

Spring 5-1-2014

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## Recommended Citation

Ciccaglione, Kateri R., "From Inclusion to Empowerment: The Political Implications of Microfinance" (2014). *Honors Scholar Theses*. 386.

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# From Inclusion to Empowerment: The Political Implications of Microfinance

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*POLS 4994 Honors Thesis Final Draft*

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**Abstract:** There has been extensive literature on the positive effects of microfinance in developing countries with regards to financial inclusion of the poor, economic growth and poverty reduction. This paper seeks to take these facts one step further, arguing that microfinance paves the way for the political empowerment of the poor because it creates social capital in developing economies. I make the case that a growth in social capital due to financial inclusion helps impoverished people realize their political potential by instilling a need for political awareness and increased participation in the political process. An analysis of the current literature concerning the various social effects of microfinance is presented with a focus on social capital growth and feelings of empowerment. Raw data collected from microfinance institutions in two Central Asian countries provide an appropriate case to evaluate the political effects of microfinance because of the growing microfinance industry in the region. Additionally, relevant qualitative data exists with regards to this topic in the region that helps to conceptualize the link between social capital, self-efficacy and political empowerment.

## Introduction

This paper seeks to determine the political implications of microfinance in developing countries. Much of the literature on microfinance has to do with its successes and failures of lending to the poor in terms of default rates and actual poverty alleviation. Much else of the literature focuses on its social affects in communities such as women empowerment and a growth of networks, norms and trust. The research presented here will take these established views of microfinance one step further and argue that while little attention has been given to the political implications of microfinance, analysis in this field could prove their existence. The purpose of this paper is to conceptualize, analyze and propose the political implications of microfinance that arise from the creation of social capital in developing economies.

To begin, one must understand what microfinance is and how it has been a successful tool of poverty alleviation. Microfinance is the provision of a full range of commercial financial services including credit, savings, deposits and insurance to micro-entrepreneurs and poor families. The two main mechanisms for the delivery of financial services to clients are a relationship-based banking for individual entrepreneurs and small businesses, and group-based models where several entrepreneurs come together to apply for loans and other services as a group. In both of these cases, microfinance has demonstrated its ability to deliver financial services to impoverished people who otherwise would not receive these services because of high transaction costs, risks and lack of collateral. In this way, microfinance institutions expand the portion of the population included in the financial sector, bringing groups of people into its active participation (Pitt, 2003).

It is well understood that the positive effects of microfinance include but are not limited to: financial inclusion of the poor, stimulation of economic growth, poverty reduction and growth of social capital. As former Secretary-General of the United Nations Kofi Annan has declared, providing microloans to help poor people launch small businesses recognizes that “they are the solution, not the problem. It is a way to build on their ideas...to grow productive enterprises, and so allow communities to prosper” (Boudreaux, 2008). While microfinance is arguably not the solution to global poverty, it is an important tool used to empower the poor with some control over their lives. It is also important to note that many microfinance institutions target women clients, as women are especially excluded from financial markets and are found to be good credit risks. The United Nations estimates that women make up 76% of microcredit customers around the world (Bordreaux, 2008). In addition, although the benefits of microfinance may not be an explicit return on investment, the effects of these loans on poor families are very real. Life becomes easier to manage when small loans allow people to keep their children in school, send a family member to a clinic or build up secure savings. This improves the well being of both the family and the entire community (Boudreaux, 2008).

The causal relationship this paper seeks to explore is a two-tier process: that microfinance leads to social capital growth, which in turn leads to political empowerment and its associated implications. I argue that the development of social capital and self-efficacy is the link between microcredit, political awareness and activism of the poor, and ultimately their political empowerment. I believe this research is important because it analyzes an effective tool of development that has been given much attention and even it’s own “year” by the United Nations in 2005. There is extensive literature on microfinance, the Grameen Bank, and the effects of microfinance on development and poverty, but bringing microfinance under a political science

scope could help fill a gap in the literature. Analyzing this contemporary and successful tool for development, I hope to shine light on another positive effect of microfinance: its ability to politically empower recipients.

### Empowerment and The Grameen Bank

By definition, empowerment means, “to promote the self-actualization of” (Merriam Webster Dictionary). Empowerment promotes self-actualization through educational, social and political strength in individuals. This paper focuses on both social and political empowerment, first arguing that microfinance socially empowers lenders to make their own decisions and become more self-sufficient causing a realization of their self-efficacy. Secondly, the paper will discuss political empowerment by explaining the link between social capital stemming from group loans in microfinance institutions and an improvement in the political empowerment of borrowers. Political empowerment is defined in terms of political awareness that comes from *access to information* and *political participation*. Political participation not only includes voting, but also participation in community organizations, campaigning, contacting, petitioning, protesting, litigating, and unionizing (Bayulgen, 2008).

Since the 1980’s, the assumption that the poor cannot save and that underdeveloped countries cannot organize financial resources has been undermined. During this time, organizations like the Grameen Bank in Bangladesh, ACCION International in Latin America and Bank Rakayat in Indonesia introduced microfinance into the developing world. The success of these institutions proved that the poor could be trusted in paying back loans and that the institutions providing loans could become sustainable businesses. The poor do save, and have done so at a much higher rate than that of the nonpoor (Quinones, 2000). Microfinance institutions help the poor save and are therefore a sustainable form of human development,

which takes a people-centered approach to poverty alleviation. This participatory means of poverty alleviation ensures that people have a stake in the decisions that shape their lives (Holcombe, 1995).

Perhaps the most well-known microfinance institution is The Grameen Bank, a Nobel Peace Prize-winning microfinance organization founded by Muhammad Yunus in 1983. The Grameen Bank, like many other microfinance organizations that have been modeled after it, makes loans to very poor people in rural areas who already have the skills, but need the small amount of capital required to operate a viable productive enterprise. The successes of the Grameen Bank include the almost 98% rate of recovery of loans, the measurable improvement in income, and the increase in assets of borrower-members (Holcombe, 1995). To put this into a current perspective, the September 2013 Grameen Bank Monthly Update reveals these consistent accomplishments. The rate of loan recovery in this issue is 97.27%, with \$148.53 million disbursed in the month of September and \$148.09 million repaid. At the time of this survey, 1,244,438 village members had phones in their households and almost 700,000 houses have been built with housing loans given by the bank; this data signifies the increase in assets of borrower-members of the bank. Additionally, through higher education loans, 52,425 students have furthered their education because of the Grameen Bank. The Grameen Bank currently has 8,453,573 members and has cumulatively disbursed \$14,236.12 million since its inception (Grameen Bank, 2013).

The Grameen Bank and other microfinance institutions have not only been effective in providing loans to alleviate poverty, but also in growing social capital, the first focus of this paper. According to Robert Putnam, social capital refers to “features of social organization, such as networks, norms and trust that facilitate coordination and cooperation for mutual benefit”

(Putnam, 1993). Social capital is the producer of civic engagement and a broad societal measure of communal health. It is often linked to the success of democracy and political involvement as well as economic development (Putnam, 1993). Because social capital is based on norms of reciprocity and interpersonal trust, it enables the formation of autonomous organizations through social networks and increases the ability of connected individuals to act collectively (Radnitz, 2009). Social capital reduces the cost of information and helps solve collective action problems in communities.

Microfinance produces social capital when provisioned in a unique way, through group loans. Group loans are given to lenders who become a team of individuals connected by loans they must repay to the microfinance institution. Studies discussed in the literature portion of this paper will describe the causal relationship between group loans and an enhancement of social capital among lenders because of the networks that arise from being part of the group loan; these networks create a form of social trust that allows individual norms to transition into shared norms (Bayulgen, 2008). The substantial amount of group loans stimulates cohesion and strengthens social networks, as pressures by the group to its members not to default on a loan exist, as does a sense of community working towards a unified goal of poverty alleviation.

#### The Grameen Bank as a Model for Social Capital Growth

A study conducted in the Philippines describes the poverty alleviating aspects of microfinance. Benjamin Quinones and Hans Dieter Seibel (1990) proved how deregulating microfinance institutions in the Philippines, by allowing them to function like the Grameen Bank in terms of loaning in groups primarily to women, improved levels of social capital in the region. In the early 1990's, the national government of the Philippines sought to deregulate the banking system to make it more efficient when lending to small clients. At the time, the banks were not

providing sufficient accessibility of financial services: there was more of a demand for credit among the poor than a supply of loans. Pro-reform groups in the government mobilized into three groups: the National Credit Council, the People's Credit and Finance Corporation and the People's Trust and Development Fund. These groups helped to pass banking deregulation policies that allowed non-governmental organizations to replicate the "Grameen approach" in the Philippines (Quinones, 2000).

Under the new laws, banks like Ahon Sa Hiras, Inc. (ASHI) were opened exclusively to poor women. This NGO successfully replicated a form of social capital accumulation among the poor in the Philippines by organizing itself similarly to Grameen. Poor households were organized into small groups and groups into centers. Group cohesiveness was established through weekly meetings, at which the groups discussed the status of their repayment and monitored each other in terms of who was able to repay and who was at risk for default. The deregulation of the banking industry allowed ASHI to increase its outreach to the poor and empower them to fight poverty. The removal of restrictive regulations of the formal financial system reversed the effects of financial repression and allowed microfinance institutions to successfully generate social capital through cohesive networks among group lenders. Public policy ultimately influenced these institutions to grow and enhance the capacity of poor households for cooperation and mutual support among clients (Quinones, 2000).

In addition to poverty alleviation and economic development, some of the most beneficial outcomes of microfinance institutions are social empowerment and increased self-esteem and dignity, which also contribute to the level of social capital in a community. These results stem from the increased trust in others and in the overall community when loans are properly distributed and repaid. Because group members exert a pressure amongst each other to repay the

loans, and to be honest about their financial statuses, a network is formed among members, which generates trust. If the borrowers fail to repay the loan, the consequences could be that none of the members ever receive another loan, so being the incentive for the group as a whole not to default. In the case of the Grameen Bank, trust in its borrowers to repay the loans instilled in them a sense of responsibility to pay the loans back on time. This trustworthiness of the poor affected the level of trust in a number of different commercial and state institutions (Dowla, 2006). But how might this trust, or growth in social capital, lead to increased political empowerment, or any political implications at all?

