

How Legal Steps Can Help to Pave the Way to Ending Poverty

By Muhammad Yunus

There is no better time for a serious discussion of how the law and lawyers can enable the poor to help themselves—throughout the world, and especially in the United States.

Right now, highly regulated banks in the developed world (many of them in the United States) are having trouble pricing and trading complex mortgage-backed securities. At the same time, however, trust-based microfinance banks like Bangladesh's Grameen Bank continue to do well, unaffected by the financial uncertainty in the rest of the world.

How the Trust-Based Grameen Bank Works

The Grameen Bank issues loans using very simple trust-based financial arrangements; no legal documents are involved because, in part, Grameen's borrowers are poor and have no collateral. So, Grameen relies on trust and the positive incentives of continued access to credit and other support to ensure repayments—and Grameen's repayment rates have averaged better than 98 percent. Because Grameen's loans are based on trust and positive incentives and no legal documents, Grameen has never used lawyers or courts to collect any of its loans. Grameen has about 7.5 million borrowers in Bangladesh, and has loaned approximately \$7 billion since its inception, with an average loan size of about \$150.

When a potential borrower wants a loan, she has to form a group of five or join such a group of borrowers from her neighborhood and agree to meet with that group once a week. Each loan is made to an individual in the group and is the responsibility of that one individual, but others in the group cannot get their next loans if any member of the group is late in her payments.

Grameen's borrowers are also required to maintain a regular savings plan, and today its borrowers and their nonborrowing neighbors as a group have \$150 in savings for every \$100 in loans outstanding. Today, the Grameen Bank is funded by the savings deposits of the poor. It has been profitable for all but three of the last twenty-five years.

Grameen's interest rates for loans and savings are clearly available to all at www.grameen.com. All loans are intended for income-producing activities, housing, or education, not for consumption. The basic interest rate for most business loans is 20 percent. In addition, Grameen has issued more than 600,000 housing loans at 8 percent and about 20,000 educational loans at 5 percent.

Grameen also has arranged loans for about 100,000 beggars, whom it calls "struggling members." These loans are interest-free and offered without time limits. The goal is to encourage these members to cease begging and to become regular savers and borrowers. To date, 10 percent of these borrowers have left begging behind completely.

The Grameen bank is 96 percent owned by the borrowers, 97 percent of whom are women. Nine of its twelve directors are women.

Its bankers, using bicycles or motorcycles, go to a borrower's neighborhood for the weekly meetings. Typically, ten or so groups of five borrowers (sixty individual borrowers total) meet every week for about an hour to pay back existing loans, to receive new loans, and to exchange ideas in an open and transparent way in front of the whole group of fellow borrowers. The approach is practical also because Grameen's borrowers typically cannot read financial statements.

Grameen's borrowers have established some of their own rules. Known as the Sixteen Decisions, many of these rules have to do with the health of the family and the care and education of children (see www.grameen.com for details).

Complex Isn't Always Better

In view of the general financial uncertainty in the world, one wonders how helpful complex legal contracts have proven to be for the subprime borrowers or for the lenders who are currently experiencing difficulties. How useful are these contracts if the transactions are not ultimately based on trust between bankers and borrowers who know each other? In 50 percent of the current housing foreclosures in the United States, no direct communication exists between the borrower and the lender. Grameen's bankers and borrowers meet and look each other in the eye each and every week during the group meetings.

One must also ask how successful all of the disclosure statements are if they are buried in a large pile of documents that are so long and complex that no one, including the bankers, seems to fully understand the implications of the interest rate adjustments in the documentation. So many of the more complex mortgages and mortgage-based securities in the United States are faltering or failing. But Grameen's much simpler trust-based loans to poor women with no collateral seem to be doing well.

A similar situation occurred in 1997, when microfinance continued to grow steadily despite the financial instability that accompanied the Asian currency crisis. The macroeconomies in a number of Asian countries declined steeply when a bubble of speculative lending burst, but the microfinance organizations in those countries continued to thrive. During a financial crisis, microfinance organizations can be an island of stability.

In a recent meeting, U.S. Federal Reserve Chairman Ben Bernanke commented that the United States has less of an informal or unregulated sector than developing countries do. The discussion turned to the importance of a culture of thrift, hard work, savings, and mutual aid, and to whether those qualities remained important in the United States. Federal Reserve Board governor Randall Kroszner, who was also in attendance, cited the book *From Mutual Aid to the Welfare State* by David T. Beito. Beito's book documents the importance of thrift, hard work, and savings in the growth of the United States, where local community-based voluntary mutual aid societies provided bottom-up delivery of health care and financial services and promoted a culture of thrift and work for the poor.

