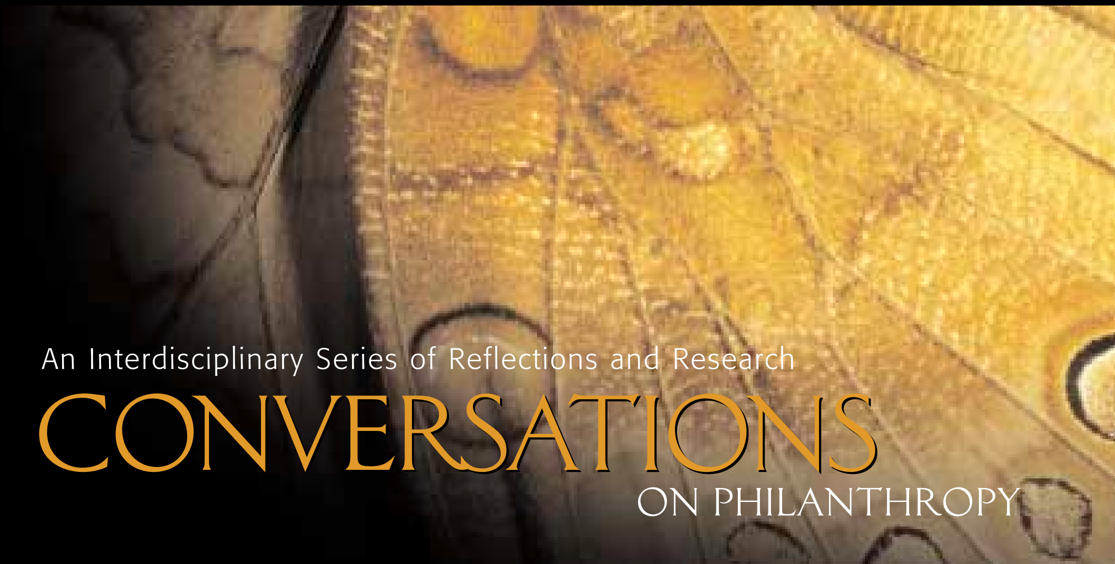

An Interdisciplinary Series of Reflections and Research

CONVERSATIONS ON PHILANTHROPY

Volume III
Philanthropic Transformations

2006

CONVERSATIONS ON PHILANTHROPY

Conversations on Philanthropy is an occasional publication of the Project for New Philanthropy Studies at DonorsTrust. *Conversations* will typically feature essays or academic papers by scholars, philanthropists, social critics and activists, along with critiques by one or more invited commentators.

The mission of the Project for New Philanthropy Studies is to define a "new" philanthropy appropriate to the radically altered circumstances of the present cybernetic age. We are not seeking to build a consensus, but to elaborate an alternative approach to the philanthropic enterprise, describe the opportunities open to it, and suggest what tools social investors will need as they make responsible choices and assess results in an unfamiliar atmosphere.

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of Reflections and Research

Volume III
Philanthropic Transformations

Lenore T. Ealy

SERIES EDITOR

Conversations on Philanthropy

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PHILANTHROPIC TRANSFORMATIONS

INTRODUCTION

Volume III of *Conversations on Philanthropy* marks the beginning of our second full year of publication. In this volume, themed *Philanthropic Transformations*, we somewhat modify our previous conversational formula to bring you a single conversation rather than two. The two papers anchoring this volume, "Dancing the Measures of Transformation," by anthropologist Heather Wood Ion, and "Fostering Sustainable Complexity in the Microfinance Industry: Which Way Forward?" by economist Emily Chamlee-Wright, proved sufficiently complementary that we asked our commentators to engage both essays in their reflections.

The field of microfinance has been one of the most dynamic areas of philanthropic endeavor over the past decade. In the papers here, Ion and Chamlee-Wright each take microfinance as their point of departure in reflecting on the role of philanthropy in advancing prosperity among the world's poorest people. With the eye and ear of a poet, Ion brings us an anthropologist's sensitivity to the potential of microenterprise not only to improve the economic conditions of people but fundamentally to transform their personal and cultural narratives. Chamlee-Wright, who has spent time among women microentrepreneurs in Ghana, examines the microfinance industry through the lens of an economist and points out the importance of arrangements that connect microentrepreneurs to extended social and economic networks.