### Microfinance and Social Capital

“Building Social Capital Through Microfinance” was published in 2010 and provides experimental evidence on the economic returns to social interaction in the context of microfinance. The results of this study indicate that group lending is successful in reaching low rates of default without needing collateral from the poor because of existing social capital and because it builds new social capital among participants. Group lending has received much attention in the literature for creating social capital. The theory is that repeated interactions among individuals can help build and maintain social capital. This experiment randomly assigned first-time borrowers in India to meet as a group either once per week or once per month. The experiment thus generated differences in individuals’ knowledge of the other members as well as social contact with the other members. The study found that clients in weekly groups were more likely to have visited other members’ homes outside of the loan process and to contact each other outside of meetings. The higher meeting frequency generated social capital because it facilitated risk sharing, which led to increased trust among the group members. The more frequent meetings also helped sustain cooperation by reducing the costs of coordinating

actions. The findings show that social capital is harnessed through joint liability contracts because if one member defaults the rest have to pay, and through regular social interaction among members (Feigenberg et al, 2010).

This article was also interesting because the experimenters administered a survey similar to the one that Professor Bayulgen gave to borrowers in Azerbaijan and Kazakhstan. The survey asked both weekly and monthly clients if they would give transfers to individuals in their group. The weekly clients were more likely to do so, which presents a positive return to social capital. Overall, the average monthly client defaulted more than the average weekly client, and the authors conclude that clients are better off on a weekly, “social capital” growing schedule. By broadening and strengthening social networks within the group through more frequent meetings, the results of this study show that development programs (microfinance institutions) can increase social ties and enhance social capital among communities. The authors also propose applying these findings to other fast-growing urban areas of cities in developing countries where microfinance is spreading rapidly, in a region such as Central Asia (Feigenberg et al, 2010).

Dean Karlan at Yale University has written extensively on access to finance, studies concerning microfinance, and his own field research. “Social Connections and Group Banking” (2007) provides strong evidence of peers’ successful monitoring and enforcing of joint-liability loans. When group members have stronger social connections to fellow members, Karlan states, these groups have higher repayment and savings. Karlan (2007) discusses how the Grameen Bank and FINCA in Latin America have embraced group lending in their attempts at financially including the poor. Group lending is beneficial to these NGOs because it is less expensive than administering individual loans, it is less difficult to monitor, and it is a practice proven to result in low default rates. Karlan (2007) notes that group lending works for a few reasons that all rely

on social connections: group members select credit worthy peers to be part of their group, the members are able to monitor each other's use of funds and ability to repay, and they are able to enforce repayment and make each other more likely to repay because of the social rejection they would face if they defaulted. Karlan defines social capital from an article by Adler and Kwon as "the links and commonalities that bind a group of people together and determine their social interactions" (Adler, 2000). Microfinance, then, is a broader form of social capital because it encompasses the transaction costs of successful monitoring, information gathering and punishment in the case of default (Karlan, 2007).

The way Karlan measures social connections of the lenders is through geographic proximity and cultural similarity, because these measures are unlikely to be influenced by participation in the credit program and can be measured accurately. They are also easily observable in the community. He analyzes these effects at a FINCA bank in Peru, and spends some time discussing FINCA itself. The analysis of FINCA is relevant to this paper because the survey data collected by Professor Bayulgen in Azerbaijan was collected from FINCA-Azerbaijan members. According to Karlan, FINCA's mission includes building new social connections and the organization prefers that initial group members do not know each other.

FINCA's operating philosophy encourages its clients to develop social capital through propaganda posters in the meeting halls that present values like camaraderie, trust and teamwork. Also, in the training materials provided to employees and clients, there is a stress on promoting group cohesiveness among group members. Karlan's experiment of thirty women members of FINCA-Peru was a natural experiment because FINCA forms groups with little-self selection: the organization creates groups based on a list that once it reaches thirty, a group is formed. His research finds evidence to support that group lending, through monitoring and enforcement

activities, does improve the outcomes. Social connections facilitate this monitoring and enforcement of joint liability loan contracts. Because more connected individuals who share a loan trust each other and value each other's relationships more, the group develops social capital and becomes a cohesive unit. Finally, Karlan (2007) concludes that within group lending programs, groups with higher social capital perform better than groups with lower social capital because the connections between the group members facilitate successful group borrowing (Karlan, 2007). This research is useful to make connections between FINCA-Peru and FINCA-Azerbaijan because the institutions operate under a similar group lending philosophy. Because of this, we can make connections between Karlan's findings in FINCA Peru and Bayulgen's findings in the survey answers of the FINCA-Azerbaijan members. Social Capital Growth and

#### Political Empowerment

Referring again to the Grameen Bank, it can be seen that the borrowers had an increased sense of empowerment and a structure to their lives that enables cooperation (Larance, 1998). The nature of the workings of the Grameen Bank stimulates empowerment because the bank rotates a group chairperson to collect repayment from the members, providing a corruption-free environment (Holcombe, 1995). In addition, the borrowers have established a set of norms that includes their commitment to hard work, education, higher incomes, and to take part in all social activities *collectively*.

The creation of trust among borrowers and lenders at the Grameen Bank was the most important for the growth of social capital (Dowla, 2006). The establishment of trust in the poor due to their almost 98% repayment rate paved the way for other NGOs to extend credit to the poor and, through group lending, stimulate social capital in Bangladesh. The bank created an enabling environment conducive to the formation of social capital, which enhanced the political

participation of the poor. Although the purpose of center meetings is not to discuss political issues, members were encouraged in this accepting and cohesive environment to vote and go to the voting centers as a unified group (Dowla, 2006).

Most importantly to this research, the trust and social networks generated through group lending at the Grameen Bank have been found to be instruments for *political action* and *political empowerment*. In 1991, the Grameen borrowers embraced the idea of exercising their democratic rights in the national election. Muhammad Yunus himself reported that as the borrowers improved their self-esteem they were *ready* and *willing* to express their opinions (Yunus, 2003). The borrowers felt an increased sense of political awareness and participation; could this apply to other microfinance organizations as well? This paper will explore this question with a focus on Central Asia, as it is a fertile region because it has a growing microfinance industry. Additionally, it is the only region for which raw survey data on the political implications of microfinance exist. This data, collected by Professor Oksan Bayulgen at the University of Connecticut, is vital to the analysis of the hypothesis of this paper.

#### Microfinance, Social Empowerment and Self-Efficacy

Ashraf, Karlan and Yin (2010) analyze female (social) empowerment stemming from microfinance. They define empowerment as “increasing the bargaining power of women within the household through increased influence in household decisions and through household outcomes that greater reflect her preferences.” This study randomly distributed a commitment savings product, an instrument of microfinance, to women in the Philippines and measured its household impact. Ashraf et al (2010) find that the commitment product positively impacted household decision-making power for women because they were more likely to buy female-oriented durables. It also improved self-perception of savings behavior because it provided the

women with a substantial method by which to save. In this savings product, there was a legal contract in which access to the account was restricted to the individual it was distributed to. This created a formal barrier to second persons that the account holder had relationships with. Because of this restricted access, the impact of the savings product could be measured solely in terms of the women to whom the product was given. The results showed that women made increased consumption decisions regarding goods, amongst other household impacts and Ashraf et al (2010) thus conclude that the provision of this microfinancial service empowered the Philippine women. It is also interesting that the study recorded different reasons to save by the women: 48% wanted to save for a celebration such as a “fiesta.” A “fiesta” in the Philippines refers to a local celebration for each small political unit (barangay) and defined community. That the savings products were used to generate funds for events that produce cohesiveness and a chance for the community to build trust and participate in cultural norms suggests a major social implication of microfinance. The procurement of microfinancial services in this community helped build social capital by empowering women *and* providing a way to save for social events (Ashraf, 2010).

Ngo and Wahhaj (2011) similarly regard microfinance as a way to affect intra-household decision-making and welfare. The authors posit that access to loans can lead to a variety of outcomes for intra-household decision-making and that targeting women is the most effective means to deliver wider social benefits. Ngo and Wahhaj (2011) realize that providing women access to credit strengthens their bargaining position within the household and makes them more likely to spend resources in ways that benefit the entire household. Their main area of interest is patriarchal societies where social norms impose strong restrictions on the type of productive activities a married woman can participate in. The authors’ data provide evidence of two

instances in which a woman is most likely to benefit from microcredit: when there is possibility to invest in a joint activity (group lending) and when a large share of the household budget is devoted to public goods (Ngo & Wahhaj, 2011). When these conditions are met, women are more likely to feel socially empowered in terms of their control over household spending, a factor contributing to an improvement in their self-efficacy.

#### A Focus on Central Asia

As has been established, there is a clear relationship between microfinance organizations lending to groups and a formation of social capital. To narrow the scope of my argument, I seek to determine if social capital stimulated through group loans *anywhere* can translate into political empowerment. While there are many places in the world where a link between microfinance and political empowerment can and should be studied, not much research has been done in an attempt to prove this relationship. Professor Bayulgen has identified Central Asia as a prime laboratory to study this relationship for a number of reasons: it is a region in transition to capitalism with a growing number of poor living under their previous standard of living (some torn by conflict), and many small businesses have turned to microfinance institutions for loans because they lack credit and collateral to borrow from commercial banks. The remainder of this paper will examine research in the literature under a scope attempting to prove that microfinance grows self-efficacy, social capital and ultimately political empowerment in Central Asia.

