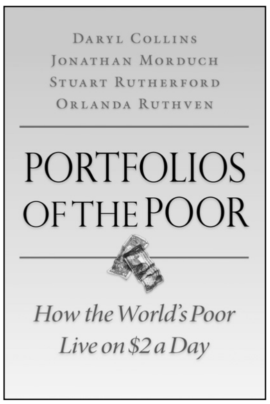
Reviews and resources

To recognize a particularly significant book, we publish two reviews of *Portfolios of the Poor*.



Portfolios of the Poor. How the World's Poor Live on $2 a Day
Daryl Collins, Jonathan Morduch, Stuart Rutherford, Orlanda Ruthven
2009, Princeton: Princeton University Press, ISBN: 978 1 4008 2996 5, £20.95, 320pp

Review by Rich Rosenberg

People sometimes ask me to recommend a single book about finance for the poor. For years, I've answered, 'That's easy – get Stuart Rutherford's book *The Poor and Their Money*'. But not any more. Piling up breathless superlatives is not a particularly useful way to review a good book, but I can't resist starting with an arm-waving proclamation that this is not just a good book but a great one, a really astonishing piece of reporting and analysis and a wonderful read as well.

The edifice of modern microfinance has been built on a number of assumptions about what poor people need. *Portfolios* focuses insistently on what poor people actually do. It draws a high-resolution picture of the ways that low-income households manage their cash. This picture sheds a surprising amount of light on common assumptions, undermining some widespread ones in the process.

The book is based on hundreds of year-long financial diaries, collected about twice a month from rural and urban households in India, Bangladesh and South Africa. The diaries revealed that households actively used a wide range of savings and loans, often many of them at once. Flow of cash in and out of these instruments ranged from 75 per cent to 330 per cent of annual household income in India and Bangladesh, and up to 500 per cent in South Africa. Relative to their income, these poor households engaged in more financial intermediation than richer people do.

Portfolios explains this surprising result. We tend to think poverty means not having enough annual income. This view misses another hugely burdensome dimension of poverty: income is variable and risky. Because poor people live so close to the edge, they have to – and do – scramble more than the rest of us to avoid going hungry, or to scrape together the larger amounts that they occasionally need for life events or investment opportunities. Savings and loans are their principal tools for doing this.

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Thus, 'microfinance' as we know it is not delivering financial services to people who otherwise would have none. It is adding additional tools to the ones that poor people already have at their disposal. However, most of those tools have serious drawbacks, especially in terms of reliability. Diary households valued the services of microfinance institutions because of their reliability, though they still used informal services because those tend to be more flexible. The book devotes a chapter to the redesign of Grameen Bank after its default crisis of the late 1990s. 'Grameen II' added a lot of flexibility to Grameen's services, and has been hugely successful in terms of uptake and (not incidentally) repayment.

Portfolios offers important insights on other topics I can't do more than mention here, including poor people's use of both loans and savings to assemble the larger amounts of cash they need for life events or investment, the importance of structured instruments that they use to reinforce savings discipline, how poor people view the prices of financial services (hint: differently from economists), and finally recommendations on how microfinance providers and others can improve the services they offer.

The core finding of the book is that the poor households in the study value and use financial services more for managing household consumption and cash flow than for business investment purposes. In other words, they are like most of the rest of us. The difference is that managing consumption is far more critical for the poor. When we are told that the evidence about microfinance lifting people out of poverty is unclear, and that many (sometimes most) clients use microloans and savings to smooth consumption rather than to grow microenterprises, we tend to be disappointed and to view consumption smoothing as a mere palliative. 'If that's all it is, why bother?' we ask. We react this way only because our own basic consumption needs are seldom if ever threatened. As this book demonstrates, poor people see it differently.