Both of our authors suggest that the field of microfinance can bear a rich harvest for philanthropic investors seeking to ameliorate conditions of poverty. Taking their insights together, we learn that the best philanthropy in the field would be that which utilizes resources to provide seed capital, research, and development to elicit and build upon local knowledge and initiative while also attending to the need to expand the horizons of microentrepreneurs and to foster the building of bridges between microentrepreneurs and commercially sustained markets.

Frederick Turner (whose essay "Creating a Culture of Gift" appeared in *Conversations on Philanthropy*, Volume II) begins our comments on Ion's and Chamlee-Wright's essays with the astute observation that a first principle of philanthropy should be to provide aid in ways that assist rather than hinder the ability of people to construct life stories bearing narrative coherence. Turner appreciates Ion's application of an aesthetic of transformation to the field, and indeed Ion makes an eloquent case that the transformations sought by philanthropists require as much application of the art of discernment as they do the science of measurement.

Ion's recognition of the complexity of transformation is extended by J. D. Von Pischke, who contributes to our conversation the important insight that economic activity in itself can facilitate personal transformations in proportion to the opportunities it provides for forays into the moral realm of the extended order, where respect for property, fidelity to contract, increased spheres of trust, expanded time horizons, creative capacity, and new means of managing risk emerge. "Transformation occurs as microentrepreneurs explore the extended order," writes Von Pischke, and "continues, even with the constant quantitative soundings that are the daily routine of finance."

In her paper, Chamlee-Wright introduces us to the concept of the extended order framed by Nobel Laureate Friedrich Hayek and makes the case that philanthropists should always be seeking to connect recipients of aid to the extended order. The insight shared by Turner and Von Pischke, that the extended order is indeed a moral order, suggests that the sharp lines often drawn between commercial and nonprofit motivations need to be softened.

Alejandro Chafuen concurs with Ion that many of the most important outcomes of philanthropic activity are immeasurable, but he contends that we should not therefore dispense with measurement in areas where it can sharpen our thinking and practice. Chafuen finds in Chamlee-Wright's analysis of the role of market structures in the creation and dissemination of knowledge a welcome framework by which philanthropists might also engage in what he calls *intellectual entrepreneurship*. According to Chafuen, intellectual entrepreneurs seek to identify and foster the development of public policies and legal frameworks that are most conducive to wealth creation and retention even by the poorest of the poor.

Claire Morgan likewise attends to the need to understand the institutions and incentives that can contribute to the success of microfinance initiatives as both economic and philanthropic endeavors. She sees in the WORTH program, as described by Ion, the potential not only for entrepreneurial success but also for philanthropic replication as the successful entrepreneurs share their stories with others and thus become "viral" agents of change in their communities as others emulate their success. Morgan also points to the importance of savings models of microfinance, as opposed to credit models. It is David Ellerman's comment, however, that most thoroughly introduces us to the shift that is transpiring in the field in this regard.

Ellerman, who brings a decade of experience at the World Bank to our conversation, finds much of value in Ion's advocacy of transformational versus transactional help as well as in Chamlee-Wright's application of Hayek's concept of extended order to the field. What he finds missing is explicit attention to the role of savings-led microfinance models as a superior approach both to sustainability and to the avoidance of "unhelpful help." Ellerman's contribution is particularly welcome for reminding us that at least a few of those who have been involved with large-scale development assistance in recent years are genuinely willing to approach this work as a process of discovery about how best to accelerate wealth creation among the world's poor. We must hope that Ellerman's willingness to challenge the field to learn will help displace failed but entrenched models of practice in the world's most powerful development agencies. Ellerman's attached bibliography provides an excellent starting point for readers interested in delving more deeply into these questions.

We have also appended to this conversation a short note by Jeffrey Ashe, manager of community finance at Oxfam America. Ashe does not engage Ion's or Chamlee-Wright's papers directly, but rather provides the reader a recent update on the spread of savings-led microfinance programs.

