invest in entrepreneurs in developing nations as they reduced the minimum requirements for investment and improved accessibility.

Currently there are seven different P2P lending platforms that focus their investment on developing nations. Kiva was the first of these development-oriented platforms to be created in November 2005. Since then MicroPlace, dhanaX, MyC4, RangDe, Investors Without Borders, and Globefunder India have added variety to the choices available to socially conscious investors.<sup>4</sup> While all of the platforms have a similar goal of improving access to financing as means of promoting development, some variety exists in how the sites themselves function.

## **P2P Lending Models**

### **Model One**

Among P2P lending sites there are three different models that have been developed thus far. The first model, referred to as direct P2P lending, is one in which the platform facilitates virtual meetings between lenders and borrowers. Lenders browse through borrower profiles and choose where and how much they wish to invest. The interest rate is then chosen by an open auction in which the best bids win and are consolidated into one loan offer for the borrower. The site itself is then in control of distributing and collecting the loan. Currently none of the P2P sites focused on developing nations run with this model. DhanaX and Investors Without Borders are working towards this model, hoping to make the loans from the site directly available and distributable to well established MFIs.<sup>5</sup>

### **Model Two**

By nature of trying to disburse loans to individuals in foreign developing nations, many of P2P lending sites focused on development follow the Intermediary Model. In this case the website acts as a virtual market place for the lenders to be able to “shop” for the entrepreneur whom they would like to support. Once the lender chooses their borrower and how much they would like to offer as a loan, the loan itself is “sourced, verified, disbursed and serviced <sup>6</sup>” by an intermediary, not the platform itself. Intermediaries are

generally MFIs or NGOs that work in the location where the loan is being sent. As discussed at greater length later in the chapter, these intermediaries are necessary for being able to disburse loans in developing nations.

### **Model Three**

The third model seen in P2P lending is the MicroPlace Model. By strict definition, it no longer is truly P2P lending site, but nevertheless, is still included in the category as it uses similar means to accomplish the same goal as P2P lending sites. In this model the lender does not choose a person to invest in but instead invests in securities that are issued by an investment fund. The fund loans money to groups of MFIs, which then disburse the funds to individual entrepreneurs and businesses. As a result the risk for the lender no longer lies with the individual or even the MFI but instead with the investment fund. There is less of a direct connection between lender and borrower, as the lender does not know specifically to whom or to where their loan is being disbursed. To still allow the lender preference and control over the use of their loan, the lender is able to browse the profiles of the MFIs and choose ones whose work they prefer. To still provide some level of intimacy, there are stories of sample clients of each of the MFIs available for lenders to read.

The personal link between the lender and the borrower is sacrificed for the opportunity to allow the lender to make returns on their investments. As a result, the MicroPlace model appeals less to emotional incentives, focusing more on the economic interest of the socially conscious lender. This model, since it deals with securities and funds instead of individual organizations has great scale up potential.<sup>7</sup>

	<b>Launch Date</b>	<b>Legal Status</b>	<b>Country of Origin</b>	<b>Geographic Coverage</b>	<b>Methodology</b>	<b>Funds Lent on Site to Date (Sept. 2008)</b>
<b>Kiva</b>	Nov 05	Non Profit	United States	Global	Intermediary Model	49,000,000
<b>MyC4</b>	May 07	For Profit	Denmark	Cote D'Ivoire, Ghana, Kenya, Rwanda, Senegal, Tanzania & Uganda***	Intermediary Model	6,750,000
<b>Micro-Place</b>	Oct 07	For Profit	Unites States	Global	Investment Model	NA
<b>RangDe</b>	Jan 08	Non Profit	India	India	Intermediary Model	20,000
<b>DhanaX</b>	Feb 08	For Profit	India	India	Intermediary Model (Direct P2P Model to Come)	25,000
<b>Investors Without Border</b>	Expected in 2009	For Profit	United States	Ghana (to start)	Intermediary Model & Direct P2P Model	-
<b>Globe Funder</b>	Pending	Non-Profit	India	India	Intermediary Model <sup>8</sup>	-

## Role of Intermediaries

The majority of P2P lending sites that issue loans to developing nations are based in developed nations and therefore need local connections and representation. The entrepreneurs to whom they are lending often do not have access to the Internet; let alone the financial resources, technological training or even the adequate literacy level needed to be able to manage site accounts themselves. In these developing nations there is often no credit history or credit score available for the poor and middle class that the P2P lending sites are trying to reach. As a result these intermediaries, or field partners, have a key role not only in the administration of the loan but also in selecting borrowers. Intermediaries determine which entrepreneurs can have access to advertising for a loan on the site by running credit assessments on all possible borrowers.

The relations between the platforms and the intermediaries vary from site to site. Kiva, for example, only works with MFIs that have already established a loan portfolio. MyC4 requires organizations to find borrowers for their site specifically. Some of the sites require the partners to agree to work only with them. Other sites such as dhanaX, provide different tools and training for their intermediaries such as automated credit scoring programs for assessing potential borrowers.<sup>9</sup>

Intermediaries, while a necessity for P2P lending sites to provide financial access to the poor in developing nations, bring with them a new set of challenges regarding risk and transparency. First of all, there is increased complication and confusion for the lender in knowing where exactly the risk of their loan is located. A second point of concern is the ambiguity around the actual amount of interest that is charged of the borrower. Overall, there is a large gap between the interest (if any) that the lender is receiving from a loan and the amount of interest that the borrower is paying. Up until now there has been little done by the platforms themselves to place limits on this margin.

## **Profit, Versus Not For Profit**

One of the main differences between two of the main P2P lending sites, Kiva and MicroPlace, is that the latter is for profit while the former is nonprofit. In the planning stages of Kiva, the founders contemplated the idea of creating the possibility for returns on investments. In order to allow interest returns on investments for lenders the site must be able to be registered as a security issuer. Kiva did not have the legal capacity to acquire this accreditation.<sup>10</sup> As founder, Matt Flannery explains, the main goal of Kiva is to create personal connections between the lender and borrower that would be inhibited by the growth required to make for profit approval possible.<sup>11</sup> MicroPlace, on the other hand, is capable of being a for-profit P2P lending site. It created its own model, moving a little away from direct P2P lending by operating through investment funds. In order to make this shift and offer investments on its website, MicroPlace was required to register with the Securities and Exchange Commission (SEC). As explained on its website MicroPlace, since it is a “registered broker”, also has to be a member of the Financial Industry Regulatory Authority (FINRA). FINRA works to provide oversight of compliance to the standards set by the SEC.



## **Closer Look: Kiva**

Kiva, created in November 2005, is the first of P2P lending sites to focus on developing nations. The mission of Kiva, as stated on its website, is to “connect people through lending for the sake of alleviating poverty.” The founders had four very specific goals. They wanted to allow Internet users to loan out money to micro-borrowers of their own choice. Kiva wanted to partner with MFIs in hope to have them administer loans, keep track of borrowers’ information and post any updates on progress. Crucial to their venture was the fact that a financial connection would evolve between the lender and the borrower where all the risk lay in the hands of the lender. Finally, the goal was to allow loans to flow specifically between individuals instead of between organizations.

In providing financing to individuals in developing nations, Kiva saw the advantage of supporting microfinance already in place at local levels in these countries. Kiva was very intent on partnering with what is known as the long tail of the MFI community. These are the small and often not yet sustainable MFIs that have little chance of accessing credit or developing credit worthiness. It wanted P2P lending to be a path through which MFIs could “journey from donor dependence to tapping into the capital markets.”<sup>12</sup> Ideally, Kiva hopes to have a good mix of well-established and commercial MFIs as well as small ones aiming to reach a commercial level. It is possible for this long tail of the MFI community to partner with Kiva since it has such a large quantity of individuals investing small amounts it is a more “risk tolerant” lending environment.<sup>13</sup>

A closer look at this site demonstrates the workings of online P2P lending and how the idea of transparency is being achieved, as well as an assessment of the risks involved for the lender. Kiva is a prime example of a not for profit Intermediary Model P2P lending site. As Kiva works to create full transparency throughout the flow of the loan money, the role of the intermediary, or field partner, is key. The field partner screens each entrepreneur by looking specifically at their loan history, their village reputation, and their business feasibility.

Despite all the work done by intermediaries to screen the potential borrowers, there is still an inherent risk for the lender. The Kiva website discusses the various factors outside of the individual entrepreneurs control. Business problems, such a crop failure, health issues such as malaria or AIDS, or unexpected hardships such as theft, can prevent

an individual from being able to make loan repayments. If a default occurs on a loan, the field partner is expected to investigate and report with full transparency to the site the circumstances surrounding the default of the loan.

Despite their necessity, there is a risk in coordinating with the field partners as well. There is a potential for the field partner to go bankrupt or for fraud to occur within the organization if field partner staff embezzle funds. The field partner may have a poor operating system in the nation and fail to distribute or collect loans efficiently. To allow lenders to make well-informed decision on where to invest, Kiva rates the field partners it operates with on a scale from one (being a partner with a high risk) to five (a partner with a very low risk) on its website.

The Kiva website also mentions that in addition to risks involved with the individual entrepreneur and the field partner distributing the loan, there is also risk involved with the nation to where the loan is being sent. Currency can, especially in developing nations, be volatile and devalue rapidly. Political unrest or natural disasters such as tsunamis or floods can also impact investments made in the nation.

Kiva currently has 111 field partners found in 49 different nations. Kiva has found that when field partners use the correct screening policies, a return rate of at least 95 percent is very feasible. One screening or risk reduction policy that is frequently used is to lend to entrepreneurs who are members of a borrowing group. One example of this would be five women who all know each other and live in the same village. The loan provided to them is contingent on each member of the group repaying their loan. The result is a natural system of peer monitoring as well as support that has been shown to result in a high repayment rate in the past.

Each field partner has loan officers to travel to the locations where the entrepreneurs live on a monthly basis to collect the repayments. After collecting the loan, the field partner then transfers the repaid funds back to Kiva where software automatically distributes the money back to the lenders. In doing all of this the intermediaries are also expected to keep up to date journals of the progress of each entrepreneur.

## **Selecting Entrepreneurs**

What makes many P2P lending sites so successful is the personal connection that it created between lenders and borrowers; relying on the emotional responses of socially responsible individuals to lend money. While this is a central component of the majority of the platforms- it also has the potential to create biases implicit when decision are made on an emotional basis. Kiva is aware of this, referring to it as an “unusual cross-cultural form of competition.”<sup>14</sup> While every business that has used the site has been funded within an average of 2.2 days, the reality of funding speed varies greatly across gender, geographical location and business type. On average African entrepreneurs, women and agricultural projects were all funded first. This small example demonstrates the need for further investigation and research into what even greater biases may be inherent or created in by the P2P platform.

## **Impact on Borrowers**

Regardless of the other criteria that can and is used to rate P2P lending, the most important aspect and measure of success should be the impact they have on the people borrowing the money. With an awareness of the failure of foreign aid, there has been a movement in recent years away from the top-down approach towards development that most developed nations and organizations have taken until now. Impoverished entrepreneurs do not need handouts; they need access to capital in order for them to make use of their drive and concepts for businesses. Microfinance projects and P2P lending programs work to provide this capital that is the missing component in the path towards economic growth for otherwise qualified and ambitious entrepreneurs.

### **Case Study: Elizabeth Omalla**

Elizabeth Omalla is an excellent example of the impact a loan can have on an individual's livelihood. As a woman, and especially as a widow, in a rural town close to Lake Victoria, Elizabeth Omalla had little opportunity to access to the credit necessary to start any business ventures with which she might provide for her seven children. In 2000, Village Enterprise Fund provided her with her first loan of \$100, allowing her start a business of buying and selling vegetables. The next year, through the same organization, she was given access to business training. As a result, Omalla switched her business focus to fish mongering; a more profitable business in her area. Her fish business began with her buying fish through a middleman. This was successful enough for her to buy cows and goats for her family and leaving her enough to send her children to school.

Omalla received a second loan of \$500 from Kiva that she used to expand her fish business. She was able to cut out the need for a middleman and now travels to Lake Victoria and sells the fish to vendors in local markets. She hopes all her children will receive a higher education and has started a small savings account for pay for this.<sup>15</sup>

(Source: Flannery: 2007)

What is evident from this “success story” is the ripple effect that results from providing an entrepreneur with a small loan. The loan gives the individual the chance to expand their business in a way that may be more profitable. It connects them with further training in their field. It also changes the future of the next generation in the country, as education becomes a more realistic option for them.

### **Impact on Lenders**

P2P lending is an important new player in the development realm not just because of the impact that it has on the borrowers but also because of the whole new wealth of lenders it has uncovered, or rather connected. The very fact that the loans are small allows individuals to take part in what was previously reserved just for large investors or companies. As Bill Clinton states, “people, even with a very modest amount of money, can have a huge impact.”<sup>16</sup> The speed at which the loans are made is incredible as well. Statistics show that there was a loan made on Kiva every 37 seconds for the first quarter of

2008. Once a loan is posted on the website, it only takes an average of 85 hours to receive funding.<sup>17</sup>

## **Interest Rates**

While P2P lending sites significantly increase the accessibility of funds for the poor in developing nations, they have done little to reduce the actual interest that is paid on the loan by the borrower. The potential is there for these sites to reduce interest rates but the majority have no regulations in place to set maximum interest rates that can be charged of the borrowers. RangDe so far is the only P2P site that has placed a cap on interest rates. Kiva does not put any limits on the end interest rate and does not always know how much the borrower really has to pay in the end. The result is that in some cases the margins between what the lender receives and what the borrower pays end up being as high as 50 percent. Some reduction has occurred on the sites where the borrower is able to bid on interest rates proposed by lenders. For example, MyC4 allows the lenders to bid on the interest rate they will accept and reserves the right to place a cap in the interest rates imposed by the intermediary. Despite the additional interest placed on loans by the intermediaries, the financing offered through MyC4 has proved to still be one of the cheapest available to developing nations.<sup>18</sup>

## **Administrative Costs**

One main question that rises from the P2P lending site models is how the organizations themselves stay solvent and sustainable. The quality and source of their funding is a crucial factor in ensuring that these platforms become sustainable. The way in which administrative costs such as staff salaries or site maintenance are funded varies from model to model.

