Chapter 1

Introduction

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1.1 Introduction

The term seasonality and its impact on agrarian societies are not uncommon in the developing world. Seasonality which is often termed as Lean periods can occur due to agriculture cycles or natural disasters, such as draught, flood, cyclones, climate change, or river erosion. However in Bangladesh, the term seasonality is associated with seasonal food deprivation which is locally know as “Monga” (Khandker 2012).

The rural life of Bangladesh very much revolves around the agricultural cycle which is characterized as three crop season based on three categories of rice: Aus (December/January to March), Boro (March/April to June/July), and Aman (July/August to November/December). As a consequence of this cycle, two major seasonal deficits occur, one from late September to early November and the other from late March to early May. With the widespread expansion of Boro cultivation, the incidence of the early summer lean period has significantly declined. However, the autumn lean season that comes after the plantation of the Aman crop still affects almost all parts of the country, and especially the northwest part of Bangladesh. Almost no alternative agricultural activity persists in that period, and the non-firm sector is insufficient to absorb the seasonal unemployed labor.

During the lean season unemployment led income downfall is the major reason for the lack of food consumption and has been well documented (for example see Rahman 1991). During the lean season, such lack of income and alternative means for earnings limit the purchasing power of the people, which cannot be mitigated by with minuscule amount of assets and savings of poor households. Anecdotal evidence suggests that on an average number of meal consumption significantly reduces during the time of

Monga and families of young and elderly members suffer the most. Lack of functional credit market obstructs households to smooth consumption (Pitt and Khandker 2002) as a result many individuals borrow from the land-lords with a very high interest rate and falls into the debt trap.

1.2 Migration

During the periods of Monga, many people move from rural areas to nearby cities or towns for a short period of time in an attempt to maintain their living standards. An individual may prefer a temporary move to a permanent one because such a decision offers an opportunity to combine village-based existence with urban opportunities. Faced with highly seasonal labor demand, villagers may see temporary migration to urban areas as a relatively practical and rational strategy to cope with seasonal downturns. The most important factor, resulting in a temporary move rather than a permanent one, is the reversal of the urban-rural wage differential that occurs during the peak labor demand season in the agricultural sector.

However, not every individual would be able to take the opportunity to migrate during the lean season. Households with female heads or with disable heads may not be able to take the migration decision during the lean season. Moreover, lack of inappropriate credit market would make the financing of migration difficult for many and asymmetric information problem of temporary informal job also impedes individuals from migration.

1.3 Micro-credit

One recent policy development in developing countries has been the emergence of micro-credit institutions in poverty alleviation. It is argued that if given access to (small) credits, entrepreneurs from poor households will find opportunities to engage in viable income-generating activities, often secondary to their primary occupation, and thus get rid of the poverty by their own. Micro-credit is accessible in rural areas through Microfinance institutions (MFIs) that have expanded quite rapidly in recent years. According to the Micro-credit Summit Campaign, as of December 2007 Microfinance institutions had 154,825,825 clients of which more than 100 million were women. In

2006, Mohammad Yunus and the Grameen Bank were awarded the Nobel Prize for Peace for their contribution to the reduction of poverty, especially in Bangladesh. However, among academics there is so far no consensus on the impact of micro-credit on income improvement and poverty reduction (Banerjee et. al., 2009). On the one hand, various studies on the impact of micro-credit in developing countries have found evidence of consumption smoothing, asset building (Pitt and Khandker, 1998) and reduction of poverty (Khandker, 2005). Conversely, using the same data set of Pitt and Khandker (1998), Morduch (1999) found that the average impact of micro-finance is "nonexistent". Similarly, Navajas et. al. (2000) concluded that micro-credit is largely unsuccessful in reaching the poor and the vulnerable.