Wali Mondal (2010) gives a decent overview of the new countries after the breakdown of the USSR in 1991. As opposed to the previous central planning philosophy, these countries chose to create market economies. Because of the dramatic decline of GDP (a drop of more than 40%) there was reduced spending on health, education and other social programs. A massive influx of foreign aid helped these economies recover, and soon after the dissolution of the Soviet

Union all fifteen states started to form regional organizations to foster economic growth. Since the mid-1990s, most of these Central Asian and Transcaucasia countries have adopted microfinance to promote economic growth by offering loans to small and medium-size enterprises. Mondal states that the essence of microcredit is “the absence of physical collateral.” This allows recipients of credit to improve the status of their living through access to additional capital without needing collateral. The following table is useful to help contextualize the beginnings of the microfinance industry in Central Asia, where the majority of countries have a growing number of microfinance intuitions, and they all offer both group and individual loans: (Mondal, 2010)

**Table 2: MFIs in Post-Soviet Central Asian Countries**

Country	Per Capita GDP, 2009, U.S. \$ (cons. prices)	Number of MFI	Average Loan Size U.S. \$	Group (G), Individual (I) Loan	Large Individual Loans
Kazakhstan	8719	13	18,977	G, I	Yes
Kyrgyzstan	2184	16	2,161	G, I	Yes
Tajikistan	2022	11	616	G, I	No
Turkmenistan	5756	N.A.	N.A.	N.A.	N.A.
Uzbekistan	1026	3	1,011	G, I	No

“Microfinance Institution Activities in Central Asia: A Case Study of Tajikistan and Uzbekistan” (2013) discusses the key issues concerning the nature of competition among microfinance institutions (MFIs) in these countries, and compares them with more established MFIs in South Asia. The research identifies how MFIs select their clients, the preferences regarding group lending and the different types of loans. These Central Asian countries have the youngest but most rapidly growing microfinance sectors in the world. After the liberalization of microfinance legislation in Central Asian countries there was a rapid spread of MFIs in the region. Many institutions, such as international financial institutions, NGOs and both private and public financial institutions are now involved with microfinance in Central Asia. In Tajikistan, a low-income country with more than two-thirds of the population living on less than \$2.15 per

day, the microfinance industry was introduced in the mid 90s. At first, it was mainly influenced by international NGOs and their donor's assistance. However, after the liberalization of legislation, many local NGOs were established. Unlike Uzbekistan, the country to which it is compared to in this article, the international organizations in Tajikistan are very involved with local MFIs, and have a higher share of the microfinance industry than in any other Central Asian country. According to Beurkle (2013), microfinance clients in Tajikistan had higher rates of permanent job creation, better access to education, improvement in food consumption and better access to medical and financial services than did non-microfinance clients. This shows the social impacts of microfinance are measurable in Tajikistan (Sabi, 2013).

Contrastingly, in Uzbekistan, the government gives priority to microfinance initiatives through credit unions and is directly involved with the microfinance operations through several micro-lending programs managed through specific funds and commercial banks. The major players in the microfinance market in Uzbekistan are Imon International, FINCA, Huma and Partners. Compared with Tajikistan, microfinance institutions in Uzbekistan are smaller and have fewer officers at all levels. Hardly any MFIs in Uzbekistan have social objectives or offer group loans. Additionally, all of the MFIs require collateral, compared to Tajikistan where only 59% do. In the region as a whole, there is no true group lending like India or Bangladesh, which leads to the assumption that comparing Central Asian countries that do not offer group lending with countries that do might show greater social impacts in the countries that do. Because the practices in Uzbekistan are not in accordance with other MFIs, it may be hard to prove growth in social capital and ultimately political empowerment. In Uzbekistan, the microfinance industry is not geared towards the poor or women. The author concludes that political motives can help explain why non-traditional MFIs are popular in Central Asia: because the government wants to

sustain its authoritarian regime. Sabi suggests that NGOs should finance traditional MFIs that lend to the poor and to women in order for social impacts to occur as a result of MFIs in Central Asia (Sabi, 2013).

“The Origins of Social Capital: Evidence from a survey of post-soviet Central Asia” (2009) asks two related questions: whether networks, norms and trust are empirically related, and the extent to which culture, regime type, perceptions of government responsiveness and development interventions predict levels of social capital. The results of this study show that interaction increases by intervention. In terms of this research, there is evidence that the level of networks, norms and trust could increase because of intervention by microfinance industries. Radnitz (2009) finds that high levels of social capital lead to a better chance for democracy, prosperity and stability. His research tests the link between social capital growth resulting from interventions and the existence of democracy (political implications). The article describes social capital in a way applicable to microfinance: “based on norms of reciprocity and interpersonal trust, it enables the formation of autonomous organizations through social networks that increase the capacity of individuals in these networks to act collectively” (Radnitz, 2009).

Additionally, Radnitz hypothesizes that social capital is put to best use when the state governs to complement activities of informal social groups because high trust and cooperation will strengthen the state in its ability to provide public goods. This is a cyclical process and can be generated through community-driven development programs, such as microfinance institutions and group lending practices. The case study focuses on transition countries of the Soviet Union, specifically Uzbekistan and Kyrgyzstan who face a double burden. Not only are they in a post-soviet era of civil society, they also have exclusive political systems. The study attempts to prove whether outside intervention can help in creating stable democratic institutions

and economic growth. It tests whether these interventions can strengthen civil society and empower people to shape their countries' futures. The results show that recipients of NGOs and international donor aid have a greater tendency to *network* and *trust* than do people in countries that do not receive such aid. In addition, a less repressive state and greater contact with NGOs lead to a significantly higher level of networking. The results of this study prove that social capital can be altered through induced structural change, such as the implementation of group-lending MFIs. Finally, the author concludes that there is a long-term payoff for the international community to invest in strengthening citizen interaction because broad-based interaction is a prerequisite for a strong civil society and thus a healthy democracy (Radnitz, 2009).

This study is the only article I have found that links social capital to successful democracy and political empowerment. All the more relevant, it is a case study of Central Asia. It provides evidence that where international assistance is offered to grow social capital, such as group lending MFIs, those that don't require collateral, and those with similar structures to Grameen or FINCA, social capital will lead to a thriving democracy. Under this framework, we can analyze the MFIs in Central Asia to hypothesize *where* political implications may arise, and under what conditions it would be *more conducive* for them to do so (Radnitz, 2009).

#### Research Methodology

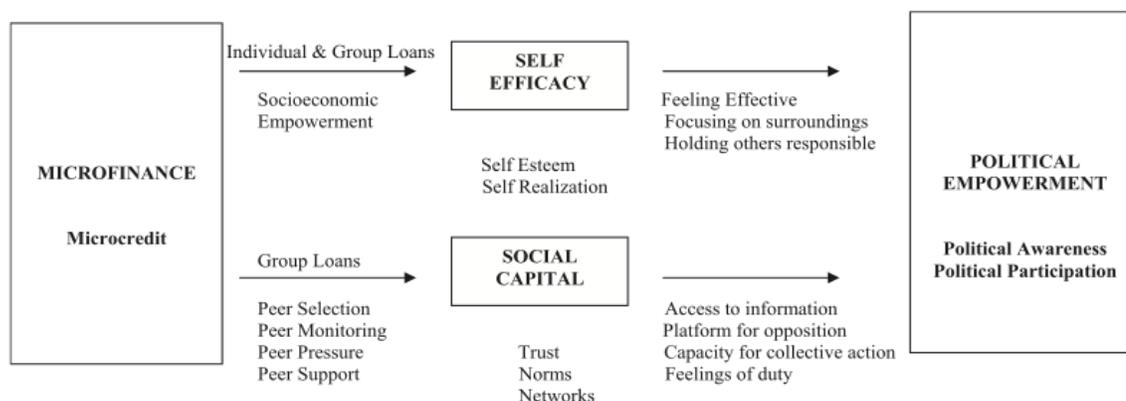


FIG. 2. Effects of microfinance on political empowerment.

The two-part question of this research stems from an article by Professor Bayulgen titled “Muhammad Yunus, Grameen Bank and the Nobel Peace Prize: What Political Science Can Contribute to and Learn From the Study of Microcredit” (2008). The above diagram comes from the article, and is the basis for my argument and hypothesis. The overall question is twofold in that it asks, “Does microfinance grow social capital?” and “Can the social capital established from microfinance lead to the political empowerment of its recipients?” This paper seeks to prove a causal link between financial inclusion, social capital and political empowerment. The posited casual relationship stems from the growing literature concerning the social effects of microfinance institutions. Because microfinance institutions expand the portion of populations included in the financial sector, and bring groups of people into its active participation (Pitt, 2003), social capital and consequently the empowerment of members can be established. To review, this paper has defined social capital according to Robert Putnam as the collective value of all social networks, trusts and norms in a society. In his book entitled “Making Democracy Work,” Putnam (1993) shows that social capital produces civic engagement and can be used as a broad societal measure of communal health. It is often linked to the success of democracy and political involvement as well as economic development (Putnam, 1993). By providing poor

people with credit, microfinance institutions help them to develop self-efficacy and social capital within their communities (Bayulgen, 2008). My argument follows that the development of social capital and self-efficacy is the link between microcredit, political awareness and activism of the poor, hence their political empowerment.

Many empirical papers confirm the empowerment that stems from microfinance institutions, specifically when microcredit is given to group lenders. This group-lending process is the typical Grameen Bank-style microfinance program in which clients meet regularly in groups to make loan payments. By meeting as a group, the members engage in a sort of peer-pressure environment in which defaulting on the loans has repercussions from the entire group (Fouillet, 2013). Studies discussed in the literature portion of this paper have shown that group lending creates a cohesive environment in which trusts and norms, therefore social capital, are established.

In answering the first part of my research question, I have mapped out the causal relationship between the existence of microfinance institutions in developing countries and a growth of self-efficacy within these communities. There are a few case studies that have been most significant to the hypothesis that microfinance institutions establish social empowerment in communities. The first is a study that calls into question the ways to measure women's empowerment that comes from access to credit. Supriya Garikipati (2012) argues that if women have a significant role in the processes of loan use, they are likely to be empowered. These processes include how the loans are used, how the women manage businesses, and loan repayments. Garikipati argues that if measurements are focused on the outcomes for women, such as the way in which they live their lives, contribution to household economy and access to spending money, these measurements are insufficient and can be misleading to the actual

empowerment of women by microcredit. The data in this article describes the processes and outcomes of three hundred ninety-seven women borrowers in India and shows that only around 20% use their loans for businesses and in the majority of cases (80%) loans were diverted into household needs such as production and consumption. She further analyzes that around 62% of eighty-two women who do use loans to start or enhance their own businesses are in full control of their loans. In contrast, 100% of the twenty-seven women who exert no control over their loans see their loans used to meet household needs. Garikipati concludes that microcredit can help women improve their ability to earn money, which leads to greater confidence and the ability to overcome cultural asymmetries ultimately leading to improvements in their self-efficacy, but this can only be measured by an in-depth analysis of the processes involved. If women are not in control of the loans then dependence on their husbands deepens and they are less likely to invest in their own businesses, which prohibits their self-efficacy and ultimate empowerment. This article establishes a framework for conditions sufficient to women's empowerment through microfinance: knowledge of how the loans are used, how the women manage businesses, if that is what the loans are being used for, and loan repayments is necessary (Garikipati, 2012).