Kiva uses two different methods to fund its administrative costs. The site maintains a clear distinction between its Loan Volume and Revenue in an attempt to maintain transparency throughout the flow of money. The Loan Volume is the capital that lenders send to entrepreneurs of which 100 percent is channeled directly to the entrepreneurs. Neither Kiva nor any of its field partners are allowed to use this stream of capital. Kiva then has revenue, or capital, that flows in for direct use by the organization

itself. The first method through which revenue comes in is through optional donations that lenders are given the choice to make during check out. Around seven out of every ten users chooses to donate an extra 10 percent on top of the loan they are sending, directly to Kiva. These donations are tax deductible and no taxes are paid on profits made from them. The second source of revenue for the site is from float; the interest collected on money that sits in the organizations accounts before being dispersed.<sup>19</sup> In the year 2008, for every \$1 that the organization used, \$8 were loaned out. The company budget for the year was \$4.7 million and the user base sent out \$37 million to entrepreneurs.<sup>20</sup>

Each P2P lending site has its own strategy for covering the administrative costs; placing the burden of the cost at different stops along the flow of loans. For example, MyC4 places the burden of the administrative costs not on the lenders, but on the businesses in Africa that receive funds through MyC4. Each business, upon receiving their loan, is required to pay around 3 percent of each loan that is disbursed, partially when the loan is disbursed and partially when the loan is repaid. MicroPlace, on the other hand, places the burden on the Investment Funds that choose to advertise themselves on their site. These three P2P lending sites show that the lenders, borrowers or the intermediaries, can cover the burden of the administrative costs.

## **Future Challenges for P2P Lending Sites**

As has been touched on above, there are a number of challenges and questions facing P2P lending sites. The first that comes up is the sustainability and longevity of these sites, which will depend on how reliable their sources of revenue and donation end up being. The motivation for many lenders is emotional and therefore may be a more fickle source. While the platforms have showed remarkable growth since their conceptions; the question remains as to whether this growth can be sustained. Kiva in its first year of existence funded only \$1 million in loans; an amount it now funds less than 10 days.<sup>21</sup>

The current economic situation has highlighted this challenge. The benefit that lending platforms have over charities that depend on outside funding is that more than half the loans continue to replenish themselves. If lenders continue to reinvest loans once they are repaid, little new funding is needed to maintain the current loan quantities available.

This means that the amount of loan quantities will not decrease for most platforms due to the recession, but the growth of loan amount will most likely slow down.<sup>22</sup>

Many of the P2P lending platforms, despite their remarkable growth, have not yet been able to break even. While for the non-profit platforms this kind of sustainability for profit is not necessary, there is still a risk present in the nature of their funding. The following years will be a crucial test of the longevity of P2P lending projects. The question arises as to whether or not lending will continue when the novelty of P2P lending dwindles. With the right promotional tactics the for-profit platforms hope to achieve sustainability within the next three to five years. This sustainability depends on them being able to maintain a minimum loan volume.<sup>23</sup>

The necessity of local partners and intermediaries is also a part of the system that requires development and further analysis. DhanaX and Investors Without Borders, two of the newest P2P sites are hoping to cut out this intermediary position as they develop their sites.<sup>24</sup> Without an intermediary, even greater transparency in money flow could be achieved but this improvement might require sacrificing a greater breadth of impact that the sites can have. Another challenging aspect for P2P lending sites worth further investigation is the regulatory environments, politics and currencies in developing nations where P2P lending sites work.

One of the huge challenges and goals of P2P lending is to continue to enhance the transparency that exists between the borrower and investor; something that has been lacking for a long time in the international aid regime. Transparency in online lending relationships is especially complex as the lender and borrower never officially meet and so a trust between them must somehow be created. In addition to creating transparency between the lender and the borrower, P2P sites themselves must be completely transparent in their handling of loans and money processing.

A specific example of the challenges of transparency in the process is seen in the interactions between the intermediary and the lending site. On some sites, such as Kiva, the intermediaries are given rating based on the repayment rate of their loans. The ratings are posted on the site for lenders to see as they browse through profiles. Naturally the intermediaries need these repayment rates to be as high as possible for them to be able to remain competitive on the sites. This means that if an entrepreneur defaults on a loan, it is

often cheaper, and a better financial decision in the long run, for the intermediary to repay this loan out of its own pocket. In doing so it never has to list that one of its entrepreneurs has defaulted on a loan and therefore can maintain high ratings on the site.

### **Marketplace Model Applied on a Wider Scale**

The wide success of P2P lending sites in just the past three to four years begs for further study as to the application potential of this model on a much broader level in the development world. The concept of one online marketplace for development aid has entered many discussions around the changes needed in the aid industry. The network could connect programs strong in regional and practical knowledge and experience with both institutions and people possessing the necessary resources, as well as with those on the ground carrying out the development projects. The idea would be similar to the P2P lending site models, but in this case various aid projects would be competing for funding from the different sources available through the site. The potential this has to revolutionize not only funding, but also project generation and implementation, is huge. Both the collaboration between projects in different regions and the funding options and choices open to donors would improve.<sup>25</sup>

There is especially a large potential in this idea of the marketplace to tap into a huge new reservoir of resources that P2P lending sites have just uncovered. Individual donations, which would be simplified and enhanced by a marketplace for aid, have been on the rise in the last decade. Data shows that while US official development assistance in 2000 was \$10 billion, the total private assistance abroad was estimated to be around \$33.6 billion. Around \$ 18 billion of this was in the form of remittances. The rest all came from private funding, of which over half was from individuals- those whose donating experience would be the most effected and improved by a larger marketplace site for development aid.<sup>26</sup>

The potential for rapid improvements in development projects themselves is another key motivation behind creating a marketplace for these projects. As Whittle and Kuraishi point out that there is an “explosive tendency for successful enterprises to spin off from other ones.”<sup>27</sup> This means that in a marketplace for development, people running



different projects can in essence be close enough together to learn and build off of each other's experiences.

## **Concluding Remarks: Challenges and Opportunities**

At a time when change is needed in how foreign aid and development are funded and managed, P2P lending sites provide a unique alternative with great transparency and efficiency in distributing funds. The potential that exists within P2P lending sites for increasing the impact made by each dollar given towards development is vast. However, great potential also means that space exists for complications and challenges that may hinder this potential from being realized.

The personal connections between lender and borrower that are created by P2P lending sites are an important motivating force for many lenders. The ability to watch how the money an individual has lent is changing the life of a borrower is one of the key features that has allowed for P2P lending to be an attractive alternative to charity donations. However, the personal and transparent aspect of some P2P lending sites could be difficult to maintain if moves are made towards the up-scaling of these sites. A dramatic increase in funding would require a similar increase in borrowers that realistically will be a challenge if the same personal attention is required. With the current quantity of lenders, sites are already having difficulty keeping up with loan demands. The benefit of P2P lending sites is that they facilitate coordination with existing MFIs and their projects instead of adding to the numbers. However, the role of these MFIs or intermediaries is one aspect that hinders the complete transparency that P2P lending sites are striving for.

The format or model that P2P lending sites have developed can be taken and applied to other aspects of coordinating development. The United States development strategies and projects will benefit from engaging with the incredible potential exhibited by the P2P lending model. With outside guidance and oversight, the potential of P2P lending can be realized and the challenges facing it tackled.

## **OPTIONS**

The P2P lending movement is at a critical point in its growth where the right policies could ensure that it has a long lasting and effective future in impacting and improving development around the world. There are a number of simple, yet crucial steps the government could take to provide coordination between and guidance among the P2P lending platforms that are and will continue to emerge. Having only existed for the last four years, this is the time for coordination and standardization to be put into place. Standardization should set a standard of quality and responsibility amongst these sites, visible and available to the “consumers” (both lenders and borrowers) in such a way that does not impede effectiveness or inhibit the transparency these sites are trying to create.

- **Option One: Channel US AID Funds into P2P Lending**

One option would be for the United States government to channel a portion of its own funds into P2P lending funds. This could be done directly by the US government itself to P2P lending sites. Another method would be to give people more choice and agency over their own tax dollars that are being used for foreign aid. The government could distribute ‘vouchers’ to all citizens only redeemable at P2P lending sites. Once the loan money was repaid it could not be taken out of the lending site but only reinvested. This would significantly increase the amount of funding for P2P sites- funding that would continually renew itself.

There are a couple of potential problems that arise from this policy. One of the main goals of P2P lending sites is to foster connections between lenders and borrowers. This is currently possible because most of the sites are still operating on a reasonably small scale. To scale up these programs so they could support the huge increase in lending that would result would be almost impossible while maintaining some level of personal connection between lender and borrower. Lending sites such as MicroPlace will be more likely to be able to handle these size increases. However, the issue of whether or not profit could be made from aid dollars would need to be addressed. The final challenge with this option is whether or not tax vouchers would be used effectively or if they would distract from the personal donations made by individuals.

- **Option Two: Create Oversight Committees for P2P Lending**

Another option for the United States government is to create a standardization method that could be applied to P2P lending sites. At this beginning stage in P2P lending, this would be a very useful step. As more and more sites begin to emerge, a process of quality control must be implemented to prevent scams as well as to provide users with guidance in deciding where to invest their money. A simple oversight committee could be created whose sign of approval would appear on the site. This sign would mean that the site's work had met standards set by this governing board, such as sufficient transparency in money transfers as well as legitimacy of MFIs co-coordinated with.

While the legitimacy and quality of sites could be regulated if this policy was implemented a number of problems may arise from this standardization process. The challenge would be to make this standardization process simple but effective so that it would only prevent corruption but not inhibit the growth and development of sites. Increased government involvement and control has the potential to prevent growth and innovation if the government overwhelms organizations with bureaucratic regulations. The US government would need to ensure that what they develop is a simple standard to which all P2P lending sites must adhere with a small oversight committee to ensure compliance.

- **Option Three: Initiate Research of Project Impact and Effectiveness**

A third response or strategy that the US could take would be to begin research investigating the effectiveness or impact that P2P lending sites have made. Due to their newness, the sites' long term impact and effectiveness have yet to be proven. These are criteria that require research, as projects have been around for long enough to create a measurable difference in specific areas.

Investigation and research in the area could inform the US as to whether or not P2P lending sites would be worth investing US AID funds into. The challenge would be to create a standard that could be applied in all locations that would genuinely measure the impact of each P2P lending site on development. The impact that the MFIs in each location are having would have to be separated from the impact coming directly from P2P

lending. While challenging to implement, this research is key to the future of P2P lending and its role in development.

- **Option Four: Promote P2P Lending Sites**

The final option available to the US government is to provide assistance in advertizing and promotion of P2P lending sites. This might be as simple as coordinating US AID projects directly with projects supported by MFIs that are linked with P2P lending models. Through this coordination, P2P lending sites would be mentioned alongside US AID projects, providing them with increased recognition and legitimacy in many cases. Another route would be to put funds behind advertizing and promotion campaigns for online lending. Most of the promotion of Kiva, for example, happens simply by word of mouth and coverage by the press.<sup>28</sup> This nearly nonexistent advertizing means that the amount of lenders could see a huge rise if actual add campaigns were funded. There are two main challenges that accompany this option. This option faces a similar challenge to Option One as it questions whether or not the quantity of loans could match the quantity of lenders that could result from advertizing. The second challenge is that this option would need options two and three to be carried out first in order for the government to truly support specific P2P lending sites.

## **Recommendations**

Given US interests in promoting human rights, democracy, and economic development in the rest of the world, P2P lending programs provide a new, innovative approach to increase the effectiveness and productivity of development programs. In engaging with P2P lending sites, a combination of option two and option three would make the best use of the strengths of the government while making progress towards the goals that are within their best interest.

Research into the effectiveness of P2P lending programs, highlighted in the third option, is an essential for the US government. This option specifically calls for the government to initiate research into the impact and sustainability of P2P lending and the MFI projects they connect with. Before choosing to promote or even financially support P2P lending sites the United States will need to have some form of research proving the

long-term effectiveness of P2P lending sites. This can only be discovered through the immediate start of research into specific projects.

Option two calls for the government to create an oversight committee for P2P lending sites. This would be the next step, after assessing effectiveness, to ensure continued transparency and effectiveness of P2P lending. As more and more P2P lending sites begin to emerge, a standard of assessment and quality is necessary. The government has a natural advantage for creating and enforcing methods of standardization and through this can create greater accountability.

The US government can most effectively engage with P2P lending sites by combining research into effectiveness of these sites with the creation of a standard of quality for P2P transparency.