I look forward now to having an opportunity to hear from our original authors how these comments and recent developments will advance their own thinking about the ways in which philanthropy can promote transformations of people and communities by helping them enrich themselves on many levels.

Finally, a quick remark about our cover art. It did not require much creativity to choose the butterfly for our graphic element. The mystery of metamorphosis, that transformation from earthbound caterpillar measuring its way inch-by-inch along a branch to the colorful and buoyant butterfly dancing to a different beat, has intrigued the human imagination across time and cultures. The Blackfoot Indians speak of the butterfly as a mysterious gift-bringer:

> You know that it is the butterfly who brings us our dreams—who brings the news to us when we are asleep. Have you never heard a

> man say, when he sees a butterfly fluttering over the prairie, 'There is a little fellow flying about that is going to bring news to someone tonight'? Or have you not heard a person say after the fire burns low and the people begin to make up their beds about the lodge, 'Well, let us go to bed and see what news the butterfly will bring?'[1]

Modeling the elusiveness of nonlinear transformation, symbolizing the bridges of interconnection that amazingly knit the knowledge of individual persons into the extended social and economic order, bringing hidden beauty to the surface—read on and discover what flights of fancy the butterfly can bring.

—Lenore T. Ealy
Series Editor

1 Ronald A. Gagliardi, "Lepidopteral Symbiology," ed. Dexter Sear (http://www.insects.org/ced4/symbol_list2.html).

CONVERSATION 5

Dancing the Measures of Transformation

Heather Wood Ion

Fostering Sustainable Complexity in the Microfinance Industry: Which Way Forward?

Emily Chamlee-Wright

WITH COMMENTS BY

Frederick Turner

J.D. Von Pischke

Alejandro Chafuen

Claire Morgan

David Ellerman

NOTE BY

Jeffrey Ashe

Conversations on Philanthropy Volume III: Philanthropic Transformations

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DANCING THE MEASURES OF TRANSFORMATION

Heather Wood Ion

Peter Drucker said that 95 percent of what matters in an organization cannot be counted. J. K. Galbraith said, “If it is not counted, it tends not to be noticed.” Demming estimated that 95 percent of the time within an organization is spent on measuring or counting something. The implications of these facts are obvious. In addition, Drucker (1994) said that no time in recorded history has seen such a radical social transformation as our own. Many of us share a purpose of supporting social and personal transformations, in part because of the additional sense of meaning such activity brings to us, and in part because we all share a sense of frustration that the disconnections of our world are too frequently increased rather than improved by conventional efforts to ameliorate them.

As we attempt something new in the world of philanthropy, we must ask several questions:

- What really matters to people struggling to transform their lives?
- How do we know that it matters?
- How do we know what works as the transformation occurs?
- Can we replicate success?
- Can we, or should we, count what counts?
- Can we create a space in which to connect others to these reflections?

Just as a reminder: more than two billion people in the world live without electricity; four billion rarely make a phone call; three billion have never seen a doctor; more than a billion are illiterate. The poorest people in our world live on a dollar or less per day, and the buying power of their income is decreasing (North and Swider, 2001). Now more than ever, Dr. Jonas Salk’s question, “Are we being good ancestors?” is a critical one for us to answer.

An earlier paper by this author (which bears the same title as this one) (Ion 1995) considered the measures used to assess the impact and value of prenatal care. That paper looked at the average number of insurance claims paid for mothers' prenatal visits as related to birth weight and the costs of medical complications experienced, to derive an understanding of the standard of care commonly given women during pregnancy. Curiously, the study found that once the aggregate number of five visits was accepted, an understanding of the effectiveness of those five visits or the content of what took place at any visit was not pursued as part of the assessment of quality and has rarely been explored. What counts in pregnancy is the mother's health and a healthy baby, but what is typically measured is the cost and frequency of episodic encounters with a disease-care system.