As discussed in the literature portion of this paper, there are profound effects of microfinance institutions on the growth of economic and social empowerment and social capital. The remainder of this paper attempts to prove the second part of my research question: a causal relationship between the social capital stemming from microfinance institutions and the political implications this social capital is responsible for, as measured by the political empowerment of lenders. In analyzing the political implications that arise from social capital stemming from microfinance, I take a more theoretical approach due to the minimal data that exists regarding

social effects of microfinance that can actually be considered political empowerment. The theory that will explain the concluding portion of my paper is derived from the following logic: Microfinance, through individual and group loans, contributes to self-efficacy and social capital that develop feelings of effectiveness and responsibility in its lenders, as well as provides them with access to information, capacity for collective action and feelings of duty ultimately leading to their political awareness and participation (Bayulgen, 2008).

#### Relevant Experiments and Data

Pitt & Khandker (2003) use a quasi-experimental survey design to estimate the impact of participation in microfinance institutions on labor supply, schooling, household expenditure and assets. For the purpose of this research, these household behaviors fall within the realm of increasing self-efficacy, as increased socioeconomic status plays a key role in the belief in one's own efforts to control desired outcomes (Bayulgen, 2008). The authors find that program credit participation, measured by the quantity of cumulative borrowing, has a robust effect on these behaviors in households and a larger effect when women are the primary participants. The authors note that group based lending is good for women because, absent such loans, it is hard for them to generate enough capital to begin self-employment. They also state the benefits of group lending: members can monitor, train and assist each other with ease and at a lower cost than if the lender had to do so. Through their continued contact and group meetings, the members are able to observe each other to make sure everyone is involved in group decisions to assist members who are at risk of default.

Perhaps most significant in this article is a discussion of empowerment factors of women who are given credit. The authors find in their results that female credit had a positive and highly significant effect on the factor encompassing all the questions in their survey, which

represents an *improvement in a general level of empowerment*. Not only does this include the empowerment factor describing women's autonomy with purchasing, it also includes factors such as the woman's access to and control over economic resources and her own personal finances, and her power to conduct major household economic transactions. The study also found a significant correlation between female credit and both mobility and ability to network with other members of society. This shows a causal relationship between access to microfinance services and social capital because, through networks such as the group loan, trust was built and social capital formed in the community. Most importantly to the second part of my research question, this article provides evidence that female credit positively affects the factor relating to women's awareness and activism in a political sense. The authors measured political empowerment in this survey by asking whether or not the woman was informed of a pre-marital bridal contract that can help her in case of divorce. They found that *female credit positively influenced the answer to this question*. They also found that female credit positively affects the probability that a woman knows the name of the Member of Parliament in her area, the probability that she voted in the last election, and the probability that she voted independently from her husband. These measures are extremely valuable to this paper because it is one of the only surveys I have found that shows a *link between credit and political empowerment* (Pitt, 2003). The study is unique to this research in that it provides statistically significant data showing a causal relationship between microfinance and increased political awareness, access to information and social empowerment. Further research of this sort would be extremely useful in proving a causal relationship between the political empowerment and microfinance.

Another source of important quantitative data comes from an analysis of The Grameen Bank. The Grameen Bank makes loans to very poor people in rural areas who already have the

skills, but need the small amount of capital required to operate a viable, productive enterprise. The bank has been very successful in providing financial outreach to impoverished people and is thus a model organization for many other microfinance institutions. According to Lisa Larance, in her case study on the social impacts of Grameen clients, borrowers were more *empowered* to structure their lives and cooperate with other members of their community (Larance, 1998). The Grameen borrowers have also established a set of norms that denote their commitment to hard work, education, higher incomes, and to take part in all social activities collectively. By being a part of the bank, the borrowers exhibit feelings of trust and share norms in order to cooperate efficiently and effectively. These social impacts are the social capital established by the Grameen Bank.

Most importantly to this research, the trust and social networks created among members by the Grameen Bank have been utilized as *instruments for political action*. In 1991, the Grameen borrowers embraced the idea of exercising their democratic rights in the national election. Muhammad Yunus himself reported, “The members of many centers...were voting as a block,” “local politicians addressed Grameen center meetings,” and “four hundred Grameen borrowers were elected to union councils.” In 1997, over 1,750 borrowers were elected to local offices and in some cases as chiefs of local bodies. According to Yunus, these results proved that as the borrowers improved their self-esteem they were *ready and willing to express their opinions* (Yunus, 2003). These results of the Grameen Bank in stimulating the political action of its borrowers were the foundation for this research. As the bank has served as a model for other microfinance institutions, perhaps the same social networks and trust created by the bank that are used as instruments for political action can be found elsewhere, in microfinance institutions around the world.

### Outside of Bangladesh: Microfinance Around the World

On a global development scale, most countries have begun to recognize the necessity of financial inclusion of the poor in order to stimulate economic growth. This section will provide information about microfinance around the world, and the major countries and organizations that have facilitated the spread of microfinance institutions in their efforts to financially include the poor. The “Group of 20” (G20) countries represent around 85% of global gross domestic product, over 75% of global trade, and two-thirds of the world’s population (Advancing Financial Inclusion to Improve the Lives of the Poor, 2013). In 2009, the leaders of these countries put financial inclusion on their development agenda, realizing the need to refocus development initiatives on more comprehensive financial needs of clients, consumer protection and responsible finance. The leaders of Australia, Brazil, Canada, China, France, Germany, India, The US and the European Union, to name a few, have increasingly recognized and accepted the broader notion of financial inclusion as being key to a stable economic system. The significance of the G20 leaders vowing to combat financial exclusion is that emerging countries, such as China, India and Brazil will have a stronger voice in how the global economy is and should be run by participating in this group. The White House Fact Sheet from 2009 also recognized the need for financial inclusion, noting that the G20 countries are “the countries needed to build a stronger, more balanced global economy, [to] reform the financial system and lives of the poorest” (Advancing Financial Inclusion to Improve the Lives of the Poor, 2013).

The Consultative Group to Assist the Poor (CGAP) is a global partnership of thirty-four organizations that seek to promote financial inclusion. Housed at the World Bank, its members include bilateral and multilateral development agencies, regional development banks, private foundations and international financial institutions. Additionally, CGAP is the *microfinance*

*center for Central and Eastern Europe*. CGAP has helped improve the understanding by policy leaders that “more equitable access to finance is inextricably linked to both *economic and political stability*. Its work has focused on improving internal financial systems and promoting standards for responsible microfinance funding across countries. For the purpose of this research, it is important to note organizations like CGAP, founded on a mission of financial inclusion, because these groups realize “an inclusive financial system that reaches all its citizens is important for economic and social progress.” (Advancing Financial Inclusion to Improve the Lives of the Poor, 2013) Such organizations are conducting extremely helpful work to provide outlets for the financial inclusion of the poor. Furthermore, organizations, like CGAP, which recognize the social benefits of microfinance, provide more effective outlets for the growth of social capital and consequent political empowerment of members.

#### Spotlight on Eastern Europe and Central Asia

Because the raw data in this paper was collected in microfinance organizations in Kazakhstan and Azerbaijan, it is useful to provide a brief discussion of the current microfinance market in Eastern Europe and Central Asia. The Microfinance Information Exchange (MIX) Market is a nonprofit organization that acts as a business information provider to the microfinance sector. MIX collects a variety of data on different microfinance institutions in regions around the world. According to the MIX Market survey of the microfinance sector in Eastern Europe and Central Asia<sup>1</sup> (ECA) the population of people living below the national poverty line is almost 20% (2011). 43% of people living in ECA live in rural areas. The gross national income per capita is \$7,328, much less than the level in the United States, which is \$52,340. In 2010 there were 8,358 microfinance providers in the region lending to 8.3 million

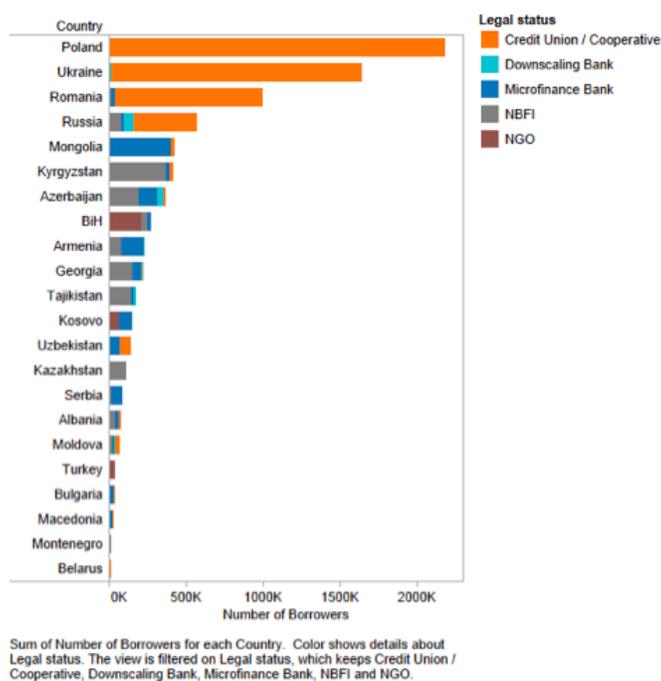
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<sup>1</sup> The countries in this category are: Poland, Ukraine, Romania, Russia, Mongolia, Kyrgyzstan, Azerbaijan, Bosnia, Herzegovina, Armenia, Georgia, Tajikistan, Kosovo, Uzbekistan, Kazakhstan, Serbia, Albania, Moldova, Turkey, Bulgaria, Macedonia, Montenegro and Belarus.

borrowers. To more specifically describe the landscape of microfinance providers in ECA, there are 6,190 credit unions, which are large credit cooperatives that make loans to individuals. There are 2,075 non-bank financial intermediaries, which are smaller institutions more present in *Kazakhstan*, *Kyrgyzstan*, *Russia* and *Tajikistan*. While most microfinance institutions are regulated non-bank financial intermediaries, some non-governmental organizations also provide microfinancial services. In ECA, there are twenty-five NGOs of this type. The European Bank for Reconstruction and Development supports 26 commercial banks with a micro and small business product line in the region, with its largest markets in *Azerbaijan* and *Russia*. Finally, there are twenty-two microfinance banks, which specifically provide only microfinancial services. Most of these banks are part of a large holding network or were formerly state-owned (2011 Eastern Europe and Central Asia Regional Snapshot, 2011).