#### **Existing Person-to-Person Lending Sites**

<b>Kiva</b>	<a href="http://www.kiva.org">www.kiva.org</a>
<b>MicroPlace</b>	<a href="http://www.microplace.com">www.microplace.com</a>
<b>MyC4</b>	<a href="http://www.MyC4.com">www.MyC4.com</a>
<b>RangDe</b>	<a href="http://www.rangde.org">www.rangde.org</a>
<b>DhanaX</b>	<a href="http://www.dhanax.com">www.dhanax.com</a>
<b>Investors Without Borders</b>	<a href="http://www.investorswithoutborders.wordpress.com">www.investorswithoutborders.wordpress.com</a>
<b>Globe Funder</b>	<a href="http://www.globefunder.in">www.globefunder.in</a>

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- <sup>1</sup> USAID. "Person-to-Person Lending: Is Financial Democracy a Click Away?" 2008.
- <sup>2</sup> Ibid
- <sup>3</sup> USAID, 2.
- <sup>4</sup> Ibid
- <sup>5</sup> Ibid
- <sup>6</sup> USAID, 14.
- <sup>7</sup> Ibid
- <sup>8</sup> Ibid
- <sup>9</sup> USAID
- <sup>10</sup> Flannery, Matt. "Kiva and the Birth of Person-to-Person Microfinance." *Innovations*. (Issue 1-2 (2007): 30-56.)
- <sup>11</sup> Flannery: 2009
- <sup>12</sup> Matt Flannery. "Kiva and the Birth of Person-to-Person Microfinance, 37.
- <sup>13</sup> Ibid
- <sup>14</sup> Flannery, "Kiva and the Birth of Person-to-Person Microfinance", 50.
- <sup>15</sup> Flannery "Kiva and the Birth of Person-to-Person Microfinance", 38.
- <sup>16</sup> Roberta Avery. "Changing the world from a Toronto Home \$25 at a time; How the first person-to-person lending website in the world is democratizing philanthropy." (*The Toronto Star*, July 17, 2008.),1
- <sup>17</sup> Ibid
- <sup>18</sup> USAID.
- <sup>19</sup> Flannery. "Kiva and the Birth of Person-to-Person Microfinance."
- <sup>20</sup> Matt Flannery. "Contours of a Crisis (II)" 01/07/2009
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<sup>26</sup> Ibid

<sup>27</sup> Whittle and Kuraishi, 477.

<sup>28</sup> Flannery: 2009



## Chapter 13

### UNLOCKING THE POTENTIAL OF CELL PHONES

*Justine Marie Sherry*

#### **ISSUES**

The rapid rise of mobile phone use in poor countries is well known as an exemplary case of a technology enabling bottom-up empowerment through information access, driven by small-margin business and end-user innovation. While many are not mobile phone owners themselves, few today face a several mile walk to access an often-disconnected landline phone for communication, which was a regular occurrence only ten years ago. But even as some marvel at the rapid changes brought about by mobile phone use, a second generation boom is already occurring, developing innovative applications for the now widespread mobile phone platform.

Building off this new connectivity, there are new programs aiming to provide public information access, data storage and accounting, and even mobile banking, mostly utilizing only the cheapest phone models. Whether for-profit or as charity, these applications are seen by many as the next step in leveraging the power of mobile phone diffusion to provide information access cheaply and efficiently to the world's poorest.

While some may see this new movement as over-exuberant, high-profile new programs are being driven by enthusiasts representing the technology industry, academic research groups, and international aid organizations. As a result, the future of mobile phone applications, as well as most technology in development, is relevant to business and trade policy, research investment, as well as traditional development aid programs.

#### **BACKGROUND**

##### **Introduction**

Extending the benefits of mobile phone use is now the focus for countless development projects. Although many technical projects target assisting aid workers or

providing group tools for whole communities, mobile phones have uniquely become easily accessible and useful for individual users. The rapid spread of phone usage, generally unaligned with formal aid programs, has prompted support for “connectivity for its own sake,”<sup>1</sup> the idea that giving people a tool to connect them to information should be a primary goal – and that less focus needs to be placed on exactly what users are accessing. The fact remains, however, that the power provided by a mobile phone can be expanded significantly by thinking about exactly what people are accessing and how to improve it. “Bottom billion” users have shown extreme ingenuity with their phones, discovering new benefits and finding new uses wildly unexpected by mobile phone designers. Building off this, there is reason to believe that changes and new programs can be implemented to further expand the benefits and uses of mobile phones.

### **Comparison to PC and Internet Based Solutions**

Although the capabilities provided by a mobile phone are limited compared to the extensive functionality provided by a PC and the Internet, mobile phone applications fill a significant niche at a much lower cost than PC applications and with a guaranteed base of penetration. PC-based “interventions,” such as community kiosks and the One Laptop Per Child project, require providing expensive hardware, a consistent power source, and an extensive, expensive Internet infrastructure. Increasing skepticism for these interventions are growing out of the difficulty of successfully deploying such programs.<sup>2</sup> However, through simple mobile phone applications, clever designers are managing to duplicate some of the benefits of PC-based Internet access without the heavy infrastructure costs associated with distributing PCs.

Mobile phone programs can address the need to consistently obtain valuable information. Mobile phone access has already provided great benefits by allowing users to connect to contacts from anywhere, allowing them to instantaneously access the knowledge of those in their community. One-to-one communication, though, limits an individual to information known by a contact that they already have. If a user wants to know what the weather is like in Kibera, he needs to know someone in Kibera. If a user wants to know what the weather will be like tomorrow in Kibera, he needs to know a weatherman, or someone who has read the news forecast in Kibera. Alternatively, a user with Internet access can openly access tomorrow's or next week's weather report without

any contacts whatsoever. Mobile phone applications can bridge this gap. Attempting to allow open access to targeted, useful information known to have direct benefits (such as weather forecasts or market prices for specific crops) thus constitutes many of the new mobile phone applications being developed.

Another function often only imagined on a PC or website is the ability to utilize personalized applications or tools. In the United States, the average PC and Internet user interacts with dozens of online applications every day. These applications are everyday utilities allowing their users to streamline regular activities, many of them business related, such as financial data storage. There is no equivalent tool for a remote mobile phone user who simply lives without these tools altogether. While the mobile phone may not be able to match the computing power and usability of the PC, there have been several innovative programs in allowing the development of some interactive applications, most prominently in creating personal crop data and interactive sharing of business information.

### **Recognizing the Strengths of the Mobile Phone Platform**

Still, it is important to recognize that the mobile phone is a very different tool than a PC, and not only has limitations compared to the PC, but also unique strengths. As a result, it is important to also look for creative new uses for the phone that are not simply mimicking functionality provided by computers in wealthy countries. A successful example of this type of thinking is visible in mobile banking projects, which look not only to online banking for inspiration, but also to mobile phone distribution networks and brick-and-mortar banking institutions for models of what to provide their users. As a result of these combined influences, the technologies running mobile banking projects are unrivaled in wealthy countries.

### **A Unique Opportunity**

Mobile phone programs are still a rapidly growing area of Information and Communication Technology for Development (ICT for Development). There is significant success already behind the mobile phone movement, visible in its penetration rate in poor countries as well as economic benefits that have been well demonstrated. Current activists are looking at the rapid expansion of mobile phone access not as a finished success but as a stepping stone for new growth. Although the new applications that are currently expanding utilize extremely simple interfaces and a very basic technology, they are still managing to

mimic many of the capabilities of Internet and PC access, and even to provide completely new uses of mobile phones, tailored to their poor users. As a result, these new applications are poised to vastly expand the capabilities of an already successful, widely adopted tool.

## **The Successes of Mobile Phones Today**

### **How Mobile Phones Have Reached the Masses**

In 1999, connectivity, the ability to exchange information between distant locations through telecommunications, in Africa was dismal. While the developed world was experiencing soaring growth in communication accessibility with Internet access reaching businesses, homes, and schools, experts began to worry about the growing “digital divide” between rich and poor nations. Information was becoming the most important commodity for the 21<sup>st</sup> century, and yet African countries had only 1.7 fixed lines, 0.98 mobile phones, and 0.12 internet subscribers for every 100 individuals.<sup>3</sup> By 2006, however, the mobile phone had made a spectacular breakthrough. While fixed lines stagnated at only 3.1 per 100 people, and the internet still failed to reach the masses, having grown to only 1.2 subscriptions per 100 people, mobile phone penetration had improved to an astounding 22 per 100 individuals.<sup>4</sup> With almost one in four people owning a phone, it is hard to imagine someone who does not at least know someone with a phone. African countries are showing the most growth out of all developing nations, with South Africa and Nigeria at the top, followed by Algeria, Egypt, and Morocco.<sup>5</sup> In addition, Asian countries are making significant gains as well, with China and India leading Asia with their substantial populations.<sup>6</sup> Furthermore, users in developing nations outnumber those in wealthy countries, making up 58% of subscribers worldwide.<sup>7</sup> In sum, the developing world has become a connected world.

### **Mobile Phones from a Bottom-Up Perspective**

Beyond its model status in the ICT for Development community, the mobile phone also stands as an excellent case study for bottom-up development. Phone based tools have certainly been deployed in top-down contexts to great benefit: aiding hospital assistants, providing a simple avenue for data submission for field workers, and providing tools for community and educational usage. Nonetheless, the most surprising attribute of mobile

phone usage in developing countries has been its availability to poor individuals, who choose to purchase the phone deciding that the benefits of owning a phone justify the cost. Information access creates individual empowerment by allowing users to make more effective choices with a good understanding of options and solutions available to them.<sup>8</sup> In addition, just as bottom-up perspectives have developed mostly in recent years, moving away from a long history of “top-down” programs, ICT for Development had a predecessor in “development communication,” which focused on television and radio.<sup>9</sup> Although the defining difference between ICT for Development and “development communication” is technological, shifting focus to mobile phones and the Internet, the ideological distinction that stems from this technological shift parallels the shift in development policy. This new technology moves the focus from shipping ideas out to allowing individuals to access information of their choice, as well as spread their own information to others.

### **Economic Impact**

Beyond ideology, the economic impact at the “bottom of the pyramid” has been remarkable. One study demonstrated a positive correlation between mobile phone ownership and GDP, and further claimed that “a developing country that had an average of 10 more mobile phones per 100 population between 1996 and 2003 would have enjoyed per capita GDP growth that was 0.59 percent higher than an otherwise identical country.”<sup>10</sup> The on-the ground underpinnings of this correlation are clear. In a survey over 14 African countries, 80% of small market enterprises surveyed used a mobile phone for business, and 95% of small market enterprises agreed that mobile phones were important or very important for their business operations.<sup>11</sup>

Mobile phone companies have also made steps to integrate interesting distribution policies allowing for extended micro-entrepreneurship, policies which allow them to efficiently organize their sales while including the poor in their profit chain. One original program, copied by mobile phone companies worldwide, is that of the shared phone; a mobile phone sold to one person who then re-sells phone use to neighbors.<sup>12</sup> This pattern is repeated from the iconic “phone ladies” of Bangladesh, to the “umbrella people” of Nigeria,

to the “community phones” of South Africa.<sup>13</sup> Another, new development growing in Ghana is the re-sale of airtime, allowing the mobile phone networks to avoid printing airtime distribution vouchers. Under this program, a vendor may buy a “commercial” account and purchase pre-paid mobile phone minutes in bulk at a special, low rate, and then re-sell the airtime through a phone interface to their local customers.<sup>14</sup> As a result, the path of mobile expansion has become a path of economic growth and empowerment.

### **A Baseline for Future Success**

Mobile phones provide a starting platform, which already demonstrates several of the qualities of a successful technical intervention. Because they are already well-deployed, any application for the mobile phone platform does not require large-scale distribution of expensive technology. Since mobile phones have already had an economic impact, future applications have a model of how the mobile phone can create positive change, and can work to improve or extend those benefits. Unlike many other experimental technologies, mobile phone applications are being designed in known territories, where models of success are visible from the start.

## **Methods for Application Design**

### **Options and Limitations**

As new ideas are emerging from many backgrounds, from software development to economic development, it is important for all parties to be aware of the framework within which they are designing their new interventions. Working with mobile phones is an extremely limited environment, which is often hard to imagine for those coming from a perspective of ubiquitous technology access. The shift in perspective, though, is necessary. While the latest high-tech devices are constantly being adopted in wealthy countries, only the cheapest phones are affordable to poor users in poor countries, meaning that working with existing tools is paramount<sup>15</sup>. However, this still leaves design choices that can be cleverly utilized depending on how the proposed program is deployed. Currently, there are two primary methods of building a mobile phone application, each with individual benefits and restrictions. These two prominent methods use either an SMS server, or a proactive SIM card. In addition to these methods ready for design, there are many other platforms

and methods which are under trial in research environments, but which currently lack the deployment and/or low cost of the first two methods.

### **Designing with an SMS Server**

Applications based on an SMS (Short Message Service) server are widely used, and work entirely through text messaging. From the user's perspective, they can send and receive text messages to a specific phone number and can both submit and access data. For example, a weather application might be accessed by a user by sending a message to a specified phone number saying “weather tomorrow Accra”, and then would receive back a message saying “Sunny skies, 30 degrees C.” This implementation is extremely limited – long dialogues are not convenient and most programs involving SMS involve simple one-for-one information submission and retrieval. However, the necessary investment for such a system is quite low: the designers only need a mobile phone connected to a computer, and then to design their program to receive and respond to messages. Microsoft Research has even designed an interface called the “SMS Server Toolkit” to assist software developers in designing such a program.<sup>16</sup> Furthermore, there is nothing special to deploy to end users; they just need to be informed of the special number to message and how to contact it.