Thinking in Terms of Transfomations

Interestingly, the most effective assistance for pregnant women in helping their children is maternal literacy—"teach the mother, reach the child"—which does not even appear on the radar screen of conventional health outcome measures. As a matter of course, the necessary and unwavering baseline for care is based on the worst indicators. Typically, indicators of quality are derived from aggregations of adverse experiences and negative outcomes, rather than from comparison with a desired or successful end result. Such episodic counts or aggregates provide transactional information, but neglect more transformative dimensions of the activity being examined. Pregnancy is a transformational experience and neither its process nor its outcomes can be understood by simply counting discrete transactions, such as visits to a health care provider. Hence, the question of "Can What Counts Be Counted?" is used here to provoke and evoke reflections about our philanthropic processes, how we manage and learn from those processes, and how we share what we learn. The question is not intended to contrast a true and a false approach or right and wrong ones.

Literacy is another transformation. Let's look at what is counted when we appraise literacy. At present, we evaluate our educational system by saying that the school dropout rate in this country is around 29 percent, an aggregate tally of how many students quit attending school. SAT scores, which measure only one kind of intelligence and performance, are likewise a transactional measure of our educational system, providing episodic information about student performance at one moment in time. Whether SAT scores go up or down is said to indicate improvement or decline in the educational work of our schools. Another such figure is that an estimated 90 million adults in this country cannot read a ballot in order to vote (Kirsch 1993). Similarly, it is estimated that 49 percent of the nation's high school graduates—*not dropouts*—are functionally illiterate (meaning that they have difficulty with the basic reading and writing levels required to find employment or be trained for the working world). Such indicators may have their uses, but they do not provide sufficient insight into the transformational and long-lasting ends of education. An indicator or measure of what really counts about literacy which would not be merely transactional would be how many individuals are literate enough to perform the jobs available in their local economy. Processes, like patterns, are best understood not in terms of episodes or aggregates, but in terms of variances and diversity, which makes comparison possible.

Wise educators will say the following:

- What is taught is not what is learned.
- What is graded is not what is known.
- What is said is not what is heard.
- What is meant is not what is said.
- What is known is not what works.
- What works is hardly ever known.

Much of the confusion that results from using our traditional accounting measures when looking at philanthropic activities stems from the fact that these numbers measure volumes only. They do not measure effectiveness, which is the accuracy or utility of the particular tool or intervention, how well we did what we were doing. Nor do they measure efficacy, the ability to produce a desired effect, which is a measure of change, the difference the actions made to the recipient. Transactional accounting measures look at a point, not at a process, and transformation is an unpredictable and dynamic process, not a point. Furthermore, we cannot look at relationships as mere components of an aggregate. Measurement is an activity directly related to the premises of reduction, and the derivative professions of evaluation and assessment also presuppose reduction to a unit appropriate to the tool being used.[1] Measuring is not, in most organizations, disciplined by the question of how a particular measure informs us about necessary and sufficient strategies for improvement. For instance, microcredit exists to alleviate poverty, but the performance indicators used to look at the effectiveness of programs measure the profitability of the lending institution and the quality of its portfolio. Such financial measures do not inform us about whether the services are actually alleviating poverty (Cheston 1999).

Asking the right questions seems to be a lost art, and even in the field of evaluation few questions address the issue of what the organization is trying to achieve in consequence of what it is doing, or exactly what effect it is trying to cause through its activities. The movement of Appreciative Inquiry, started by David Cooperrider at Case Western Reserve University, initially was based on this premise of asking questions of appreciation and in all questions avoiding deficit discourse and volumetric measures. Several related movements for the use of asset-based language and positive discourse also generally avoid transactional measures in their reporting work.[2] This is not the way most such evaluations are done today. Most granting organizations request an evaluation strategy, which is usually taken to mean a cost/benefit description of the use of grant funds, not a strategy for fully understanding what has been achieved. Educational workshops, for example, distribute evaluation sheets to assess the presentation but tend not to look for successful application of the lessons learned; community action organizations report measures such as employment and enrollment, but not on how resources were used to change lives in a lasting way. One of the great tragedies of the "associative", or what Kenneth Boulding calls the "integrative", sector of our economy is that there is no communication network through which lessons learned can be captured or collaboration established as mutually beneficial.[3] Without such information, how can philanthropic organizations and donors know whether they are creating transformational change

Characteristics of Transformation

If you search for the word *transformation* on the Internet, you will find 13 million references ranging from lycanthropy to specific mathematical exercises.