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Review by Isabelle Guérin

Portfolios of the Poor should be read by anyone interested in microfinance, but also who are interested in poverty more generally and in how the poor manage their day-to-day lives. It describes clearly and with highly convincing detail how the poor deal in their everyday lives with the 'triple whammy' with which most of them are faced. These are low incomes, irregular cash flows and the poor quality and unreliability of the financial instruments to which they have access. The book is also policy-oriented, working from the idea that microfinance can help the poor to improve their budget management, and hence their daily lives.

One of the ways in which the book distinguishes itself is through its recourse to financial diaries. This methodology, previously tested by one of the authors, Stuart Rutherford, is to document cash flows as regards both spending and income. The regularity and quality of the relationships established with households appear indispensable in obtaining reliable information and consistent figures to reveal the diversity, complexity and intensity of financial intermediation. Surveys were conducted in both urban and rural areas, in three countries: Bangladesh, India and South Africa. Despite such diverse contexts, fascinating similarities as to how the poor perceive and make use of finance are observed, and one of the main goals of the book is to highlight them.

Of additional interest is how the book calls into question a number of prejudices. While some of the ideas presented are not entirely new, reiterating those already highlighted by economic anthropology, the book has the immense merit of being written in a simple and accessible language. Moreover, its arguments are supported and strengthened by figures, as has rarely been the case with economic anthropological approaches.

The first prejudice relates to the perception of the poor as financially unsophisticated as a result of illiteracy. Increased interest in 'financial education', as witnessed in development milieus, has reinforced this conception. Meticulous analysis of how the poor manage their cash flow serves to highlight the existence of extremely complex and sophisticated skills and know-how, showing that the poor do in fact plan, calculate, anticipate and save. The strategies and motivations implicated in this are sometimes surprising, but have their own rationale. Whether for the purposes of managing day-to-day expenses, coping with emergencies or building up lump sums, poor households use and combine a huge diversity of financial tools and moreover they regularly invent new ones. It is far from true that a poor income amounts to poor financial intermediation, and the high level of funds borrowed, paid out, lent, recovered, deposited and withdrawn, and frequency of transactions can be impressive. Struggling to make ends meet does not prevent the poor from saving, accumulating and making the most of 'opportunities'. They are able to do so by transforming small regular payments into lump sums, either through borrowing or saving. Indeed, the distinction between the two is rather blurred, as was already a key argument in the book of Stuart Rutherford (2001).

Moreover, the book offers a fresh analysis of interest rates. One of its first interesting results concerns informal finance, which is far from being necessarily synonymous with usury. In all three countries, the most common source of cash is friends and relatives. This is usually cost free and based on reciprocal borrowing. In some cases, however, including that of microfinance, it is observed that the poor are willing to pay rates that seem extremely high, and in a chapter specifically devoted to the price of money, the authors offer various explanations. Not only is price just a single component in the transaction, but people value price in a particular way, perceiving interest rates more as a fee than a rate. The short-term nature of lending, the relatively small size of the principal, the lack of compounding interest, the flexibility of arrangements and the possibility to reschedule the repayment all come into the picture.

The authors do not restrict themselves to describing in detail how people understand, perceive and make use of finance, but also consider ways to help the poor better manage their budgets. Following on from a chapter on how the Grameen Bank has managed to evolve and design higher quality services (the Grameen II), the concluding chapter is a plea to make microfinance 'the first reliable universal service'.

According to the authors, informal finance has both numerous strengths and weaknesses. Informal finance is convenient, close at hand and simple, and as already stated, in many cases there is no financial price to be paid; even where there is, terms may be flexible and the price can be negotiated down. There are, however, many costs to informal finance, which are not necessarily financial but social and psychological, including feelings of intimidation, shame or the obligation to reciprocate. Informal finance is often unreliable, insecure, non-transparent and limited to the short term. In other words, it is argued that poor households use informal finance mainly owing to a lack of other options. The policy implications of this are clear: 'if poor households enjoyed assured access to a handful of better financial tools, their chances of improving their lives would be much higher' (p.4). The authors advocate that microfinance could be the 'first high quality basic services available to the poor on a near-universal basis' (p.176). They argue that a universal microfinance service should combine the following basic principles.