### **Designing with a Proactive SIM**

The other major interface, using a proactive SIM, allows programs that can be a bit more complex than those simply functioning by exchanging text messages – these programs work through a series of menus and dialogues, and can display messages on the phone, send messages, set up calls and play sounds.<sup>17</sup> All of these allow interaction to be more complex than a simple one-for-one exchange of messages. Because these programs are installed on network-provided SIM cards (the card sold by the network provider and inserted into the user's phone when they register for network service), they are only available to programs endorsed and developed with network operators. This is not an entirely restrictive factor, though, as many telecoms are beginning to seek recognition as participants in development progress, with the UK's Vodafone going so far as to claim that “development today is understood to be unachievable without the engagement of the private sector.”<sup>18</sup> Furthermore, because they require a special card, deployment is more

complex than SMS server programs, which doesn't require any special additions to the standard phone.

### **Designing for the Future**

While applications utilizing an SMS server or a proactive SIM card are the most feasible for current deployment, several future-looking research projects have started investigating mediums which would utilize higher-tech mobile phones. These theoretical designs may become more useful as technology improves and as prices for features from current high-end phones begin to drop. Many projects have been developed for “smart phones”, internet-capable phones capable of running multiple applications.<sup>19</sup> Seeking the most useful features for the phones of tomorrow, researchers have identified built in cameras,<sup>20</sup> GPS service,<sup>21</sup> and cell-based Internet access<sup>22</sup> as existing features in higher-end phones, which hold strong potential for the low-cost phones of tomorrow. Another prospect that has excited many is “fixed mobile convergence”, the integration of multiple communications such as internet, email, and phone service, all within one mobile device.<sup>23</sup> In some places this convergence is approaching more rapidly - in Latvia, 67% of households receive their internet access through a mobile phone.<sup>24</sup> Fixed-mobile convergence holds special promise for developing countries, where landline Internet access requires an almost unachievable level of infrastructure and satellite access is far too expensive for sustainable use. Still, all of these promises are looking far into the future. The most feasible projects today will involve the simplest technologies on the simplest phones, and it is necessary to creatively envision current applications to function within that restricted context.

### **Successful Projects Today**

#### **Types of Programs**

Many applications indeed have risen to success by creatively working within the context of simple mobile phone design. All of these attempt to springboard off of existing mobile phone successes to hit large numbers of the poor and provide them economic benefit. Most provide functionality that those in wealthy countries traditionally envision on a PC. Some simply work to expand information access, and others act as tools for



personalized data use and interactivity. Mobile banking defies standard conceptions of PC type designs by providing banking features that rival traditional banking institutions.

### **Information Access**

Accessing targeted information has proven particularly simple to implement using an SMS server. As a result, many programs have arisen to expand user access to information that is known to be extremely pertinent to users.

Information access is not simply an educational feature of technological access – it has crucial role in individual decision making and direct impact on economic success. The canonical study on this effect with regard to mobile phones came with a study of South Indian fishermen. Jensen showed that as mobile phone access came to fishermen, they gradually moved away from selling their fish only in their local market.<sup>25</sup> In addition, they began to sell almost all of their catch, rather than wasting much of it as they had before.<sup>26</sup> Furthermore, market prices in the region shifted quickly with the introduction of mobile phones, from rapid, unpredictable fluctuations to a more steady and consistent price line.<sup>27</sup> As a result, both phone users and non-users benefited from increased profits – with phone users increasing their profits almost twice as much as non-users.<sup>28</sup> These results demonstrate that as individuals have to access a wider range of market prices, they make better informed choices about when and where to sell their goods. As a result the market stabilizes and all those involved benefit tremendously.

### **Expanding Available Information**

Extended up-to-date information access is convenient to provide to individuals through mobile phones, and it has a direct impact on the lives of those effected. In pursuit of this convenient usage, several programs have been designed attempting to provide more extensive knowledge of pertinent data, especially sales and pricing data, to the poor involved in business activity. These programs have been driven both by commercial groups as well as non-profit organizations, and mostly focus on agricultural information and trade data. Examples include:

- A program in Maharashtra, India providing both weather prediction as well as market price data is under development by Reuters, the United Kingdom based news service. This should allow them to decide when to sow and harvest their crops,

as well as where to sell them most efficiently.<sup>29</sup>

- A program in Senegal utilizes both a SMS-server and a cell-phone optimized web site for mobile phones with internet access to provide data on product prices at several local markets. The program, called Xammarsé, is being run commercially by a company named Manobi and has over 3,400 users among producers, middlemen, traders, and hotel keepers involved in the local trade network.<sup>30</sup>
- In Burkina Faso and Mali, a UNCTAD-supported program called “Trade at Hand” sends information on product prices in international markets to agricultural exporters via SMS, allowing them to negotiate better deals for their produce. Current plans are moving towards making the program self-sustainable.<sup>31</sup>

All three of these programs target the entrepreneurial poor: they are developed in both for-profit and non-profit contexts. They attempt to extend the protection provided from market inconsistency through information and control as seen among the Indian fishermen. Expanding the information distributed to both agricultural and weather information should give farmers better control over their planting cycles, protect them from weather anomalies, and enable farmers to make the most informed choices about how to manage their crops.

### **Interactivity and Assuming the Role of the PC**

There are also many interactive programs which involve users submitting and receiving data relevant to them (and often, their businesses), and challenge many of the traditional ideas about what is necessary for a successful computer program. These programs mostly target the storage and sharing of agricultural data. Programs of this type can be implemented either using an SMS server interface or a proactive SIM interface. Because these programs store simple data through simple interfaces but are still useful, they directly challenge theories that a PC is necessary for the basic functionality taken for granted by those in wealthy countries.

The success of a mobile phone application in duplicating PC behavior is well visible through the “Warana Unwired” program. Researchers in this program visited a several year old PC Kiosk that had been placed in an agricultural collective to provide information services to small-scale farmers.<sup>32</sup> However, they were surprised to find the PC in disrepair, and that out of 9 intended uses for the PC, only one program was actually

being used.<sup>33</sup> The researchers, after realizing that the storage and retrieval of personalized sugarcane data was the only feature that farmers were interested in, quickly realized that such a simple task could be accomplished with much simpler technology. The result was an SMS-server based program which successfully replaced all of the PC functionality and was even more popular with farmers than the previous system.<sup>34</sup> As a result of this popularity, although the initial pilot had only included 7 phones, by the time the researchers ended their study, the program had unexpectedly expanded to 61 phones, as friends of the kiosk owners had their phones added to the database.<sup>35</sup> Following the study, the cooperative kept the mobile phone service, which suited their needs and was much cheaper than the PC service.<sup>36</sup>

Many other programs target personalized agricultural information using mobile phones, even allowing farmers to interactively share data. In Uganda, the Collecting and Exchanging Local Agricultural Content (CELAC) allows farmers to share agricultural data, with several farmers submitting and receiving relevant data to one central database via SMS.<sup>37</sup> Another program in South Africa combines an information-access based approach to receive market data, with an interactive program allowing farmers to initiate trades away from a centralized market, all through a proactive-SIM interface provided by the cell provider, Vodacom.<sup>38</sup>

Through all of these programs, users have access not only to useful information, but personalized, customizable information tailored to each user. By utilizing the mobile phone as a two-way resource, for both information reception and submission to a central server, the program extends beyond passive reception and mirrors adaptability previously imaginable only with an individual PC, albeit on a much simpler scale.

## **Mobile Banking**

A few programs have started to provide banking services through mobile phone applications, including Vodafone's high-profile Kenyan investment in "M-PESA", and South Africa's growing startup called "WIZZIT". Both programs have distinct methods of bringing banking to the poor, but each illustrates quite effectively the potential of innovative business building off of technology for social benefit. Not only do m-banking programs fulfill a well-known need, they break the mold of many existing applications,

which seek only to mimic functionality available in wealthy countries. Mobile banking, as implemented, is better suited to the lifestyle of the poor than the wealthy. Furthermore, mobile banking programs break the mold of mimicking PC behaviors and instead look to brick-and-mortar banking procedures as their model for access. Finally, in an excellent extension for research, mobile banking programs are well studied by those driven by investment, and so the service providers are able to provide excellent data after only a few years of development. As a result of this planned investment and imaginative design, both programs have seen significant success.

### **Filling a Need**

M-banking addresses a well-understood need of the developing world's poor: the lack of access to banking resources. With the success of micro-finance, providing financial services in general has a spotlight as one of the most necessary changes to developing world infrastructure for individuals to improve their economic status. In particular, financial services are known to be “fundamental to entrepreneurship,”<sup>39</sup> which sparks economic activity, job creation, and trade.<sup>40</sup> Furthermore, these new m-banking financial services have begun to provide assistance not just in saving money, but in transferring it as well – an issue that individuals in developed countries are often blind to because money transfer is so convenient in a stable, fluid market economy. In essence, although those in poor countries may have money to spend and transfer, the ability to actually spend or transfer it is the major “stumbling block” for any transaction to actually take place”<sup>41</sup>. Even with the financial “stumbling blocks” well understood, it is only recently that the mobile phone's position to affect this financial gap has been recognized. As it turns out, many of the unbanked poor still have mobile phone access – in South Africa and Botswana, one-third of those without a bank account own a mobile phone or have access to one.<sup>42</sup>

### **Usage Success**

Understanding this context, M-PESA in Kenya, and WIZZIT in South Africa are addressing the financial needs of the cell-phone owning poor using in manners remarkably suited for poor countries. M-PESA launched as a trial in 2005, and fully launched in 2007.<sup>43</sup> The setup process is a simple registration at any Safaricom (the local network provider) agent's booth – these agents are already widespread and generally sell airtime and SIM cards to Safaricom users.<sup>44</sup> Once registered, users can deposit and withdraw cash

at any agent's booth, with the payments facilitated by text messages to and from a central Safaricom server, allowing both user and agent to trust each other in the financial transaction. Furthermore, the customer can transfer funds to any phone number on any network – the recipient will simply receive a text message informing them to visit a Safaricom agent to pick up their transfer.<sup>45</sup> To provide security, the program comes with customer support, transaction tracking, and anti-money laundering measure.<sup>46</sup> WIZZIT, in South Africa, offers similar phone banking services, but is more integrated in the traditional banking system than M-PESA. WIZZIT gives its users Maestro-branded debit cards, and has reciprocal agreements with several South African banks allowing its users to use their ATMs and bank branches.<sup>47</sup> Furthermore, WIZZIT allows transfer payments for services and electricity through its banking system as well.<sup>48</sup>

### **Economic Connection**

These programs have many observable successes. Between the launch of M-PESA in March 2007 and December 2007, 1.4 million customers registered for M-PESA, and over 7.4 billion Ksh (\$92.9 million USD) were transferred using the service.<sup>49</sup> For WIZZIT, their services have clearly reached the target market: a survey of users shows that 43% of its users are below the poverty line, and another 12% are between the poverty line and one and one half of the poverty line.<sup>50</sup> A WIZZIT account is one-third cheaper than an account at a normal bank<sup>51</sup> and has allowed users to actually conduct more transactions per month by their mobile phone than traditional banking customers typically do through all other channels.<sup>52</sup> Furthermore, the breadth of this extended use is remarkable. Users of M-PESA have been observed to use M-PESA as an overnight safe, to deposit money at one location and take it out at another after traveling through a dangerous neighborhood, to make business payments, to use M-PESA to purchase airtime for others, to purchase pre-paid mobile phone minutes after dark, and to transfer money to friends in town.<sup>53</sup>

### **A Development Specific Feature: Remittances**

Beyond traditional banking functions, development-specific benefit has come in through urban to rural remittances. M-PESA's "Send Money Home" program is designed to facilitate money transfers between migrant workers and their families at home in rural villages.<sup>54</sup> In poor countries, it is extremely common for urban workers to exist in a "dual system," living between urban and rural arrangements, and frequently transferring money

from their urban jobs to aid family members and even purchase property at home.<sup>55</sup> These remittances are often necessary for the survival of rural families,<sup>56</sup> and under some estimates, 13-21% of the income of recently migrated urban males is sent back to their home villages.<sup>57</sup> Before electronic transfers, users tended to transfer money through friends or relatives or with unlicensed bus drivers, but these transfers were perceived by senders as risky, and they state that losses were high.<sup>58</sup> As a result, the majority of respondents in one survey used M-PESA to “send money home” as they found it much more trustworthy than old services.<sup>59</sup>

### **A Model Program**

Hence, the m-banking phenomenon has taken off especially in developing regions. It addresses particular needs of the poor, and utilizes an accessible network of mobile phone vendors creatively along with the mobile phone itself. Vodafone has attempted to be a model corporation, investing in developing regions, and through partnerships with the UN and funding from the UK government, it has made a solid step towards corporate participation in aid work, still driving toward a profit. Finally, because M-PESA and WIZZIT are well studied both technically and from a social benefit standpoint, much understanding can be derived from the experience and applied toward future interventions. The entire area stands out as quite an exemplary case of how technical interventions can work and be successful.

### **Concluding Remarks: Challenges and Opportunities**

Mobile phone applications are widely improving the capabilities of the cell-phone owning poor of the developing world. Because mobile phones are already widely adopted among the poorest of the poor, applications deployed for mobile phone use have a ready audience already in place. Recognizing the economic impact of greater information access and understanding, many applications are finding success simply by enhancing these simple capabilities inherent in mobile phone use. Furthermore, original developments in mobile banking demonstrate the potential of mobile phones to expand beyond readily known avenues for mobile phone design. Using simple tools and simple interfaces, these

applications are creating remarkable results through programs designed in industrial, non-profit, and academic environments.

Still, the results of future mobile phone developments are not readily known. It is hard to predict what will appeal to users and have the most impact. The growth of mobile phone usage among the poor was a surprise to many, and it may be that the next successful technology will be equally surprising. Investment, deployment, and outreach all require significant effort. However, reflecting the history and current growth within mobile phone application design reveals exciting potential. The future of the mobile phone is intricately tied to the future of communication and information access for those in developing regions.

