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CONTENTS

From The Editor Syed Saad Andaleeb	vi
The Subject and Numeracy: Economics and Development Farida C. Khan	1
Does Remittance Affect Local Democracy in Developing Countries? Evidence from Local Elections in Bangladesh Shafiqur Rahman.	10
Examining the Progress towards Sustainability in the Bangladesh RMG Sector in the aftermath of the Rana Plaza Tragedy Farzana Noor Bindu and Rahim Quazi	20
Understanding the Economic Empowerment of Women: A Study of the Handicrafts Sector in the Chars and Surrounding Areas of Bangladesh Tasnuva Ahmed and Mohammad Muaz Jalil	30
The State of Lower Court Performance in Bangladesh Ashikur Rahman	41
The Theory and Practice of Microcredit (book review) by Wahiduddin Mahmud and S. R. Osmani Munir Quddus	60

The Theory and Practice of Microcredit

Routledge Taylor and Francis Press, London and New York, 2017

by Wahiduddin Mahmud and S. R. Osmani

This is a much awaited book by two of Bangladesh's most distinguished economists on a topic of great interest to scholars and policymakers working on development, not just in Bangladesh, but globally.

In the introductory chapter, the authors explain the goal of the study: “a proper understanding of this evolution in practice of microcredit is essential for both developing theories that are relevant for the real world and adopting policies that can better realize the full potential of microcredit.” Addressing the exclusive focus on Bangladesh, they respond correctly, “No other country can match its experience regarding the maturity and the extent of outreach of the microcredit programmers.”

The book has 10 chapters and 267 pages including references and index. The chapters address many of the major issues raised in the theoretical and empirical literature on microcredit: the state of microcredit in Bangladesh, how rural credit markets work, the design and workings of the original (“classic”) microcredit model, various theories of microcredit, the role played by group lending and moral hazard, adverse selection and repayment enforcement, what happens when theory meets the real world, and testing the various theories of microcredit.

Along with others, I consider microcredit as one of the most exciting strategies in the movement for the economic emancipation of the poor, sometimes referred to as a war on poverty. As the authors point out, the genesis of modern microcredit (aka microfinance) lies in the small institutional loans, which were given collateral free based on trust, to poor households in rural communities in Bangladesh by Muhammad Yunus in the early 1970s. We know from his own writings, Yunus, a curious and determined professor of economics teaching at Chittagong University, a nearby campus, conducted his research-backed innovative social experiments with the help of his students to crack the age-old puzzle of deep-seated rural poverty. Around the same time, a non-governmental organization (NGO) called BRAC was experimenting with various models to make institutional credit available to the unbanked poor in rural Bangladesh under its visionary leader, Fazle Abed, a former accountant-turned social worker.

In my view, over the next few decades, the work and energy of this dynamic duo (and many others) transformed the goal of battling poverty, by providing institutional credit through tiny loans to the poor households, into a global phenomenon that has impacted the lives of millions in Bangladesh and across the globe. Thus at a critical moment in its history, Bangladesh was fortunate to have NGO leaders such as Yunus and Abed working on poverty alleviation strategies for the masses.

The exciting story of the microcredit revolution would be incomplete without understanding the history of Bangladesh which gave birth to this novel and impactful poverty alleviation strategy that has now spread globally. After many decades of exploitation, seeking political and economic freedom to build its own destiny, on December 16, 1971, the nation previously known as East Pakistan, succeeded in liberating itself from the clutches of the tyrannical rule by Pakistan's military. Tragically, the victorious struggle for freedom was accompanied by massive destruction in life and property, and eventually led to the devastating famine of 1974.

In the ensuing years, Bangladesh emerged from the its economic rubble – at one time dubbed despairingly by Henry Kissinger as the “International basket case” – to an economic scenario today that has pleasantly surprised many experts by the vigor, and sustained growth in its economy and success in overcoming significant poverty. Modern Bangladesh has been identified by global investment funds as one of the most promising economies in Asia today. Noble prize winning economist Amartya Sen has marveled at the progress that Bangladesh has made in development, especially as measured by social and health indicators (quality of life index) that measure the welfare of the average citizen, compared to what the experts had predicted, and what its neighbors (including, India) have been able to achieve.