What makes the trust-based Grameen bottom-up model so valuable is that it builds human, family, and social capital by helping the poor (poor women in particular) to help each other in a voluntary and businesslike fashion that builds respect and self-esteem. Grameen has learned that the poor can take care of themselves, and that they can support each other and make important contributions to society. The resulting knowledge, experience, confidence, pride, and self-respect have become the basis on which Grameen has successfully built its lending program.

Where the Legal Profession Can Help

Lawyers can provide vital help to encourage and enable lower-income people to take care of themselves in the United States and internationally. The needs are universal, but laws differ among countries, so perhaps lawyers can form groups in each country to develop or revise laws that ultimately help the poor to help themselves. Perhaps one group of lawyers can be formed for each of these or similar objectives in every country where such changes are needed. Here are some areas to focus on:

1. Simpler laws for microfinance programs. Everywhere in the world, simpler laws are needed to allow microfinance programs to receive savings deposits and re-lend that money. The right regulations should allow a microfinance organization to expand through savings deposits. Expansion of lending through savings deposits would be the single most important step in expanding microfinance globally. In the United States, credit union regulations might work for microfinance organizations, and Grameen America is studying that option. The best option would be to create a new law exclusively for establishing microfinance banks for low-income people and people on welfare.
2. Laws focused on individual borrowers. In the United States in particular, low-income borrowers find that starting and managing a small business can be difficult because laws and regulations either are intended for larger businesses or simply are not essential. For example, in the state of Louisiana, a person cannot arrange and sell more than one variety of flowers in a vase for resale without taking a test to get a state license. This regulation discourages new entrepreneurs, reduces competition, and keeps the cost of flower arrangements high. The license could be voluntary and optional, allowing the end purchaser of that flower arrangement to decide if he wants flowers arranged by a licensed or unlicensed businessperson.
3. Waiver medallions for the poor. Very poor people should be entitled to sort of waiver medallion that enables them to take care of themselves through self-employment opportunities with minimal or no interference from laws that weren't designed with them in mind. Such a medallion would entitle the very poor to do what they need to do in search of earning their own legal livelihood, and no law should be allowed to interfere with that initiative. Free trade and special enterprise zones are common. Let's work to give the poor the individual right to operate in a legal interference-free zone to make a living for themselves.
4. Welfare and Medicaid laws designed to encourage independence. Welfare and Medicaid laws often too steeply limit how much a low-income person can save or earn. These laws should be designed to help people gain self-respect and independence by taking care of themselves through income-producing activities. Instead, the welfare laws seem designed to keep people on welfare longer than necessary. Creative policy changes should be put in place to help

people help themselves and to lose these subsidies gradually rather than all at once.

5. Simpler laws for the poor. Laws should be kept as simple as possible for low-income people in particular, to motivate them to take the next steps to help themselves.
6. Non-governmental loan programs. Governments should create an enabling environment for microcredit programs without getting directly involved in lending money to the poor. It's extremely difficult for a political entity to recover money that it has loaned to poor people. Some people look at government as an agency that is required to take care of them. Thus, the important discipline of paying back a loan is lost in a government program. Politicians by necessity are more focused on awarding loans and securing votes than in making sure loans are repaid. For all these reasons, loan programs should be left to the non-governmental, private sector, and social businesses.
7. Tax laws that encourage social businesses. Social businesses are designed exclusively to maximize benefits to customers, rather than maximizing profits. Social businesses serve social needs in a businesslike manner. Such a business is sustainable and makes a profit, and the investor gets back the capital he invested, over time. Profits in a social business are entirely reinvested to expand the existing social business or start new ones. A charity dollar can be used only once, but a social business investment dollar is recycled indefinitely. Current tax laws offer tax benefits to charitable organizations. New tax laws are needed that put social businesses on at least an equal footing with charities.
8. Simpler visa, immigration, and passport systems. The current visa, immigration, and passport systems worldwide are a great source of frustration and wasted time and resources. So many countries want some of Grameen's 27,000 experienced microfinance employees to come and build programs, but those same countries have complicated and expensive visa procedures. The children of developed countries want to come to Bangladesh to study microfinance. The children of Bangladesh's poor borrowers want to travel and go to international schools. Simple programs that allow people to travel more easily to share what they know should be devised. The goal should be a world where people can travel freely without the need for passports and visas.
9. Tariffs and trade barriers that favor the less powerful. Tariffs and trade barriers seem to favor the powerful over the less powerful. The relatively poor country of Bangladesh has to pay one of the highest tariffs on its textile exports to the United States. The goal should be to help poor countries to do more business with rich countries, rather than letting them depend on their foreign aid.

We must all believe in people and their ability to change their own lives. All people, including the poor, have enormous capacity to help themselves. Despite appearances, deep inside every human being exists a precious treasure of initiative and creativity waiting to be discovered, to be unleashed, to change life for the better. If we look at each and every poor person from this perspective, we will find enormous possibilities for this world.

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