## **OPTIONS**

With mobile phone application programs in a position of prominence and high success, development policy will most certainly encounter cell-phone based initiatives. How development aid policy addresses these new applications will have significant control over what direction and form these programs take, and how intensely they are pursued. Such a development policy could adopt one or several of the following options.

- **Target mobile phones only through greater ICT and development projects.**

Information and Communication Technologies for Development is an expansive field, and certainly encompasses the entirety of mobile phone activity. Mobile phones are just one of many technologies targeting development; it may be that another technology only now in development or early deployment will turn out to be the next capabilities-enhancing tool to change the lives of the world's poor. Furthermore, because mobile phones interact with a series of technologies - computer servers, satellites, wireless antennas – all of these issues might be best studied together. However, it can also be said that out of all development technologies, mobile phones stand out markedly in terms of penetration at the individual user level, economic impact, and potential expansion. Since this level success is unmatched so far by other technologies, and potential projects continue to grow, a policy singling out mobile phones from general ICT development policy might optimize upon the already well-known strengths of mobile phone deployment.

- **Partner with network providers to develop and invest in deploying mobile phone technologies.**

Both industrial and non-profit organizations participate in cell-phone based interventions in the developing world. Industrial efforts have been the recipients of government support in the past. Vodafone's intervention in Kenya through the M-PESA program was driven by a UK government “challenge fund”, offering government capital for investment in programs that had the potential to benefit individuals in developing countries. Because private mobile networks make up the majority of mobile phone infrastructure, it might make sense to support investment in their efforts to maximize the expansion of mobile phone technologies. On the other hand, companies investing in developing regions stand to make a significant profit in a new market and already have significant capital for investment, a slightly less compelling arrangement than donating the funds to a non-profit group, which is more dependent on financial support.

- **Support non-profit, non-governmental organizations to deploy cell-phone based applications that are beneficial to the poor.**

Non-profit groups form a large network of the major aid going in to developing countries, and many have begun to experiment with mobile phone programs. Groups on the ground, such as Trade at Hand and CELAC, have deployed cellphone based programs to improve information access of agricultural knowledge and trade pricing, information critically relevant to the lives of poor farmers and entrepreneurs. Local knowledge provided by those on the ground in these groups can be indispensable for any aid project. However, because the major endeavors involving mobile successful that have been successful are driven by industrial efforts, it may prove to be a sub-optimal deployment of funds. In addition, since traditional aid groups are not involved in the distribution of mobile phones the way corporate projects often are, they may be more limited in their capabilities.



- **Grant academic institutions research funding to discover the most beneficial features available for mobile phones, evaluate usage patterns and effects of existing phones, and design systems improving functionality in low-income regions.**

Academic research drives much of the new attempts at technical interventions, and many academic studies involve limited pilot programs themselves. Several United States' universities have advanced research groups targeting this branch of research, including UC Berkeley's "Tier" group, and the University of Washington's "Change" group. The technical aspects of these interventions target both new uses of currently available mobile phone features, as well as high-end mobile phones that seem far detached from the real phones that users actually own in developing countries. Further focus can be turned to economic and ethnographic studies of the effects of mobile phones both for research in academia and for government-sponsored aid projects. These studies are the marker for what is and isn't working among projects that have been deployed, and what merits more extended deployment and investment. On the other hand, mobile phone studies for development do not fall easily into the field of study of any researcher, requiring both understanding of technical and social research, so it may be hard to target such studies. Furthermore, industrial and non-profit groups designing interventions on-the-ground may have a better grasp on what the next steps should be for research and might be the better avenue to invest in future study.

## **RECOMMENDATIONS**

### **Target Cell Phones Independently of Information Communication Technology Initiatives**

Cell phones have had a unique impact upon the developing world. There are astounding numbers of users across Africa, and east and southeast Asia, and the economic impact on these users has been demonstratively beneficial. This impact has enabled decidedly bottom-up developments, as users, through a tool they themselves have purchased and own, are constantly able to communicate with contacts regardless of location, and can make use of a new tool to facilitate many of the choices and actions they take every day. This impact is not just unique among technical interventions for

development; it is a remarkable case by any standard of developmental impact. As a result, it makes sense to target mobile phones specifically as a platform for future development projects. Because organizations based in industry, academia, and the non-profit sector have all played roles in mobile phone based interventions, all three must be supported to make the most of the opportunity provided by mobile phones.

### **Invest in and Partner with Relevant Corporations**

Industrial investment plays a massive role in mobile phone deployment and progress in all areas of the world. The backbone of the cell networks is provided, for the most part, by private network providers who manage both mobile service and the distribution of physical mobile phone devices, meaning that the network providers are crucial players in how cell phone usage develops over the next several years. Many providers have already accepted their role in the developmental features of mobile phone access, as seen in Vodafone's M-PESA. Other organizations involved in the distribution of applications and information also have roles to play, as demonstrated by the involvement of groups like the Reuters news agency and Microsoft Research. Although some may be skeptical of supporting profit-driven industrial efforts in the name of aid work, previous successes from mobile phone distribution, to information access, to mobile banking have all been extensively driven by corporate entities. So long as there is accountability for how American funds are spent and exactly what developmentally beneficial outcomes are resulting from that investment, which these corporations have thus far been ready to provide, partnership with industrial, profit-driven programs can remain a viable path for improving lives through mobile phones.

### **Support Non-Profits and Encourage Corporate Partnerships**

Non-profit aid groups are the key figures in most any program for development and should continue to be involved in mobile phone based strategies. Current programs already underway and proposed programs with the ability to create successful opportunities should receive support for their efforts. However, because for-profit groups have been driving much of the success thus far, non-profit and corporate partnerships should also be encouraged to optimize on the strengths of both groups.

### **Fund Research to Develop an Understanding of Future Options**

Research and academia driven programs must also continue to be supported, both towards building the phones of the future by developing new technologies and towards deriving new understanding of what success looks like through social studies of mobile phone users. Because experimentation is the only way to discover new ideas and what works, it is crucial to maintain a steady stream of technical innovation. Only by evaluating experiments to see what does and does not work can an experimental idea develop into a successful technical intervention, so studies must focus on the usage and impact of technologies being deployed to the developing world. Providing a free field of study without overriding interests is exactly the environment provided by a government-funded academic institution, and can be a very successful environment for the creation of new ideas. Particularly if there are cooperative ventures with industry involved, it will be necessary to provide for an unbiased eye to evaluate current successes and what technologies to provide funding for in the future.

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## Chapter 14

# MAKING INFORMATION and COMMUNICATION TECHNOLOGY WORK FOR THE POOR

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### **ISSUES**

User-centered design, which empowers the voices of the poor in computer software development, is a critical component for making Information and Communications Technology (ICT) relevant and useful to world's poorest. By prioritizing input and feedback from stakeholders, and by asking how final end-users of ICTs can be more involved in the process of creating software, these user-centered processes call attention to design factors that keep computer technologies out of reach for the world's poor. In order for poor communities to fully leverage the benefits of ICT, we must make ICT appropriate for the poor.

We need to look at ways in which feedback and participation from the poor can be incorporated in the ICT design process, or else our investments in ICT for development will yield disappointing results. Computing technologies and Internet access hold incredible potential for stimulating economic growth in poor countries – by reducing transaction costs, accelerating economy-wide productivity, creating employment, and creating new spaces for doing business – but this potential has not yet been realized. As of now, an expansive digital divide excludes the global South from the ICT revolution that has driven rapid economic growth in the global North.

## **BACKGROUND**

### **Introduction**

In recent decades, innovations in Information and Communication Technology (ICT) have driven rapid economic growth throughout the world. ICT has revolutionized the way the world exchanges goods and information. In particular, computer technologies and the Internet have facilitated instant access to vast stores of knowledge and information, multiplied the number of markets for goods and ideas, accelerated productivity in every sector of the economy, and reduced economic transaction costs. Most importantly, innovations in ICT, by increasing public access to information and markets, have been a crucial factor in expanding political and economic freedoms.

However, the benefits of ICT developments have been felt unevenly across different regions of the globe, as rich countries have enjoyed the lion's share of ICT production and consumption. Meanwhile, less developed regions of the globe have, to varying extents, been excluded from the international information economy, and a widening digital divide separates the global North from the global South. This chapter will look at how interface design factors can block access to information and knowledge sharing platforms, and will explore how we might begin to bridge the digital divide by designing computer technologies that are more relevant and accessible to the 4 billion people in the world living at the bottom of the economic pyramid.<sup>1</sup>

All of the challenges involved with making ICT work for development are indeed too vast and complex for the scope of this chapter. Thus, this chapter will address only one small part of the ICT for development field, leaving the remaining gaps to be filled by other researchers and policymakers. For example, building up infrastructure for ICTs, such as increasing bandwidth and wireless capabilities, will be an absolutely necessary piece in making ICTs work for the poor. The challenges and opportunities associated with making ICT infrastructure work for development will not be discussed in this chapter due to length considerations. This chapter will not examine in-depth all of those issues relating ICT to development, but instead will choose to focus on how we should approach interface design to make computers more accessible to the world's poorest.

## **The Promise of ICT for Development**

In today's world, the capacity to generate, disseminate, and interpret information is a crucial factor behind long-term economic growth, and the advantages of ICT for development have been well documented. In developed economies, innovations in information technologies have driven much of the economic growth of the past several decades, primarily through increasing productivity. Network technologies, such as PCs, the Internet, and mobile phones, are especially powerful agents of economic growth because they act as platforms for connecting people with vast sources of information. Precisely because network technologies serve as a means to disseminate and access large amounts of information at an incredibly fast pace, these ICTs have "spillover" or externality effects, meaning they have the power to increase productivity in every sector of the economy.

Furthermore, network technologies offer powerful opportunities for expanding economic and political freedoms, in that they create new spaces for commercial activity and political discourse and organizing which lie mostly outside of governments' control. Unfortunately, the ICTs that have expanded individual liberties and propelled rich economies through the new Information Age remain largely out of reach for the world's poorest, especially when it comes to computer technologies and Internet access. Narrowing the disparity between the rich and poor's relative access to information, then, amounts to one of the greatest challenges for economic development today.

### **Mobile Phones: A Success Story**

Fortunately, though the connectivity gap dividing developed and developing countries is certainly immense, there have been some success stories in making ICT work for the poor. Most notably, mobile phone use in developing countries has increased exponentially in recent years, in spite of many development specialists' expectations. In fact, the number of mobile phone subscriptions in poor countries has tripled over the past five years, and these subscribers now account for 58% of all subscriptions worldwide.<sup>2</sup> In a regional comparison, Africa has experienced the highest rates of growth in mobile phone penetration since 2002 (see Appendix).<sup>3</sup> This trend has stupefied development experts and private cell phone corporations alike, many of which simply assumed that bottom of the pyramid (BOP) consumers living on \$2 per day or less neither had any use for nor could

afford mobile phone technology.<sup>4</sup> The diffusion of mobile phones throughout the developing world has also already had positive effects on productivity, as new cell phone applications have created more efficient ways for sharing information and doing business.

The success of mobile phones in poor regions is contrasted with the failure of more advanced network technologies, specifically PCs and Internet, to take hold in the same way. While mobile phone connectivity continues to climb even in the world's poorest and most remote areas, the digital divide between rich and poor remains as wide as ever when one considers relative levels of Internet penetration. In 2007, only 5% of the inhabitants of low-income countries were Internet users, compared with 66% in the OECD countries (see Appendix)<sup>5</sup>. This obvious disparity should be of great concern to development specialists and policymakers trying to make ICT work for the poor. If poor communities are to fully leverage the benefits of integrating into the information economy, access to broadband Internet connection must follow access to mobile telephony; one could hardly imagine developed economies operating as efficiently as they currently do without access to the Internet. While the success of mobile phones is a start, ICT clearly has yet to fulfill its promise to be a catalyst for economic growth in poor countries.

With these trends in mind, the problem now becomes: How might we replicate the mobile phone success story and extend ICT penetration in developing markets to also include personal computers (PCs) and Internet? Governments, non-profits, and corporations alike have attempted to close the digital divide by simple capital transfer, or in other words, by gifting their network technologies to poor countries. However, simple technology transfer does not guarantee that network technologies, once they are in the hands of the poor, can actually be of use to the poor as information-sharing platforms.

Recent research highlights the need to not only create access to ICT, but to also ensure that ICT is designed in such a way that the poor can actually use it and derive some value out of it. In that sense, getting computers to the poor is not an end in itself but rather a means to an end: computers are a means for creating access to information and increasing political and economic freedoms.. Thus, making ICTs relevant and accessible to the poor is less about creating to access to physical technology and more about expanding political and economic freedoms through facilitating access to information. This chapter will work

under the assumption that ICTs are important for development in that they serve as platforms for information sharing and knowledge diffusion.

Recent research indicates that in order for poor communities to fully leverage the benefits of ICT, software development must employ a user-centered design approach. User-centered design prioritizes the needs, interests, and capabilities of the poor in ICT development. This approach to ICT development synthesizes the study of human-computer interaction (HCI) with participatory research methodologies, and concerns itself with how users and stakeholders can be more involved in the process of creating software. Recent studies show that computer technologies are essentially irrelevant and inaccessible to poor users if the unique requirements of the poor are ignored in the software design process. Thus, user-centered design may provide one solution for increasing PC and Internet penetration in developing countries and for replicating the mobile phones success story. The ideas behind user-centered design and the findings of recent user-centric studies are discussed at length in the following section.