The largest specialized non-bank financial intermediary sectors exist in *Azerbaijan* and *Kyrgyzstan* because of specialized microfinance legislation in those countries as well as the availability of cross-border funding. These social initiatives have provided resources and opportunities for the growth of the microfinance sector in ECA. The graph below shows the legal status of microcredit services throughout the region. It is obvious that the countries with the most lenders are those in which credit unions/cooperative movements help to provide microfinancial services. In *Kazakhstan* and *Azerbaijan*, the main sources of microcredit services come from non-bank financial intermediaries. Non-bank financial intermediaries are useful because they compete with banks and force them to be more efficient in delivery of services. They are actively involved in allocating long-term financial resources, like securities and, obviously, microcredit (2011 Eastern Europe and Central Asia Regional Snapshot, 2011).

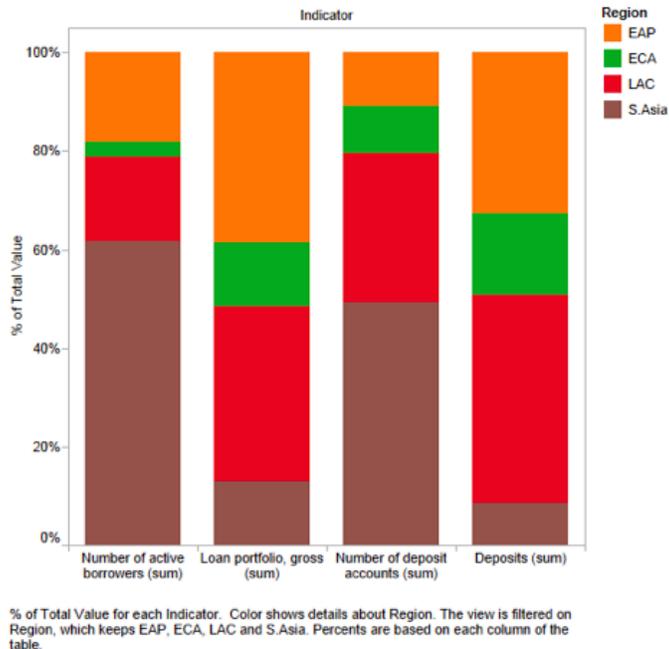
Figure 1



Source: 2011 Eastern Europe and Central Asia Regional Snapshot

The following graph situates ECA in a global context among East Asia and the Pacific (EAP), Latin America and the Caribbean (LAC) and South Asia. Microfinance institutions in ECA capture less than 3% of worldwide borrowers but have the highest average loan balances in the world. They rank second only to EAP across the chart, in number of active borrowers, gross loan portfolio, number of deposit accounts and total deposits (2011 Eastern Europe and Central Asia Regional Snapshot, 2011).

Figure 2



Source: 2011 Eastern Europe and Central Asia Regional Snapshot

As previous empirical research discussed in this paper has suggested, a major social impact of microfinance is its outreach to female clients. Many studies have proven the effect of microlending on increased female empowerment in both households and overall society. By regional comparison, MIX market found that ECA microfinance clients receive *the lowest outreach to female clients in the world*, falling short to South Asia, LAC, Africa, EAP, and The Middle East & North Africa (MENA). Only 46% of borrowers are women, which exposes the microfinance sector in ECA for not having the social initiative to lend with greater frequency to women, thus stimulating and developing their empowerment. ECA falls almost 40% below the level of outreach to women in South Asia, who lends 83% of their microcredit loans to women.

Another major social initiative of microfinance institutions is to financially include rural citizens who are at a greater demand and shorter supply of capital. ECA falls short to EAP, South Asia and Africa in terms of the percentage of rural borrowers. By lending to rural

borrowers, lenders can help lift those in rural areas out of poverty by providing them with the resources they need to run a viable business from their homelands. In EAP, 82% of microcredit loans are made to rural borrowers. South Asia ranks number two, lending 73% of its loans to those in rural areas. ECA only lends just more than half (58%) of its loans to rural borrowers, which doesn't prove a strong preference for the financial inclusion of rural borrowers. Despite the large amount of cross-border donors and investors (ECA ranks second only to South Asia), according to MIX, the microfinance sector in the region is not as social objectively oriented as other regions in the world. In 2010, donations to the microfinance sector in ECA decreased for the first time in the last four years. Perhaps donor contributions would remain at high levels if reform to the microfinance industry in ECA refocused loans to have social objectives (2011 Eastern Europe and Central Asia Regional Snapshot, 2011).

With donor and cross-border funding on the decline, financial regulator authorities such as central banks regulate most microfinance markets in ECA. These banks are scaling up by increasing their loan portfolios at a higher rate than the number of borrowers. Again, without social objectives being at the forefront of the microfinance industry, the industry is continuing to operate solely as a business and not as an effective source of economic development. Outreach to rural borrowers and the targeting of women should be the specific goals of these organizations, but instead ECA banks are relying heavily on deposits, equity investments and mostly, government funding, which is on the rise for banks in Armenia, Tajikistan and Uzbekistan. Specifically in Azerbaijan, seventeen non-bank financial intermediaries continued their consistent growth into 2011, but twelve of these banks' *outreach* in terms of microloans decreased. It seems Azerbaijan is following the overall trend in ECA to scale up their loan portfolios without reaching out to additional borrowers. Some areas of Azerbaijan are more

saturated than others by microfinance institutions, causing overcrowding and excess supply in regions where there is little demand (Advancing Financial Inclusion to Improve the Lives of the Poor, 2013).

According to CGAP's analysis of the microfinance sector in ECA in 2011, it was not a particularly easy year. Many microfinance institutions did manage to overcome the global economic crisis, but most have yet to return to their pre-crisis rates of growth. A common issue throughout the region is client over-indebtedness in the most saturated markets, like Azerbaijan, Herzegovina, Kyrgyzstan and Bosnia. CGAP also notes some issues that should be held in highest regard for the ECA microfinance sector. These issues include the growing divide between socially oriented microfinance institutions and consumer lenders, which has only become starker from 2010-2011. In addition, CGAP urges policy makers to seek preventive measures to over-indebtedness and more transparent loan cost disclosure to lenders. These reforms will make for a more efficient market, as over-indebtedness has become a major issue for many financial institutions in ECA. Most significant to this research, CGAP recognizes the need for the ECA microfinance sector to *include social performance indicators in their assessments of institutions*. This is important because there are not many institutions in ECA that take note of the social objectives of microfinance. Rather than simply distributing loans, these banks, NGOs and non-bank financial intermediaries need to stress improvement in social performance that can come from financial inclusion. At the policy level, the microfinance sector is becoming more and more integrated into the mainstream financial sector which is good for transparency, but if social performance isn't stressed to banks and borrowers, the social impacts of microfinance, which we have seen can be great, will fail to reach their full potential (Tomilova, 2012).

Another CGAP publication discusses the need to “sharpen definitions” between commercial, high-interest consumer finance and traditional *social purpose microlending* in the region. Microfinance first emerged in ECA, as it did elsewhere in the world, as a socially oriented development tool aimed particularly at helping vulnerable, low-income segments of the population transition to a market economy. As microfinance has grown to be recognized as an important part of many ECA countries’ financial systems because it is sustainable and profitable, there has been a lack in the commitment to the social benefits of lending to borrowers. What can be done to improve the social effects and thus the predicted political implications of microlending in the region (Tomilova, 2013)?

#### A Refocus on Social Objectives in ECA’s Microfinance Industry

The Smart Campaign is a global organization that has recognized the divide between commercial consumer finance and social purpose lending in the microfinance industry. This campaign is an international effort to unite microfinance leaders around a common goal: to keep clients as the driving force of the industry. By recognizing that protecting clients is the most successful and beneficial way to provide the poor with financial services, The Smart Campaign has launched a worldwide movement to provide microfinance institutions with principles that see the client as their primary focus. These principles help the microfinance industry to remain socially focused and financially sound by working with leaders to develop tools necessary to deliver transparent, respectful and prudent financial services to all clients. In Azerbaijan, there are twenty-eight total endorsers of The Smart Campaign. Microfinance organizations, such as AccessBank-Azerbaijan, Omni Finance and *FINCA-Azerbaijan*, are certified members of the campaign and make strides to become more socially oriented and client driven every day. In Kazakhstan, there are six total endorsers, including *KazMicroFinance*, Express Finance Group

and the Asian Credit Fund. Endorsers of the Smart Campaign implement practices that prevent client over-indebtedness, increase transparency of loan prices, terms and conditions, and create an environment in which clients are treated fairly and with respect. By refocusing the efforts of the microfinance industry to be more socially beneficial, The Smart Campaign “keeps clients first” and rewards organizations that are distributing financial services “the smart way.”

(Campaign Mission and Goals, 2014)

#### FINCA-Azerbaijan, Data, and Results

Both of the microfinance institutions from which data for this research was collected are endorsers of the Smart Campaign. This is important because they are institutions that have promised to be socially oriented, and are thus data from which social and political implications can hopefully be found. FINCA-Azerbaijan is an affiliate of FINCA International, which is a network of microfinance institutions headquartered in Washington D.C. FINCA stands for the Foundation for International Community Assistance and the organization has twenty-two affiliates operating in countries around the world. FINCA-Azerbaijan has been operating for fifteen years and has more than sixty-five branches throughout the country. It is the largest microfinance institution in Azerbaijan and among the top banks in the country. Their mission is not only to provide financial services but also to provide them in ways that help low-income people *build assets* and *improve their standard of living*. First founded with support from the United States Agency for International Development, FINCA-Azerbaijan now provides financial services to more than 150,000 clients and is the largest non-bank credit organization in the country. Its most utilized products are the rural loan product, solidarity credit group loan, individual rural loan and agricultural loan. These loans target entrepreneurs involved in trade, services, production or agricultural activities in rural territories. Following the Smart

Campaign's initiative for social development, FINCA-Azerbaijan has been making more loans to rural borrowers and encouraging group loans to entrepreneurs. According to these preliminary findings about the organization, I would expect the raw data from the FINCA-Azerbaijan borrowers to show increased social trust and capital among them, and more democratic political implications. (Mission, 2014)

An article titled "Happiness for Children from FINCA-Azerbaijan" shows the extent of social outreach by the organization. The microfinance institution has organized festivities throughout the country that more than two thousand children have attended. This shows the organization's commitment to community involvement and is an example of social cohesion created and encouraged by FINCA-Azerbaijan. The organization is also involved in various charity and entertainment activities throughout the year, and events that support children and adolescents on International Children's Day (Happiness for Children, 2013). FINCA-Azerbaijan is clearly invested in the overall community, outside of simply providing financial services to its members (Mission, 2014). Because of the social initiatives of the organization, I would expect the borrowers to exhibit high levels of *networks, norms and trust* (social capital) and increased *involvement and participation in the political environment* (political implications).