The success and the promise of Bangladesh is a complex story, but the nation's path to unexpected economic success and future promise could not have happened without the spread of microcredit in the countryside. The amazing work of the organically grown (and perfected) strategy of microcredit, which over the next few decades provided a lifeline of formal credit to

millions of poor households, transforming lives of many, especially women. This experience has demonstrated to the world that with hard work, grit, innovative ideas, entrepreneurship and discipline, poverty can be overcome in vast numbers. From the village of Jobra, near Chittagong, Bangladesh - which served as the initial laboratory for Yunus's experiments - the microcredit revolution has spread across the world to benefit nearly 165 million poor.

The stunning rise of microcredit has naturally received attention of scholars and policymakers of all stripes, and also of many critics. Among the later, unfortunately, the least sophisticated views have been expressed by politicians who have felt threatened by the growing success and power of microcredit and its leaders. In striking back, these politicians have not spared even the Grameen Bank from malicious criticism, based largely on ill-informed myths and distortions. For example, the developmental microcredit institutions (NGO-MFIs) were compared to blood sucking money lenders. Mahmud and Osmani inform us that the highest rates charged by MFI organizations are limited by regulations, and are substantially below what the moneylenders charge. These inaccurate depictions were made despite the fact that the Grameen Bank and its founder, Muhammad Yunus, were honored with the 2006 Noble Peace Prize. Needless to say that as the pioneering microcredit institution, Grameen Bank is widely known and admired in Bangladesh and globally for its impact on poverty, empowering women, and improving the lives of millions of poor.

Although, vast number of articles (and a few books) have been published in learned journals on the subject by economists, sociologists, anthropologists, and political scientists, Mahmud and Osmani may have published the definitive book on the subject, one that has the potential to serve as essential reading on the subject, a one-stop source of scholarship that is both balanced and comprehensive in reviewing the origins, history, theories, practices, success and failures of microcredit in the context of Bangladesh, with lessons for a global audience.

In this book, the authors succeed where many authors failed before - to discuss ideas and concepts that are often difficult to explain theoretically, but have proven their effectiveness on the ground. MC has indeed proven to be an attractive and impactful strategy in rural communities across the developing world, and yes some parts of the rich developed world. Many believe that microcredit has been successful because the set of ideas and strategies that undergird the concept is breathtakingly fresh, adaptable and innovative in its application.

The audience for this timely book is diverse. It is not easy to package so much materials, some complex, in

one book. As the authors state, there is no single theory of microcredit but many theories. Hence the burden of proof on measuring its impact and effectiveness falls on collecting the right data and empirical testing of the various hypothesis. The central explanation is that rural credit markets are imperfect, because of a lack of complete information and the inability of agents to enforce contracts. The two biggest challenges for academics is to sort through the various theories and differing methodologies for data collection and testing, and the issue of "assessing the impact of microcredit".

Whether one agrees with the view that MC has had many positive benefits and impact, the fact is that many academics remain curious and baffled about the special features of MC model, and how these work in embracing the rural poor women who are largely excluded from the formal credit markets (banks), and yet does not seem to compromise the financial viability of the donors institutions (MFIs). For the curious social scientist and researcher, there are a number of unanswered questions - how and why does MC work, even when scaled up massively? Why the bankers cannot explain its robustness? Why do the bankers still stay away from lending to the poor? Why is that the economists and development specialists failed to take MC seriously in the beginning, and still cannot explain all aspects of it satisfactorily?

For those interested in these questions and many more related to financing the needs of the poor, this brilliant book by Mahmud and Osmani is a treasure trove of ideas, solid statistics and sound analysis. The book is not easy reading, but is well worth the effort. Generations of future authors and policymakers will depend on this study to further their own research and inquiries to unpack the mysteries of the microcredit model. They will likely find that not everything in the real world can be captured by complex models or explained mathematically. Given the right mix of ideas, leadership and discipline, sometimes two plus two can add up to more than four. There is magic in some ideas, and sometimes the genius is not so much in the ideas, as in the practice and implementation.

This is a sophisticated and balanced analysis of a subject which has generated a vast amount of theoretical and empirical research. One cannot do justice to the book in a short review such as this. Suffice it to say, that those who will take the time to invest in reading the book will not be disappointed given the careful and meticulous scholarship that underlies this book. I would highly recommend this book to undergraduate and graduate students taking courses on development and poverty, as well as scholars, researchers and policymakers interested in issues of economic development in general, and rural poverty alleviation,

social entrepreneurship, and women's emancipation in particular.

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