## **Experimental Design to Increase Usability**

Network technologies cannot serve as platforms for information sharing and knowledge creation if the information stored within computers is neither easily understood nor easily accessed by the users. Such is often the case when the end users of computer technologies are those living below the poverty line. Most computer systems, for example, are designed under the assumption that users are literate and have some previous experience with computer interfaces, and that computers are supported by reliable infrastructure. These design features clearly do not reflect the realities of those who live out their daily existence in the world's most impoverished regions, and such oversights have rendered many high-minded ICT for development initiatives ineffective and wasteful in practice. Computer technologies designed for consumers in rich countries, who are most likely literate, have some level of familiarity with computer interfaces, and can take reliable ICT infrastructure for granted, are in many cases entirely useless to those at the bottom of the economic pyramid.

To solve the problem of the inaccessibility of computer interfaces, ICT researchers throughout the world have conducted small-scale experiments to investigate what

computer applications are most useful and relevant for the poor. These investigations have yielded important information about what works and what does not work with regards to interface design in the context of impoverished environments. Recent scholarship on human-computer interaction has produced important clues as to what computer features and functions should be considered when designing interfaces that are relevant and accessible to the poor. Researchers have studied, for example, what interfaces are most effective for illiterate and semi-literate users, what different computer programs are valuable for users of different ages and professions, etc. One such study, the Text-Free User Interfaces project (see box, Case Study #1), focused on developing a text-free user interface that women living in the slums of Bangalore could use without any outside intervention.

**Case Study #1: Text-Free User Interfaces for Illiterate and Semi-Literate Users**

In 2003, three researchers from Microsoft Research India used an ethnographic design process to create a text-free user interface for women domestic laborers living in the Bangalore slums. The goal of the project was to create a computer interface that the women could use self-sufficiently, without any help from outsiders. With this goal in mind, the researchers created a job-search tool for the domestic laborers as well as an application that they could use for navigating a city. The applications used graphics and voice feedback to communicate information that would normally be conveyed via text. The researchers employed an ethnographic approach in their work, meaning that they worked closely with the target community to understand the real needs and capacities of poor women and their responses to the interfaces. The results of the experiment showed that text-free user interfaces, combined with semi-abstracted graphics, voice feedback, and a consistent help feature, allowed even illiterate, first-time computer users to access and navigate complex computer functions.

(Source: Medhi, et. al., 2007)

These studies reveal that the needs and capabilities of the poor with regards to human-computer interaction are much more complex than one might first assume. With the Text-Free User Interface project, for example, the researchers encountered many

unexpected findings in their work. They hypothesized that illiterate and semi-literate women living in the slums of Bangalore would find a text-free user interface much more effective and navigable compared to a text-based interface. Indeed, the results of the experiment overwhelmingly supported this hypothesis, but as it turned out, illiteracy or semi-literacy were not the only barriers to making interfaces usable for the poor. Other problems included lack of knowledge about the capabilities of computers, not knowing how to access data that is stored in the computer, etc. These other knowledge gaps also need to be considered when designing ICT for the poor.

### **Full-Context Applications for Increasing Usability**

Pioneering research on human-computer interaction in the developing world highlights that illiteracy is only one of the many barriers that prevent poor consumers from fully leveraging the capacities of computing technologies. Research subjects also expressed a lack of understanding of what types of functions computers offered, fear and mistrust of the technology, and confusion about how information was encoded within the hardware of the computing machines.<sup>6</sup> Feedback from focus groups highlighted that, in addition to features such as text-free interfaces, semi-abstracted graphics, and voice annotation, computer software needed to offer information about what the PCs could deliver and how relevant information was embedded into the physical hardware. Taking cues from this feedback, the researchers from the Text-Free User Interfaces project continued to improve upon their original design by adding a “full-context video” application – a video tutorial that explained the various functions of the computer and how to use them. The application was “full-context” in that it not only offered instructions on how to use the interface, but also included dramatizations explaining for what purposes different applications might be useful and how data was originally built into the computer’s hardware. In the Text-Free User Interface project, the addition of the full-context video feature increased research subjects’ successful completion rate of given tasks to 100%, reduced the number of prompts necessary to achieve completion, and nearly halved completion time.<sup>7</sup>

Other experiments in user-centered design offer further evidence to support the need for similar full-context features. The technicians that developed affordable laptops for the poor with the One Laptop Per Child project, which will be discussed at greater length

in the following section, designed the laptops in such a way that users can view the codes underlying almost any one of the computer's programs or web pages at the touch of a button<sup>8</sup>. The laptop put forth by One Laptop Per Child also allows users to experiment with and rewrite the computers' programming codes if they so choose, and gives them the option to revert back to the original code at the touch of the button. This feature of the laptops gives users a visual understanding of how information is stored within the computer machines, and it also enables users to interact with and improve upon the laptops' software if they so choose.

The necessity of full-context applications in computer software programs is a significant discovery for two reasons. First, it underscores the point that bottom of the pyramid consumers require different computer functions and features compared to the existing market. While software users in developed countries often take for granted that the information they see on the computer screen is encoded into the computer hardware, among consumers in developing countries, this relationship might have to be explained to the end users. Second, full-context applications, by informing users about how computer technologies work, enable them to become the *producers* of ICTs. This represents an important step in empowering the poor to enjoy computing technologies not only as passive recipients and consumers of information, but also as proactive creators of programs and content.

## **Conclusions from Usability Studies**

The findings of these usability studies provide a variety of recommendations for software design, highlighting the need for context-specific design and further research. Yet, while the recommendations of these studies may vary, virtually all researchers agree on the necessity of employing participatory research methods in ICT design work. Collecting input and feedback from focus groups of intended end users, along with building trust in the communities where ICT research is carried out, appears to be an absolutely necessary ingredient for developing user interfaces and computer applications that the poor can and want to use.

Most importantly, the participatory research methods employed in these experimental studies underscore the need for feedback and input from the poor in every



phase of the software design process. The studies described in this section all made collection of information from the poor a central part of their work, and those that employed participatory methods were able to produce technology that was best suited for the needs and capabilities of the poor. Thus, the poor in these studies figure not as passive recipients of Western charity, but rather as experts guiding ICT for development initiatives. This paradigm shift in development assistance – that the poor are better experts on development than the highly-education “experts” of rich countries – is one of the underlying foundations to the entire school of bottom-up development.

## **Innovation from the Private Sector**

A competitive private sector could be a powerful force for creating innovative, user-centric design solutions that bridge the digital divide between developed and developing nations. In developed markets, the ICT sector develops so fast as to make existing technologies out of date or obsolete over the course of only a few years. However, developing economies remain largely unexplored as potential markets for ICTs, and these markets have done little to shape the priorities and investments of ICT firms operating out of the West. The private sector certainly has the resources and dynamism to create PC and Internet solutions that are useful and accessible to the poor, but the private sector must first recognize the BOP as a viable target market for investment and innovation.

Although firms have yet to recognize the value of the BOP market for computer technologies, this underinvestment is indicative primarily of oversights on the part of ICT corporations and of flaws in the dominant logic of these organizations, than of any lack of a viable market at the BOP. In fact, recent scholarship on corporate strategy finds that if firms take the BOP seriously as a target market and choose to innovate upon their current business models, treating their cost structures and product models as flexible, that firms stand to gain immensely from tapping into the huge BOP market.<sup>9</sup> One needs to only look to trends in the cell phone industry to find that once-considered “luxury” ICT products have infiltrated even the poorest and most remote regions of the world.

In the mobile phone market, large multinational corporations (MNCs) are already investing in ethnographic research methods to improve their products and gain an edge over their competitors. Cell phone giant Nokia, for example, currently employs

anthropologists to collect field research on how cell phones are being used on the ground in Africa.<sup>10</sup> These ethnographers are charged with finding out who is using cell phones and what tasks are accomplished through cell phone use, and the information they collect is used to develop unique cell phone design features to make Nokia phones more attractive to the African market. Nokia's user-centric research and development methods parallel those methods employed by researchers working on accessible computer interfaces as discussed in the previous section, in that they prioritize feedback from end-users to guide ICT design.

This trend among private cell phone companies, calls attention to the fact that the private sector can engage in the same participatory, user-centric research and development (R&D) methods that academic research institutions have been using on a smaller, experimental scale, provided that the private sector feels like it has an incentive to make such an investment. Indeed, while major international mobile phone service providers vie for market share among consumers in even the world's poorest countries, Internet service providers and hardware/software giants have yet to tap into the market of 4 billion at the BOP.

### **Inspiring Private Competition to Create ICT Solutions for the Poor**

Private sector investment in the BOP as a market for PCs is nowhere near the level of investment in mobile telephony, and has been initiated only by a few pioneering organizations. These few organizations have begun to develop PCs intended for sale at the BOP, though investment in developing the BOP market is anomalous in the PC sector as a whole. The most famous of such projects is perhaps One Laptop Per Child (OLPC), a non-profit founded by former MIT Media Lab director Nicholas Negroponte, who in 2005 announced his plan to build a \$100 laptop that would distributed to every poor child on earth (see box, Case Study #2). The ambitious goal of equipping every child with an affordable, high-tech learning tool both shocked and impressed those in the ICT for development field and attracted investment from some major ICT players, including Intel in 2007 and Microsoft in 2008.<sup>11</sup>

Though initially met with praise for its visionary mission, OLPC has encountered some major setbacks since its inception in 2005. The price of the XO laptop has climbed to \$200, Intel backed out of its partnership with OLPC in early 2008 to develop its own competing low-cost laptop, and orders for the XO laptops from poor governments have

fallen short of targets. For example, though Negroponte intended for poor governments and ministries of education to purchase the XO laptops in bulk by the millions, orders for the machines have amounted to only tens of thousands of units.<sup>12</sup>

### **Case Study #2: One Laptop Per Child**

At the 2005 World Economic Forum in Davos, MIT Media Lab director Nicholas Negroponte unveiled his ambitious plan to equip every child in every developing country with a personal laptop computer. These specially-designed laptops (called XO computers) would cost only \$100 and would be distributed to schoolchildren worldwide through poor governments and ministries of education. Now in its final design stages, the XO laptops offer a variety of features and functions that are specifically intended for users in technology-hostile environments: the laptops require very little recharging, the user interface is generally straightforward and easily navigable, and the laptops interact on a mesh network, meaning that if one laptop receives Internet connection, other laptops can get online too.

(Source: Pogue, 2007)

Some have explained these slow sales by making the criticism that the laptops are not only a waste poor governments' resources, while others postulate that poor governments' wariness to place large orders for the laptops owes more to government officials' unfamiliarity with open-source software, rather than because of any lack of usability in the laptops' design. Another explanation deserving consideration is that poor governments, particularly highly centralized, authoritarian governments, have been less than eager to buy the OLPC computers because, by distributing the laptops to their country's schoolchildren, they are decentralizing control over access to knowledge and thereby devolving some of their power as gatekeepers to information. Given that PCs act as a powerful platform for receiving and diffusing knowledge and also for creating private spaces for political and economic activity, it is worth examining if OLPC's unpopularity

with some governments can be explained through these governments' unwillingness to relinquish their monopolies over information.

Despite the controversies surrounding OLPC, the most important lesson from the OLPC example is that the private sector will rise to the challenge of creating an affordable laptop for consumers in developing countries. After leaving its partnership with OLPC in early 2008, Intel is now designing a \$300 laptop, the Classmate, as a competitive alternative to One Laptop Per Child's XO computer. This type of private sector competition could provide the most powerful incentives for developing a high-quality, low-cost laptop for emerging markets. Competition can push private actors to develop higher-quality laptops with greater usability, while also driving down prices and increasing the number of available alternatives for consumers.

As seen in the One Laptop Per Child example, a bold idea can inspire other firms to develop more competitive products. What firms like Intel needed was someone to make the first move. Computer and Internet firms stand to reap huge benefits by reaching into this market, provided that they see the bottom of the pyramid as a viable market in the first place.

## **Concluding Remarks: Challenges and Opportunities**

In conclusion, making computers that are relevant and appropriate for the poor is a completely achievable goal. First, as demonstrated in the Background section on usability studies, the poor are perfectly capable of appropriating and navigating advanced computing technologies, provided that the poor can access and derive utility from these technologies in the first place. Second, these technologies are within reach for the world's researchers and software developers. Just as the world's poorest billions now form the majority of the global cell phone market, so can they provide a viable market for more advanced ICTs like PCs and Internet. Making ICTs that are appropriate for the poor is at this point in time an entirely feasible goal, and it is imperative to U.S. interests that we take decisive action now to increase the accessibility of computing technologies for the poor and help to bridge the digital divide.

First of all, in these trying economic times, it is crucial that the U.S. aid dollars are spent in the most efficient way possible, and it is important that we seek poverty solutions

that produce positive ripple effects through developing economies. Indeed, every dollar spent on making ICTs more accessible for the poor has such a multiplier effect, since greater access to information improves productivity in virtually every aspect of economic and social life. Furthermore, user-centered design in particular represents a worthwhile investment for strained aid budgets, since a user-centric approach helps to ensure that computer technologies intended for the poor will actually be of value to them.

Making computer technologies work for the poor can also help to address the crucial U.S. interest of promoting peace, democracy, and stability throughout the less developed regions of the world. Access to information is a building block for democratic and open societies. In parts of the world where authoritarian governments rule over impoverished and disenfranchised masses, access to outside information can serve to delegitimize and undermine the authority of non-democratic regimes. The Internet provides a space for economic and political activity that falls outside the reach of even the most controlling governments, and thus promotes both economic growth and the strengthening of civil society. Therefore, the U.S. has a stake in promoting accessible, usable computer technologies that will facilitate information sharing in developing countries.