In Professor Bayulgen's survey, she administered thirty-six questions to fifty borrowers from FINCA-Azerbaijan and fifty borrowers from KazMicroFinance in 2010. Below I analyze the most significant responses to her questions and the full survey is attached to the end of this paper. Among the fifty FINCA-Azerbaijan borrowers, there are twenty-six women borrowers and twenty-four men. Twenty of the fifty borrowers participate in group lending and thirty borrow individual size loans. Twenty-seven borrowers live in cities and twenty-three live in rural areas. This distribution is pretty equal in terms of gender, group versus individual borrowers and

urban and rural borrowers. When asked, “Since you joined the program, do you feel like your control over your finances has improved, deteriorated or stayed the same?” forty-seven out of fifty borrowers (94%) reported that control over their finances has improved. This is significant for the first part of my research question, that microfinance acts as an outlet for socioeconomic empowerment, which leads to self-efficacy. The more control the borrowers feel they have over their personal finances, the more improved is their self-esteem. Only one out of fifty borrowers reported that control of their financial situation deteriorated, and two reported no difference.

A similar question asked more broadly, “Since you joined the program do you think your control over decisions that affect your every day activities has increased, decreased or stayed the same?” yields comparable results. 70% of FINCA-Azerbaijan borrowers reported increased control in their everyday decisions, while the remaining 30% reported no change. Another question concerning socioeconomic empowerment was, “Since you joined the program, do you feel like you and your family’s opportunities for better education, health care and public services have improved, deteriorated or stayed the same?” Education, health care and public services are important socioeconomic indicators that enhance a person’s self esteem and self-realization, as well as give people more opportunities to become valuable members of society. As discussed previously in this research, a major social implication of microfinance is the ability to improve the socioeconomic status of borrowers. A significant 80% of FINCA-Azerbaijan borrowers reported that their opportunities have improved since joining the program. 12% reported deterioration and 8% reported no change in opportunities.

The next set of questions was asked specifically of the twenty group loan recipients. Despite the 55% who reported that they trusted their group members just a little or not at all before the microcredit program, after joining the program 95% of group borrowers (nineteen out

of twenty) trust the members of their group today. Trust is a major social capital indicator in a community, and the fact that these borrowers have established more trust among each other shows that being a part of the microfinance institution and engaging in group lending created social capital among them. The trust, norms and networks encouraged by FINCA-Azerbaijan positively impacted the level of trust among the group borrowers. This helps to establish the first part of my research question, that microfinance can in fact be responsible for increased levels of social capital among group borrowers.

Another question is more concerned with the networks established by the microcredit program in Azerbaijan. Bayulgen asked the twenty group borrowers, “How often do you see the members of your group?” Seventeen out of twenty reported they see each other every day, two reported every week and only one stated that they see their members “once in a while.” In terms of establishing networks, these group members realize that in order to be successful in repaying back the loans, they must communicate on a regular basis and share norms so they remain a low risk for default. In this sense, FINCA-Azerbaijan has helped create *networks of repeated interaction* among the group borrowers, further increasing their level of social capital. As established in the article by Radnitz (2009), it is seen again how social capital can be altered through structural change, in this case the implementation of group-lending MFIs. In Azerbaijan as in Radnitz’s study of Central Asia as a whole, interaction increased by intervention. This interaction was fundamental for the enhancement of social capital in the communities.

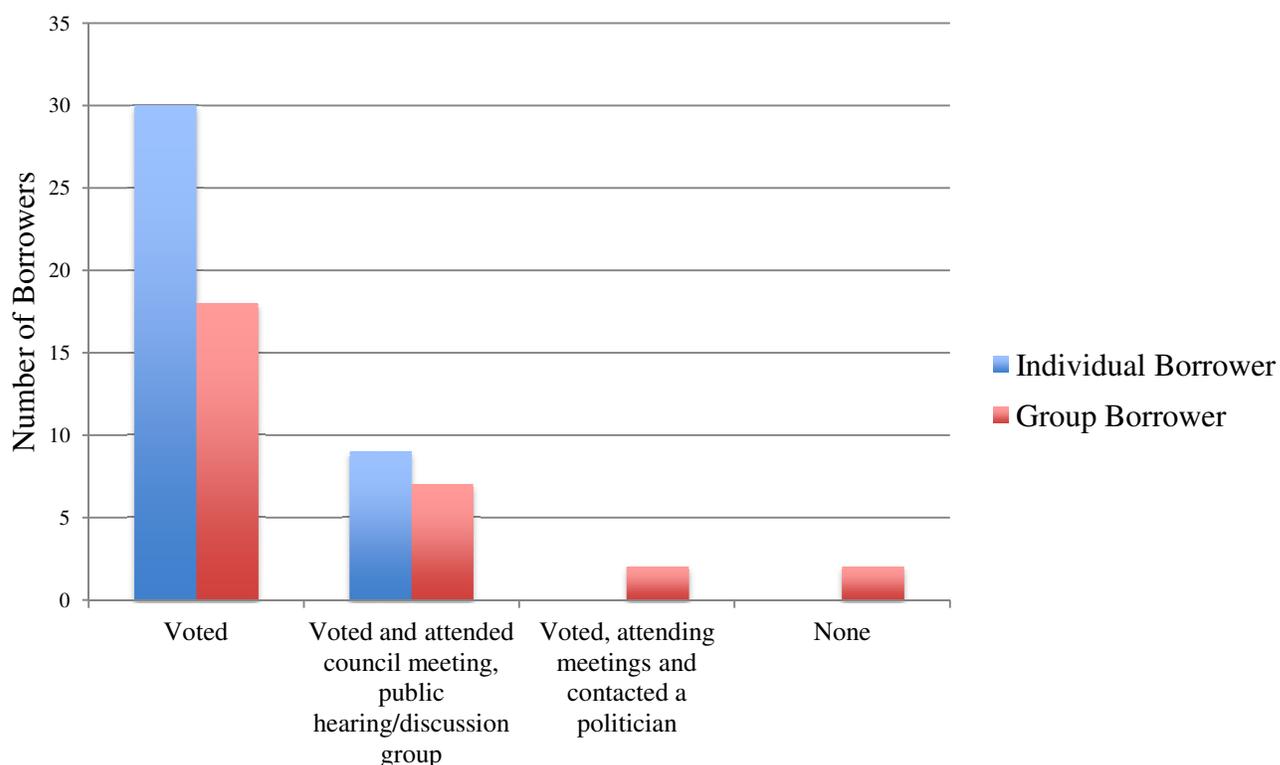
More analysis of the networks and trust among the group borrowers is found in the question that asks, “How often in the group do you help each other with small tasks, such as repair work, grocery shopping, child caring, etc.?” 55% of borrowers reported that they help each other very often, 40% stated they sometimes help each other and only 5% (one responder)

reported that they rarely help their fellow members. Additionally, when asked “Would you easily ask a group member for financial, physical or psychological help if you needed it?” 95% answered yes, and only one member reported that they would rarely do so. Again, FINCA-Azerbaijan can be seen as responsible for the networks and trust among its members, as most of these members trusted each other very loosely or not at all before participating in the program, and now a majority of them would look to their members in times of need.

I now move on to the political implications in the data. Referring back to the diagram that explains my hypothesis, the increased self-efficacy and social capital stemming from microfinance should lead to feelings of effectiveness and access to information, as well as a platform for opposition and feelings of duty which will ultimately lead to political empowerment in terms of awareness and participation (Bayulgen, 2008). Bayulgen specifically asks *all fifty* of the members, “Since you joined the program, have you worked with others in your village/neighborhood to do something for the benefit of the community.” Forty-two out of fifty (84%) FINCA-Azerbaijan borrowers reported yes, that they have benefitted the community by working in orphanages and helping the poor, to name some examples. This shows that since joining the program members feel more effective and focused on their surroundings. This is just the sort of self-efficacy I hoped to find to support the conclusion of my hypothesis. Somewhat less significant, however, when asked, “Since you joined the loan program, have you ever contacted a government official about some need or problem concerning the community as a whole?” only twelve out of the fifty borrowers reported that they had. Perhaps the thirty-eight who have not felt any need to contact an official had no problem to report. It would have been more conclusive to our data if the borrowers did show more of an inclination to hold their officials accountable for community problems.

Despite the lack of robustness in responses to the previous question, there do seem to exist other political implications in the borrowers stemming from involvement in FINCA-Azerbaijan. Bayulgen asked, “Since you joined the loan program, have you done any of the following: voted regularly in elections, attended a village or neighborhood council meeting, public hearing or public discussion group, met with a politician, called him or sent a letter, participated in a protest or demonstration, alerted a newspaper, radio or TV to a local problem or notified a police or court about a local problem.” Below is a graphical presentation of the responses of the FINCA-Azerbaijan borrowers to this question, separated into individual and group borrower categories.

Figure 3: Political Implications FINCA-Azerbaijan



An impressive 96% of all borrowers have voted regularly in elections, although we cannot be sure whether or not these voters voted before they joined the microfinance program.