A major drawback of the micro-credit framework is the usually rigid loan repayment rule. Nearly all contracts are fixed in their repayment schedules which entail constant equal weekly payments with high interest rate. However, MFIs are dealing with poor rural people who most often have uncertain income, which makes it very difficult for them to maintain such rigid weekly loan repayments. Especially in the case of lean period, when there is no job available in the rural agricultural sector, it is very hard for the poor to generate income let alone comply with their loan repayment scheme. As discussed before, during lean periods many people choose to seasonally migrate to urban areas for survival. However, strict repayment schedules prevent people with prior access to micro-credit, from migrating, and make it thus very difficult for them to repay the weekly installment of loan and keep a living. Even if the loan is targeted only for the female, rigid weekly repayment during the time of seasonal hardship even makes their misery to an extreme, forcing household to take extreme measures like selling of productive asset or borrowing from the loan-sharks with high interest rate.

Using primary data from rural households in Bangladesh, Shonchoy (2009a, b) shows that during lean season access to micro-credit does not increase the level of income of individuals compared to those who do not have access to credit. Also Shonchoy (2009a, b) at the time of survey did not find any MFI that operates some targeted micro-finance program only to tackle the seasonality like Monga.

1. 4 RCT with Flexibility

The mismatch between credit repayments and income can create serious distortions. In this project we study whether these distortions are inevitable. If MFIs could allow some

flexibility in the micro-credit repayment schedules, especially in periods of uncertain income during lean periods or after natural disasters, this may improve the livelihood of the poor, provide them with more flexibility and mobility, and in turn may improve their capacity to repay the loan. Currently MFIs are reluctant to relax their rules. It seems that the micro-credit institutions fear that allowing people to migrate by giving them a few weeks off from the repayment scheme may ruin the debt repayment discipline. Specifically, migrants might not return to their home villages, or get behaviorally used to no or lower repayments when the payments are required. Ultimately this might lead to lower recovery rates or even default.

To the best of our knowledge, the interaction of micro-credit and temporary migration has not yet been appropriately addressed in the academic and policy literatures on economic development. Hence, to bridge the knowledge gap in the literature, involving both survey and experimental methods, this study allows us to see the consequences of flexible loan repayment rules during the lean periods, both for MFIs and for participating credit takers.

Randomized Control Trial (RCT) is the new gold standard for empirical research for clearly identifying the causality issues and impact evaluation. Strong on their empirical validity, numerous RCTs has been implemented by applied economic researchers to evaluate many puzzling facts of development questions and impact evaluations. Interestingly, a large number of RCT has been done on micro-finance related research. Such research on micro-finance covers wide ranges of options like impact of micro-finance (Banerjee *et al.* 2011), weekly vs. monthly repayment (Field and Pande 2008), group vs. individual liability (Giné and Karlan 2009), random variation of meeting frequency (Feigenberg et al. 2011), varying term structure of the loan (Field el al. 2011) etc. to name a few. However, to the best of our knowledge no study has so far done RCT to customize micro-credit repayment schedule based on the local seasonality. This will be pioneering study in the field of flexible micro-credit that is geographically as well as seasonally adjusted to help the vulnerable and lean season affected poor to cope better during such period of hardship and temporary unemployment.

1. 5 Summary and Conclusion

Micro-credit schemes have improved access to the informal credit market for rural people. However, we need to know the possible loopholes and side-effects of such instruments,

and ought to find ways to improve them. The results of this project will be of importance to both the poor credit takers and micro-finance institutions and the policy makers supporting them. If we find that a relaxation of repayment schemes yields improved welfare without higher risks on the side of MFIs, those institutions will revise their contracts to the benefit of the poor. If we find that risks are too high, then policy makers can either compensate MFIs for bearing those risks, or we can look for other ways to alleviate the interaction problems associated with temporary migration and being tied to a micro-credit. For example, government and donor agencies might want to focus more on capacity building of diverse, alternative skills among both agricultural and non-agricultural professionals, skills which help them to find a better livelihood strategy during lean seasons.

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