Closing the digital divide between rich and poor countries, now more than ever, serves crucial U.S. interests. First, any investments in making ICTs work for the poor will be repaid many times over, because these technologies spark positive ripple effects throughout the entire economic system. Thus, investment in ICT represents an efficient use of U.S. aid dollars in a time when budgets are especially strained. Second, the U.S. has an interest in promoting information-sharing technologies that have the power to promote democracy and liberty in unstable parts of the world. Of course, we can better ensure that our expenditures in ICT achieve the above-stated goals by directing our efforts into technologies that are truly user-centered in its design.

## **OPTIONS**

Governments can play an instrumental role in making ICT work for the poor. Although some have argued that large-scale, traditional infrastructure projects are a better investment than high-tech solutions for development, integrating the poor into the global

information economy is hardly just a “tech dream.” Rather, network technologies can stimulate economy-wide productivity growth, reduce transaction costs, and create new spaces for commercial exchange – provided that these technologies are designed in such a way that the poor can actually use them. To address the challenges associated with making computer technologies relevant for poor users, we can pursue a variety of different policy options. Those options are described in brief below.

- **Invest in interface research.**

Current research on user-centered design has only begun to flesh out the numerous ways in which computer interfaces can better serve the poor. Thus, we could support interface research by providing full or partial funding to one or more of the various actors engaged in such research, including academic institutions, private non-profit organization, and/or private for-profit organizations. Whichever organizations we might decide to support, it is crucial that we employ some standard to evaluate the extent to which their research efforts actually empower the voices of the poor (e.g. what participatory methods and feedback and accountability mechanisms are in place).

- **Encourage private innovation and competition to spur the development of ICT solutions for developing markets.**

While the BOP can certainly act as a viable and profitable market for computer technologies, as it already is as a market for mobile phones, the private sector has yet to invest much research or marketing in the world’s poorer regions. As demonstrated by the One Laptop Per Child example, this underinvestment in the BOP can largely be attributed to a lack of leadership; firms will be more willing to invest in the BOP if they other firms enjoying success in these markets. The U.S. government could provide this leadership, and inspire an attitude of innovation and competition toward BOP markets, by offering a prize to the first firm to develop a \$100 laptop and prove its usefulness for schoolchildren in poor countries. Encouraging the private development of user-friendly computing technologies for the poor could also come in the form of offering incentives and/or direct support through tax rebates and subsidies. If the U.S. government does decide to take on a

leadership role for the private sector, however, we would need to find a way to guide the efforts of private organizations so that the ICT solutions they develop are actually beneficial and functional for the end-users.

- **Invest in human capital.**

While user-centered design focuses on how ICTs can be made more appropriate for the poor, the other side of the equation is to increase the poor's capacity to use existing ICTs. This investment in human capital could include funding for general education programs as well as training programs to increase technical literacy. This course of action would require a longer period of time to produce observable results, and also does not address the problem of getting computing technologies to the poor.

## **RECOMMENDATIONS**

Given that poverty is one of the most serious threats to national and regional stability, and given the undeniable connection between access to information and poverty alleviation, it is imperative that we close the digital divide between the rich and the poor as quickly as possible. In order to achieve the quick results that we need, it logically follows that we should focus our efforts on making computing technologies relevant and accessible to BOP consumers now, rather than on training the poor to use ICTs designed for consumers in developed markets. This chapter will recommend, then, that U.S. development assistance pursue the first two options described in the Options section, rather than the third option of making a long-term investment in human capital. The two options this chapter supports are described in more detail in the following section.

This chapter's first recommendation is to increase our investment in interface research, particularly in research conducted by academic institutions. The connection between user-centered design and increasing ICT's effectiveness for development is undeniable. Clearly, the poor cannot fully leverage the benefits of computer technologies and the Internet if these tools are not adapted to the needs and capabilities of the poor themselves. As existing research on human-computer interaction has already shown, consumers at the BOP derive great value from computer technologies if user interfaces are outfitted with unique features that do not currently exist for consumers in developed

markets, including but not limited to voice feedback, text-free interfaces, and/or full-context applications. Furthermore, academic research has so far provided some of the most detailed, reliable, and objective information available on user-centered design for the poor, and we need to build on existing scholarship by increasing our funding for this field. On top of investing in research on human-computer interaction, we need to help facilitate information sharing between researchers and the developers of these new computer technologies. To accomplish this, we could also sponsor a forum in which the organizations we fund for interface research can share their findings with each other and with representatives from the private, for-profit sector.

This chapter's second recommendation is to harness the energy of the private sector toward finding user-centered solutions to make ICT work better for the poor and for development. Ultimately, making useful, affordable, and scalable ICT solutions for development will come from the private sector, as has already been the case with mobile phones. This chapter argues that the U.S. government could and should provide leadership in helping the private sector recognize the BOP as a significant market opportunity. This goal could be achieved most effectively by offering a prize to the first organization to develop a computer that is both affordable and useful to BOP consumers. If we follow this course of action, we would only need to develop a system for evaluating the products developed by the private sector (i.e. we would need some kind of standard to determine which technologies would be most beneficial for the poor). Although only one firm would win the prize, ultimately we could expect to see this contest inspire a host of new, user-centered product alternatives for the world's poor to choose from. Therefore, this incentive system would benefit both firms in the ICT sector, by steering them toward a profitable market, as well as the poor, by offering them better and more choices for ICTs.

If the above policy recommendations are followed, we can expect to increase computers' relevance and usefulness for the poor, which will be a major step in helping to bridge the digital divide. By finding methods to harness local knowledge and empower the voices of the poor, we can begin to find solutions for making computer technologies accessible to those who stand to benefit the most from the Information Age.



## APPENDIX

**Table 1: Mobile Phone Subscribers by Level of Development and Region<sup>13</sup>**

	2002	% change 2002–2003	2003	% change 2003–2004	2004	% change 2004–2005	2005	% change 2005–2006	2006
World	1 166 620 215	21.0	1 412 020 934	24.5	1 757 737 968	23.0	2 161 999 103	23.0	2 658 551 657
Developed economies	606 945 165	9.5	664 725 049	11.3	740 018 120	8.9	805 873 152	9.5	882 647 414
Asia	87 452 320	6.5	93 154 960	5.9	98 661 436	3.9	102 545 000	7.4	110 101 800
Europe	349 980 073	9.3	382 606 705	10.6	423 027 952	9.5	463 043 252	7.1	495 694 514
North America	154 488 772	11.3	172 017 384	15.6	198 852 732	9.8	218 334 900	16.1	253 561 100
Oceania	15 024 000	12.8	16 946 000	14.9	19 476 000	12.7	21 950 000	6.1	23 290 000
Developing economies	520 151 801	30.6	679 319 888	31.6	893 760 760	31.0	1 170 638 544	32.1	1 546 324 643
Africa	36 918 573	39.4	51 456 107	50.8	77 608 792	69.9	131 863 273	43.7	189 497 105
Asia	382 884 203	31.2	502 288 259	27.7	641 318 745	24.6	798 880 468	32.0	1 054 509 700
Latin America and the Caribbean	100 079 725	25.1	125 232 228	39.2	174 347 694	37.2	239 249 946	26.1	301 640 938
Oceania	269 300	27.5	343 294	41.4	485 529	32.8	644 857	5.0	676 900
Transition economies	39 523 249	72.0	67 975 997	82.4	123 959 088	49.6	185 487 407	23.8	229 579 600

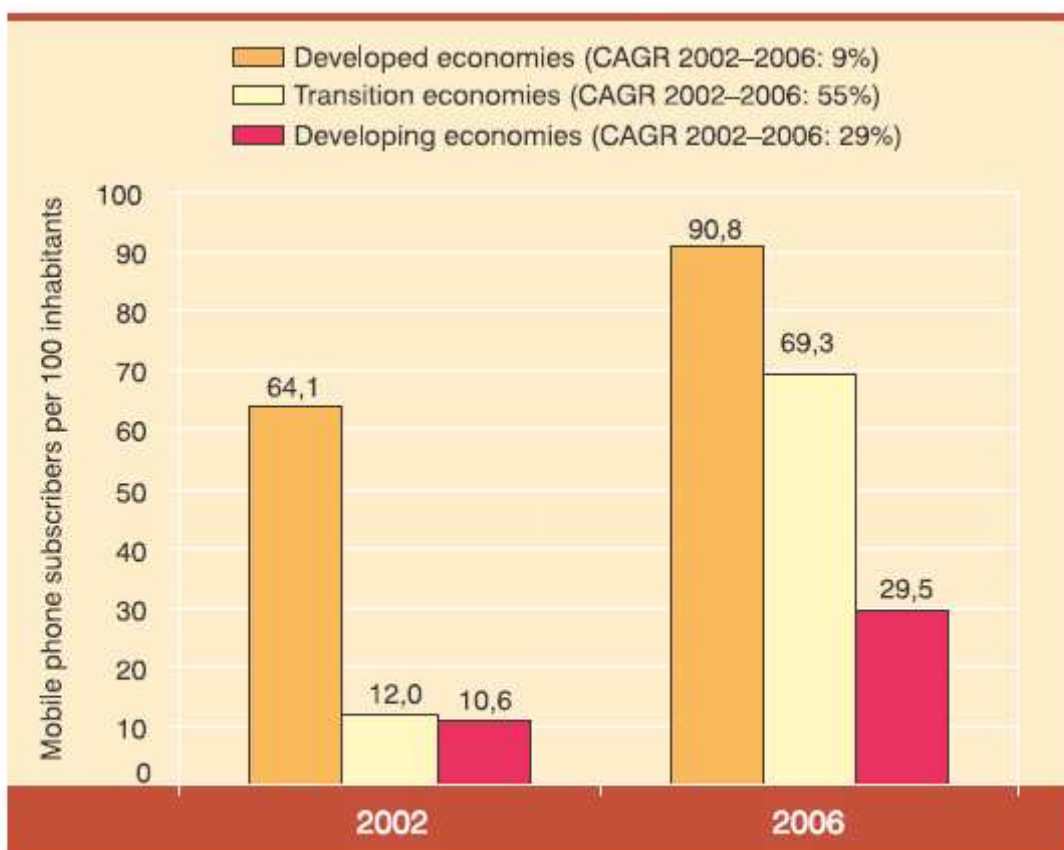
Source: UNCTAD calculations based on the ITU World Telecommunication/ICT Indicators database, 2007.

**Table 2: Internet Use by Level of Development and Region<sup>14</sup>**

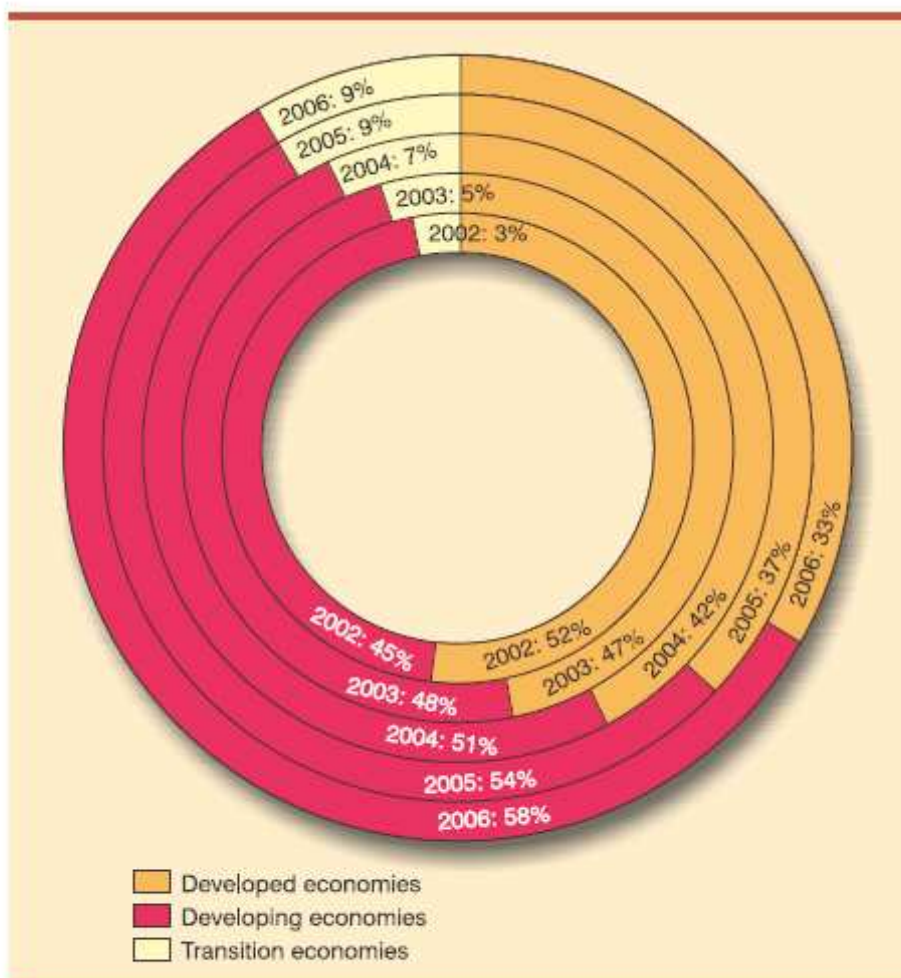
	2002	% change 2002–2003	2003	% change 2003–2004	2004	% change 2004–2005	2005	% change 2005–2006	2006
World	618 514 417	16.0	717 707 944	20.7	866 364 366	16.2	1 006 429 544	12.4	1 131 078 697
Developed economies	397 605 044	7.3	426 435 696	15.6	492 755 839	7.5	529 869 769	6.8	566 077 247
Asia	60 345 200	4.2	62 904 500	28.7	80 976 600	7.4	86 975 900	2.8	89 439 100
Europe	149 899 844	13.4	169 994 796	12.0	190 421 239	7.7	205 089 269	10.7	227 077 547
North America	174 952 000	3.0	180 126 400	14.4	206 008 000	7.2	220 860 600	4.6	231 060 600
Oceania	12 900 000	11.1	14 400 000	11.6	16 200 000	11.9	18 100 000	12.2	20 300 000
Developing economies	207 465 892	28.8	267 302 205	26.1	337 136 119	28.6	433 560 239	17.9	511 035 250
Africa	10 290 156	45.3	14 953 500	48.5	22 206 421	48.8	33 032 605	31.4	43 397 500
Asia	153 538 659	29.9	199 488 152	25.8	250 869 483	24.0	311 164 987	16.1	361 391 800
Latin America and the Caribbean	43 411 477	21.2	52 597 353	21.2	63 756 215	39.6	89 022 947	18.9	105 864 150
Oceania	225 600	16.7	263 200	15.5	304 000	11.7	339 700	12.4	381 800
Transition economies	13 443 481	78.3	23 970 043	52.2	36 472 408	17.9	42 999 536	25.5	53 966 200

Source: UNCTAD calculations based on the ITU World Telecommunication/ICT Indicators database, 2007.