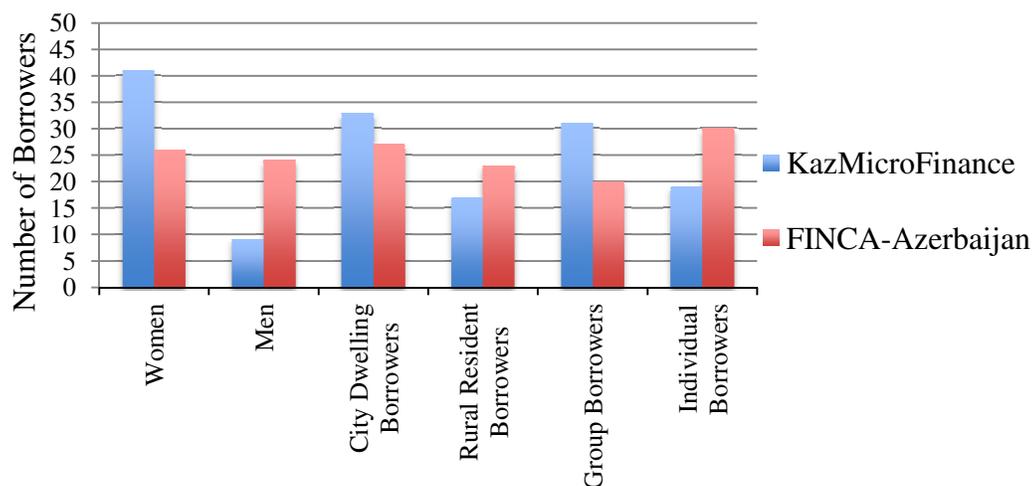
The two borrowers that voted, attended meetings *and* met with a politician were group borrowers. This speaks to our hypothesis that through *group lending*, feelings of trust, norms and networks establish social capital that leads to access to information, a capacity for collective action and feelings of duty that politically empower borrowers. Contrastingly, the two members who did not engage in any “politically empowering” behaviors were also group borrowers. One of the final questions asked by Bayulgen might help to explain this discrepancy in the results. When asked, “For your business, do you care at all who gets elected to local and national government offices?” the majority of borrowers, 62%, reported no. Only 38% of FINCA-Azerbaijan borrowers feel that elected officials of their local and national government offices have any impact on their business practices. Conceivably, if more borrowers felt an importance regarding elected officials, they would be more involved in the political process in more ways than voting. Overall, we can see from the FINCA-Azerbaijan data that both individual and group borrowers trust more and have established greater networks more so than they did before they joined the program. Additionally, the majority of borrowers are inclined to vote and be a part of the political process, although we cannot conclude that this was a result of their joining the program. I believe that the social-objective nature of FINCA-Azerbaijan’s lending practices is responsible for the improvement of the social capital, self-efficacy and political implications of its borrowers.

#### KazMicroFinance, Data and Results

KazMicroFinance (formerly Kazakhstan Loan Fund) was established in Kazakhstan in 1996 when the United States Agency for International Development (USAID) decided to fund an NGO to implement microlending in the country. Since then, KazMicroFinance (KMF) has reached a loan portfolio of 12 billion tenge, the equivalent of almost \$66 million

(KazMicroFinance, 2014). KMF has branches in fourteen major cities, ten regions and sixty districts of Kazakhstan. The organization has issued 559,721 loans, with more than 80% of these funds used to finance business development. The core values of KMF include its personnel, corporate culture, team environment and *social responsibility*. Its mission is to encourage *welfare growth* of its clients by “providing access to quality microfinance services, including those in rural areas, developing a culture of microfinance services and benefitting society while making a profit” (KazMicroFinance, 2014). KMF was recognized in 2010, in collaboration with The Smart Campaign, by an Excellence Award for lending to borrowers on principles of avoidance of over-indebtedness and ethical staff behavior. It was also recognized by the USAID for its effective governance and leadership in expanding access to financial services for micro-entrepreneurs. As a member of The Smart Campaign and a beneficiary of NGO support, it follows that KMF would lend on Grameen Bank-style principles. According to the KazMicroFinance website, the organization lends a majority of its loans to rural residents and women, 61% and 70% respectively. These important lending practices are the founding principles of the Grameen Bank and what the pioneer bank attributes its success to. As we have seen in case studies in the Philippines and Bangladesh, social impacts and promises to expand financial inclusion to the poorest and most vulnerable of society (the rural population and women) provide for a more conducive environment for social capital and self-efficacy growth. Additionally, KMF recognizes the importance of group-lending, loaning 71% of its funds to groups of borrowers with a fixed peer lending share of 60% at all times. From this initial look at KMF, it seems to be a more Grameen Bank-style organization than FINCA-Azerbaijan, and my original hypothesis was that we would see greater trust, networks and political implications here than saw in the analysis of FINCA-Azerbaijan.

Figure 4: Demographics: KMF vs. FINCA-Azerbaijan



Above is a graph comparing the demographics of KazMicroFinance and FINCA-Azerbaijan. As you can see, KMF has more women and group borrowers than FINCA-Azerbaijan, which presents KMF as a more socially oriented Grameen Bank-style organization. This selection of KMF members, however, does have more city dwelling borrowers than the FINCA organization. Similarly to the survey respondents from FINCA-Azerbaijan, the borrowers from KazMicroFinance feel that since joining the program, control over their finances has improved. 94% of respondents reported improvement in their financial control, and 6% reported no change. Fewer KMF respondents saw an improvement in their opportunities for better education, health care and public services, only 72% compared with FINCA-Azerbaijan's 80% of borrowers. 14% of KMF borrowers saw deterioration in these opportunities, and 14% reported no change. Compared to FINCA-Azerbaijan borrowers, KMF borrowers reported more increased control over decisions that affect everyday activities. 84% reported an improvement in this aspect of their lives, as opposed to only 70% of FINCA-Azerbaijan borrowers.

It is hard to come to conclusions about the level of trust among KMF borrowers because thirty out of thirty-one group borrowers already trusted each other before joining the program.

Correspondingly, thirty out of thirty-one group borrowers still trusted each other at the time of the survey. The results do show, however, that like FINCA-Azerbaijan the group borrowers see each other very frequently. Twenty-eight group borrowers report seeing each other everyday. In terms of group trust and cohesiveness, the borrowers from KMF seem less inclined to do so and act as such than the borrowers from FINCA. Sixteen of the thirty-one group borrowers reported that they never or rarely help each other with small tasks, though 90% report that they would ask a member for help if they needed it. An almost even split in the data arises from the question, “Since you joined the program, have you worked with others in your village to do something for the benefit of the community?” 54% of KMF borrowers say yes they have helped to repair roofs, plant trees, lend money, volunteered at orphanages, donated to flood victims, and helped arrange funerals. 46% of borrowers report that they have not engaged in work that benefits the community. A higher percentage of KMF borrowers report having no contact with a government official about a need or problem; only three of the borrowers in Kazakhstan have ever reached out to a politician for help in their communities. Despite this low level of outreach, more KMF borrowers care who gets elected, for business purposes. 62% of KMF borrowers reported that they do care, compared with the mere 38% of FINCA-Azerbaijan borrowers who cared. The comparison of responses between the two organizations is shown below.

Figure 5: Survey Responses

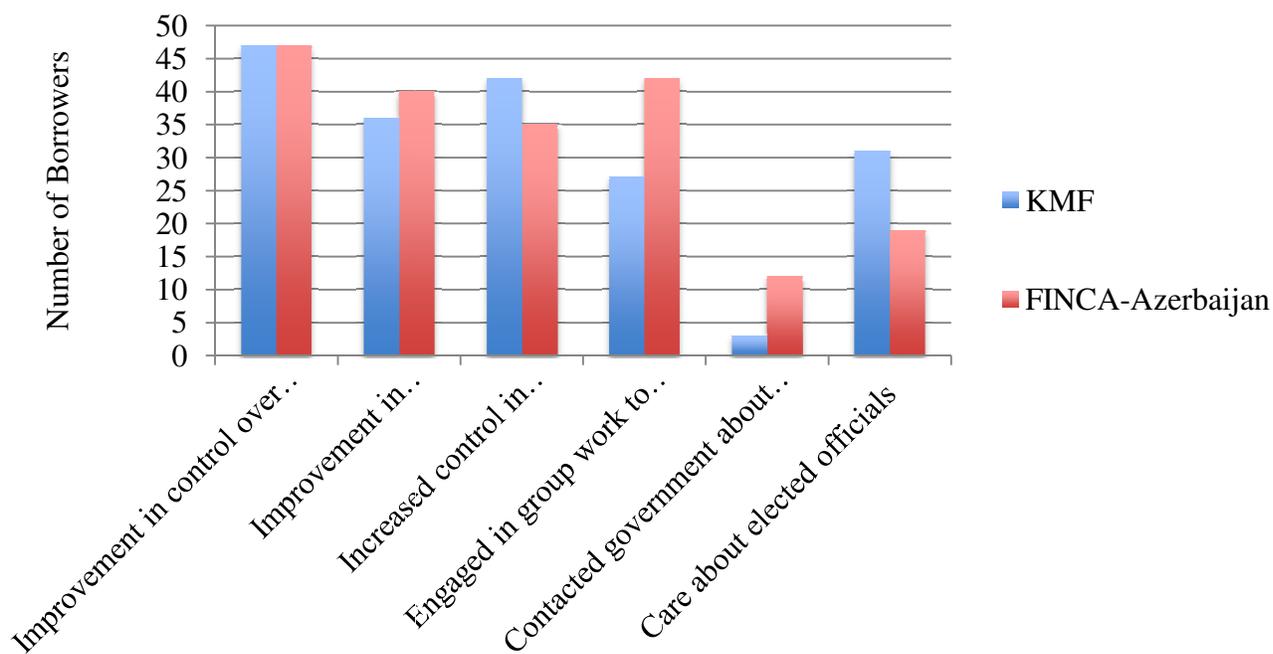
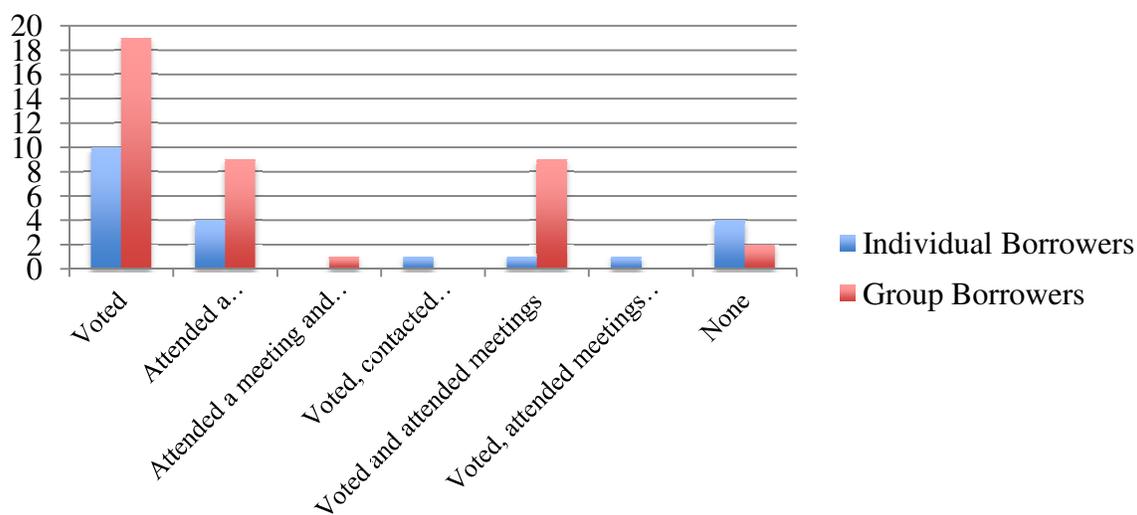