Reliability: 'delivering of services at the promised time, in the promised amount, and at the promised price' (p.180);

Convenience: 'the chance to take and repay loans and make and withdraw deposits, frequently, close to home or work, quickly, privately and unobtrusively' (p.181);

Structure: one of the main lessons of informal finance is that the poor wish to save, but struggle to do so and need self-discipline mechanisms, an example of which being the ROSCAs. An efficient saving service should offer 'regularities that promote self-discipline' (p.182), such as commitments to saving plans, as already offered by the Grameen Bank.

Flexibility: this refers to the ease with which transactions can be reconciled with cash flows, for instance via the possibility to prepay loans, flexible repayment schedules and emergency loans. It is also argued that people should be allowed to make use of their loan as they wish. The principal idea here is that the poor need loans for all kind of uses, not just for microenterprises. This argument indeed underpins the whole book, and given that microfinance continues to be seen as a tool for income generation, it is probably also one of its most provocative ideas. Two lines of argument are given in support of this proposal, the first being that it is already a reality, given that in many cases the poor already 'divert' microfinance and use it for expenditures related to health, education, the repayment of past debts, etc. But the authors also believe that there is an extraordinary opportunity to 'open up the biggest single market it is likely to find among the poor' (p.180).

While as stated above, this book offers a detailed and convincing analysis of how the poor manage their money, its policy implications are more questionable, on two grounds.

First, the book is a heartfelt plea for microfinance. The authors admit on various occasions that microfinance still has much effort to make, but they are convinced that microfinance can achieve a lot. In contrast to informal finance, they argue, microfinance is capable of reliability and transparency, without any social or psychological costs. It is also argued that with some efforts in innovation, microfinance could perform as well as informal finance in terms of flexibility, and could do much better in terms of long-term services. 'Professional and contractual' categories are seen as ways in which microfinance could outperform informal finance, but the book does not give further details. The opposition made between microfinance (considered as semi-formal) and informal finance seems somewhat simplistic. Although some microfinance institutions are likely to be transparent, many are not. Informal finance neither has the monopoly nor exclusivity of social pressure, intimidation or harassment. We now know that group lending implies social costs, as the authors themselves mention, but it is unlikely that individual lending is an exception to this. Faced with increasing productivity constraints, microcredit officers might be tempted to use robust enforcement methods. Meanwhile some forms of informal finance are sometimes perfectly transparent, reliable and contractual, for instance, pawn-broking in some parts of India This may not be the case in the three countries studied, but it would have been useful to relativize the conclusions of the study. As far as the superiority of microfinance for long-term products is concerned, the capability of microfinance institutions to deal with risk on a long-term basis remains to be proved. Rather than fixing informal, semi-formal (microfinance) and formal finance as categories, should we not admit that there is a continuum of financial arrangements, and compare these on the basis of their characteristics, and not on their status?

Second, the book is also a heartfelt plea for the use of microcredit for consumption. Convincing microfinance practitioners, and their donors, that microcredit is often diverted from 'production' is quite commendable. Claiming that the poor need to borrow for social needs is also perfectly legitimate. But should we not also consider the risks of consumer credit? And should we not rethink the conditions, particularly in terms of cost? If there is no increase in income and no redistribution mechanism, debt necessarily causes impoverishment. This is a very simple mechanical effect, unless it is free of cost, which is not the case of microfinance. The risks are even greater given that the desire to consume to achieve status in a consumer world is most probably increasing among the poor (see for instance Baumann, 1998; and Villarreal, 2009). When the labour market does not provide much opportunity for upward mobility, consumption and the desire for consumption are often the only alternative. Over-indebtedness has affected millions of North American and European households for several decades and these numbers are increasing every day. Up to now, it seems that the poor of Southern countries have been spared this type of problem. Whilst nobody can prevent them from consuming, do they really need to be encouraged to do so?

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