**Charts 1 and 2: Mobile Phone Penetration<sup>15</sup>**

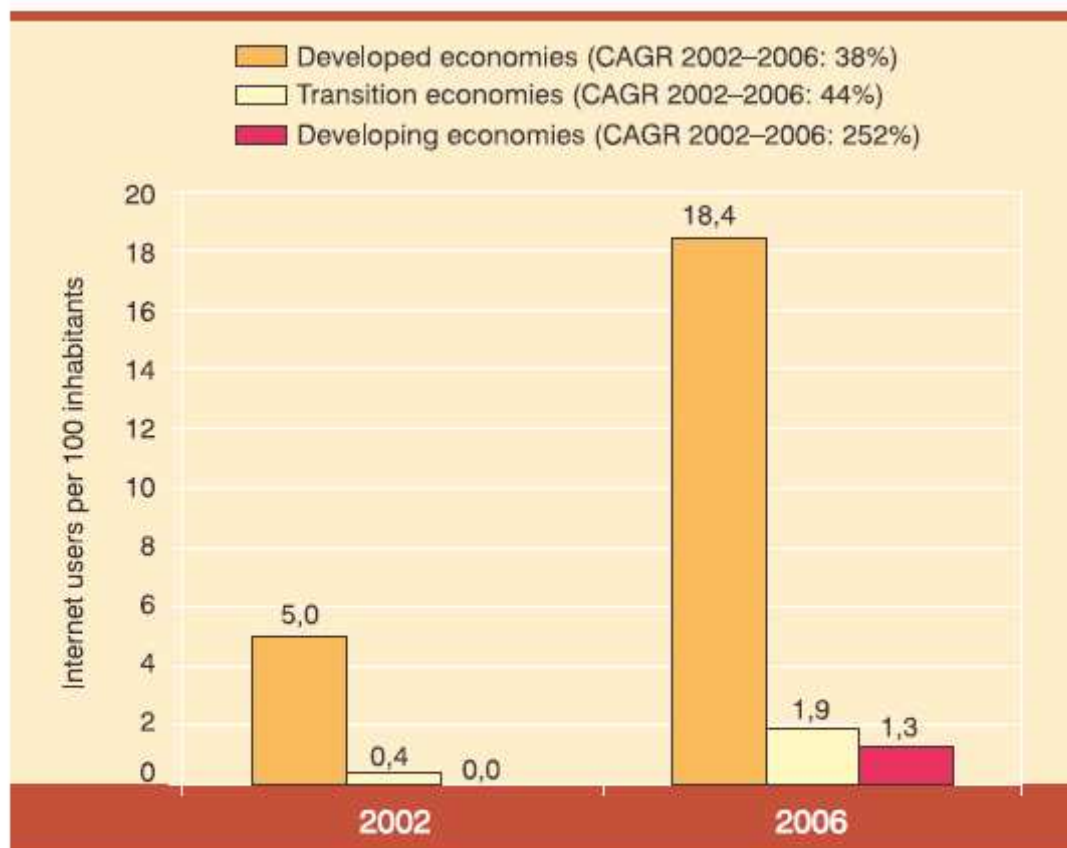


Source: UNCTAD calculations based on the ITU World Telecommunication/ICT Indicators database, 2007.

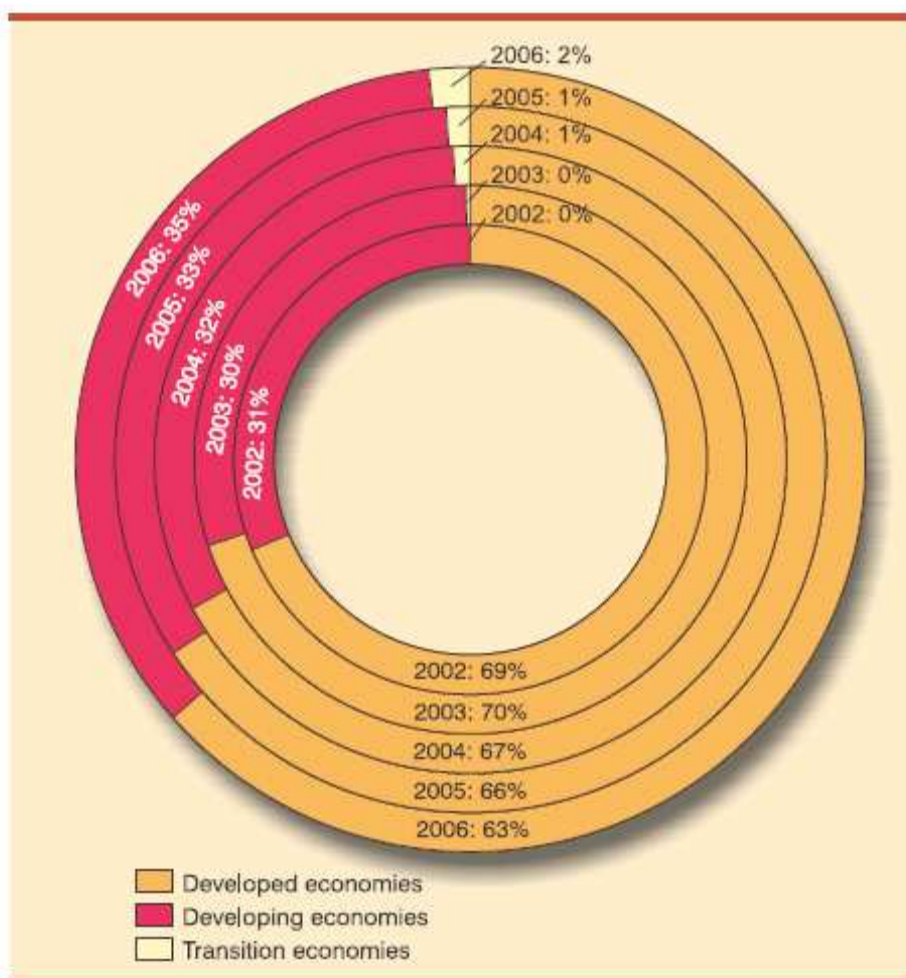


Source: UNCTAD calculations based on the ITU World Telecommunication/ICT Indicators database, 2007.

### Charts 3 and 4: Broadband Penetration<sup>16</sup>



Source: UNCTAD calculations based on the ITU World Telecommunication/ICT Indicators database, 2007.



Source: UNCTAD calculations based on the ITU World Telecommunication/ICT Indicators database, 2007.

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- <sup>16</sup> Ibid, 64.



## CONCLUSION AND RECOMMENDATIONS

*Stephanie Arbogast and Alison O’Leary (Editors)*

This report has introduced and tangibly demonstrated the concept of bottom-up development. Our goal has been to show how a bottom-up approach can provide more and better opportunities for recipients of aid, while ensuring that US tax payer’s dollars are maximized.

Bottom-up development is a pragmatic solution to delivering foreign assistance, it makes better use of tax payer’s dollars through controls such as transparent decision making, which holds service providers and governments accountable for policies, programs and budgets. Bottom-up development also fosters good governance by including the recipients of aid in evaluation of their projects, thus serving to expose poorly designed projects, or corrupt managers. Additionally, bottom-up development seeks to create projects which are regionally and culturally appropriate by directly funding programs at the local level. This approach serves to invest in local communities by sourcing goods locally, and drawing upon local experts and personal to design and implement programs. And finally, bottom-up development seeks to empower the recipients of aid by promoting policies and processes that foster self-reliance, self-respect and mutual responsibility.

### **Recommendations**

#### **Accountability and Governance**

Given the centrality of accountability in the distribution of US development assistance, our primary recommendation is a streamlining of USAID and State Department responsibilities. This will likely involve reforming the Foreign Assistance Act, which many in the policy community anticipate. Our primary concern is that the reforms include provisions that subject US development projects to more intense scrutiny and evaluation so that the resources can be most efficiently distributed. The end goal of evaluation is of course to continue effective programs and eliminate others. We feel that rights and capabilities should be used as functional metrics for evaluation, and not secondary

concerns. As we have stated throughout, we feel that a move toward policies that encourage participation, will ultimately be the most effective. We recommend that the US pursue participation not only in terms of development projects, but that it encourage participatory democracy through schemes like participatory budgeting and e-governance in poor countries. That being said, we support the continued existence of the MCC, but recommend that its requirements be revisited in search of ways to more broadly aid the poor in countries with insufficient governance indicators.

### **Business Climate and Economic Freedom**

In order to most effectively address the issues of property rights, inheritance rights and contract enforcement we recommend further research and education both for citizens of poor countries and their governments. Legal reform is a country and culture specific issue and we as the United States cannot develop and export policies in a top-down manner, disregarding sensitive factors on the ground. While acknowledging that legal reform is a process, we advocate an approach whereby the US takes on the role of consultant, promoting inclusivity. Education efforts could center on an inclusive legal system as the solution to criminal issues that stem from the extra-legal economy. This can be accomplished either through NGOs working in the legal sector, through providing fellowships to promising law students in poor countries, or by offering policy advice to governments. One specific policy we recommend is increased funding for the Women in Development Small Grants Program, which is already effectively working in this area, and has a feedback and evaluation system by which USAID can monitor its success. Further research could investigate ways of implementing in-formal contract enforcement through voluntary associations, and how the poor can mobilize to influence legal reforms that include them.

### **Education**

With the state of education in poor countries still dismal despite much effort and investment, we recommend small-scale trial programs in an effort to find solutions that work. We feel this approach is more viable given the range of conditions and barriers for families and children in poor countries. We recommend Conditional Cash Transfer (CCT) programs implemented on a trial basis in primary schools, with both incentives for households or teachers depending on the needs of the region. We also recommend voucher

programs for primary education as well as technical training and vocational education (TVET) to aid older or non-traditional students in need of job skills. TVET voucher programs should also be region specific, offering relevant and practical training.

### **Microfinance**

Given that microfinance is an incredibly valuable tool we recommend pursuing ways it can be enhanced and expanded. We recommend that the US fund microfinance initiatives that are also working to improve health and education, as well as projects that specifically target women. Furthermore we advocate the design of some coordinated oversight for microfinance providers. Considering the stakes, we believe it is imperative that microfinance not be left unregulated, but that through oversight and accountability these services can be more easily expanded to reach the poorest of the poor. This may take the form of an international supervisory body that the US could participate in, or be limited to the microfinance projects receiving US development assistance.

### **Information and Communications Technology (ICT)**

ICT is an avenue wherein rich and poor countries have the opportunity to truly form a partnership, and all aspects of development assistance can participate in this process. Our overall recommendation for ICT is that the US fund research investigating how specific technologies can best benefit the poor. We have identified three important avenues; cell phones, peer to peer lending, and computers, all of which require further research for the poor to derive maximum benefits.. In the case of computers and cell phones, we recommend funding research grants for universities, and for professionals in the private sector whose expertise is crucial in adapting these technologies to meet the needs of the poor. The government could also provide tax breaks to ICT companies researching ways to adapt their technologies to the needs of the poor. We recommend that user-centered design be paramount in this sector. To accomplish this, we advocate involving the poor in the research and design process, which could also involve TVET schemes in villages where new technologies are adapted and introduced.

For peer to peer lending we recommend researching the effectiveness of this new approach before funding existing platforms or adopting the model. We feel it is an extremely promising avenue that should be considered, however standards of sustainability

and transparency will be need to be in place before moving forward. Developing, maintaining and enforcing these standards, which would serve as seals of approval that strengthen confidence in these organizations and platforms, is essential to our goal of eliciting as many private contributions as possible to both charity and lending.

### **Concluding Remarks**

As the Jackson School of International Studies celebrates its centennial in 2009 with a retrospective examination of its beginnings, as well as an examination of its future, it is also fitting that students and practitioners of foreign aid and development likewise scrutinize the past and future of aid policies and programs. In this report we have sought to highlight weaknesses in our current approach to aid delivery and to answer those concerns with workable solutions which require the buy-in and full participation of all parties who both give and receive aid. It is with this in mind that the 16 members of the 2009 Task Force Report on Bottom-Up Development proudly join the ranks of twenty-five past years of Task Force reports in formulating and recommending policy concerning international affairs. Our report is based on the belief that in an increasingly interconnected and complex world that every voice, whether from a rich nation or a poor nation, is valuable and deserves to be heard.