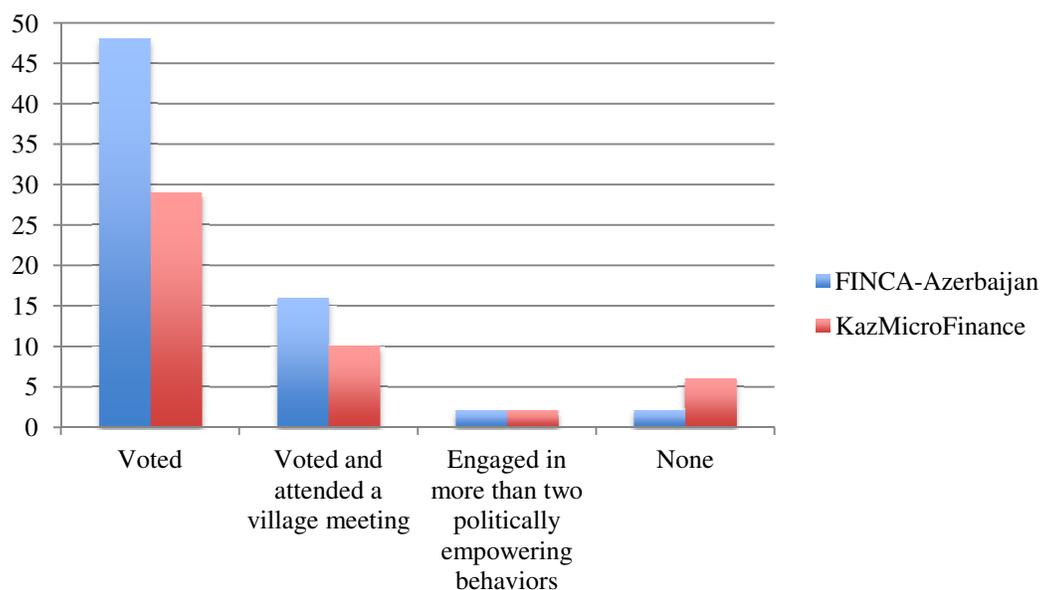
Figure 6: Political Implications: KazMicroFinance



Above is a graphical representation of the political implications derived from Bayulgen's survey data of KazMicroFinance. This graph parallels the first graph in this discussion section,

concerning the political implications of FINCA-Azerbaijan. What we see here is that more group borrowers voted, attended a village or neighborhood meeting, contacted a politician or engaged in a combination of these politically empowering behaviors than did individual borrowers. It is important to note that a much lower percentage of KMF borrowers in total have voted regularly, only 58% compared with 96% of FINCA-Azerbaijan borrowers. Similarly, a lower percentage of KMF borrowers have engaged in community-benefitting involvement, only twenty-seven of the fifty members had ever done so. We cannot conclude, as we did from the FINCA-Azerbaijan data, that being a borrower has any effect on community involvement in this sense. As this was our main indicator of trust and norms, we do not see a robust result of KMF enhancing the social capital levels of the community. Fewer KMF borrowers have been in contact with a government official than FINCA borrowers: only three out of fifty had ever done so. While it is true that more group borrowers engage in politically empowering behaviors more than individual borrowers, KMF falls short across the board in every measureable political implication of this survey, with the exception of engaging in more than two politically empowering behaviors (they tie at 2 borrowers each). Below is a graph comparing the political implications from KMF borrowers to FINCA borrowers.

Figure 7: Political Implications: KMF vs. FINCA



#### Some Caveats

While the questions in this survey were aimed to show the political implications that arise from lending microcredit to borrowers, the results of the data are limited in scope. If more time and resources were available, it would have been extremely useful for this research to be conducted on a much larger scale and compared to a control group of community members *not involved in microlending*. It is hard to prove a causal relationship between microfinance, social capital and ultimately political empowerment among so few members borrowing in such different countries. Despite this, I believe that the nature of the questions does a good job in providing us with a before and after picture. The way in which the questions were asked, “Since joining the program...” helps conceptualize the impact, if any, that participating in the microcredit programs had on its borrowers. It can be seen more so in the data collected from FINCA-Azerbaijan members that these borrowers trusted each other more and participated in community beneficial activities after joining the program more often than did the KMF members. Although there were more KMF group borrowers (thirty-one to FINCA’s twenty)

there was less community involvement, networks and thus measureable social capital in the community. More research might prove these results wrong and must be conducted to empirically test and verify the hypothetical links discussed in this paper. If more studies were done like Dean Karlan's at Yale, with comparison groups and factors controlling for externalities, we could better show causality between the factors and not be limited to simple statistics of survey responses. At first, it seemed a comparison between individual and group borrowers might be successful to indicate the contribution of social capital by the MFIs. However, from our results it seems that individual borrowers also see higher levels of improved self-efficacy from program involvement, leading to political empowerment.

#### To Conclude...

The research presented in this paper attempted to prove a causal relationship between microfinance, social capital and political empowerment. Upon preliminary research of this topic, it was apparent that the data concerning my hypothesis was scarce. The first source of data, the Grameen Bank members voting as a block and expressing their political opinions served as a model, which I sought to find elsewhere in the world. Additionally, Radnitz's study on recipients of aid having a greater tendency to network and trust than those who don't receive aid pushed further the notion that microfinance, as a form of development assistance, could be successful in creating social capital with democratic implications. If allotted more time and resources, I feel a more conclusive data collection could be extracted from the microfinance community.

Empirical studies measuring the relationship between microfinance and political empowerment should be of interest to the international community because of the long-term payoff that exists between a strong civil society and healthy democracy. If the link between

microfinance, social capital and political implications were established, organizations that seek to promote democracy on a global scale would realize that financial inclusion is important for economic and social progress and be inclined refocus their efforts on social purpose microlending. Additionally, organizations already involved in microlending need to recognize their potential for social empowerment and structure themselves under principles like the Grameen Bank and The Smart Campaign so the various social benefits can be acquired by program participants.

This paper has shown that microfinance can grow social capital through group lending practices that establish networks, norms and trust. It has also shown the empowerment effects of microfinance on its lenders in terms of feelings of effectiveness and responsibility, and how some of those effects can be seen as political implications. I would urge future researchers interested in the development field to look at how microfinance institutions are enabling their borrowers to be more self-sufficient and empowered. Microfinance institutions that have as their mission social objectives aimed at women and rural borrowers face more of a challenge in ultimately politically empowering members, but the data collected in this survey shows that there could be hope for such a goal. Microfinance is a successful tool for development, and I do not believe the development impacts have to be limited to financial inclusion of the poor. The logic of the hypothesis in this paper can and should be tested around the world, and I think if it were proven that microfinance can lead to more successful and transparent democracies, more organizations and perhaps the global development initiatives would be centered on microcredit. I would like to thank Professor Oksan Bayulgen for collecting this research, which kept my interest in both microfinance and political empowerment throughout the year. I would also like

to thank you, the reader, for hopefully walking away with new founded knowledge about the need for and power of a most successful economic development tool: microfinance.

Survey Questions

- 1) Name of the Microfinance Institution:
- 2) Gender of the client:
- 3) Location of the loan (city vs. village):
- 4) Type of loan (group vs. individual)
- 5) Why individual/group loan? Why not the other type?
- 6) Number of years in the micro-loan program:
- 7) How do you use the loan?
- 8) What did you do before joining the program (previous employment status)
- 9) How did you become involved in the program?
- 10) Who in your household makes the decisions regarding the use of the loan?
- 11) Who in your household makes the decisions about money management, family expenditures and savings etc?
- 12) Since you joined the program do you feel like your control over your finances has ...?
- 13) Since you joined the program, do you feel like your and your family's opportunities for better education, health care and public services have ...? Examples?
- 14) Since you joined the program, do you think your control over decisions that affect your everyday activities has ...?
- (Only for group loan recipients)**
- 15) Did you know the members of your loan group before you joined the program?
- 16) Thinking about the members of this group, are most of them of the same
- 17) How much did you trust group members before the MC program?
- 18) Do you trust the members of your group today?
- 19) How often do you see the members of your group?
- 20) How often in the group do you help each other with small tasks (such as repair work, grocery shopping, child caring etc.?) Examples?
- 21) Would you easily ask a group member for financial/ physical/ psychological help if you needed it? Examples?
- 22) Do you interact with other loan groups?

23) Did you become a member of other groups, organizations (such as educational, religious, sports, professional association, trade union, non-profit, political, others) since you joined the microfinance program? Examples?

**(Group and Individual)**

24) How often do you follow the news (in the newspaper, radio, or TV)?

25) Where do you get your information about government policies (such as welfare policy, taxation policy, employment benefits, permits, regulations etc.)?

26) Where do you get your information about market news (such as jobs, prices of goods, trade opportunities etc)

27) In general, compared to before you joined the program, would you say you're your access to government and market information...?

28) What are some problems that you face at your workplace?

29) Who do you go to solve your problems with business (who helps you or gives you advice)?

30) Since you joined the program, have you worked with others in your village/neighborhood to do something for the benefit of the community? Examples?

31) Since you joined the loan program, have you ever contacted a government official about some need or problem concerning the community as a whole? Examples?

32) Since you joined the loan program, have you done any of the following: voted regularly in elections, attended a village/neighborhood council meeting, public hearing or public discussion group, met with a politician, called him or sent a letter, participated in a protest or demonstration, alerted newspaper, radio, or TV to a local problem, notified police or court about a local problem, none

33) For your business, do you care at all who gets elected to local and national government offices?

34) Besides helping you with your business, which of the following would describe how microcredit affected your life? (could be more than one)

35) If you had not received a microcredit, what would you be doing right now? In what condition would your business be?

36) Do you think everyone who needs it should be given credit?

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