Trying to narrow that down by starting with the word change becomes an enchanting exploration of language: Charles Handy lists *change* as being used as a noun universal, a noun particular, a noun metaphorical, a verb transitive, a verb intransitive, a verb metaphorical, and an adjective (Handy 1990, 7). Conventional measures and evaluations of change are generally based on old views of causality, however, and do not address the dynamism of the process, nor the relationships within that process. Further, conventional measures include very little effort to juxtapose the reality of experience with the intent of the agent of change.

Some characteristics of transformation seem so basic as to be trivial, but in the contemporary atmosphere pervaded by self-help gurus and related movements, it is important to remember that these characteristics indicate a profound altering of perspective, of ways of thinking and acting, and of evaluation or reflection. Transformation cannot be purchased, nor can it be undertaken as if change were simply a commodity to be added to our other acquisitions.

Transformation is *irreversible*—a frog cannot return to being a tadpole, and a person cannot return to being illiterate after learning to read (except after a brain injury). Women's empowerment movements illustrate this in terms both of the business skills learned and in the literacy of the women involved. Even if their economic status or opportunities change from the immediate context in which they learned their new skills, the women do not revert to their previous level of disempowerment, but instead seek new ways to apply the new skills.

Transformation is *dynamic*—the process is ongoing and creates energy. Teachers and motivational speakers know that once a student or group becomes excited about the process of learning itself, each newly learned skill builds on and feeds the next. Scientists perhaps best illustrate this phenomenon in the ways in which every experiment, whether failed or not, fuels the energy to keep learning and keep experimenting further. Entrepreneurs often illustrate this same dynamism of being transformed by each effort regardless of whether society judges and rewards that effort as successful.

Another intrinsic characteristic of transformation is that it is *unpredictable*—the full outcome of the process is unclear at a given point or for a specific individual. Healing as a transformative process illustrates this well, in that the new state of health following recovery or rehabilitation cannot be predicted by even the most rigorous methods. The recent, popular television series *The Biggest Loser* was based on this premise, for as the participants learned the skills of healthy living, exercise, and nutrition, neither the audience nor their trainers could predict the outcomes of their application of those skills. Similarly, once an adult becomes literate for the first time, it is unpredictable how that new condition will change their lives.

Transformation is most essentially different from transaction in that it is *pervasive*—the effects of change are not confined to one aspect of self or one activity. For example, when a group of employees began to describe their reality to a new CEO, not only did their perspectives on their work and performance change, but also their perspectives on their identity and their lives were altered. One participant said, "By having someone else's attention given to my reality, I attended to it also, and I now see that I do have choices and power about who

I am. I never felt before that I could stand outside a situation and look at it; I always felt I was just a minor part of a machine. My whole life looks different because of that question."

Challenging to both expectations and patience is the fact that transformation is *discontinuous*—participants, and aspects of process, find their own rhythms, and the transformation may take place in fits and starts. A child does not learn to walk, or to speak, without falling or babbling, any more than Edison could create the light bulb in one smooth, continuous effort. In community development or disaster recovery, it is important that all the volunteers and workers appreciate this reality, for the periods in which progress is difficult to perceive are just as essential as the times of obvious achievement. A grassroots political campaign to save a public library was sustained over the eighteen months necessary not because of continuous achievement—actually, the failures added great definition to the cause—but because participants understood that the process was changing the entire community, perhaps especially in the quiet times of preparation.

Transformation, similarly, is *asymmetric*—imbalance and lack of homogeneity across participants or across aspects of the individual life involved affect our ability to induce change. Egalitarian prejudices often spur us to deny the reality of this characteristic, but we have all seen that leaders do emerge, and that the amount of our own energy we have to invest in ourselves is uneven. On being told that her vote was as important as anyone else's, a woman in a village in India said, "How can that be? I know less, I have learned less than others. Maybe someday I could learn, but right now I do not know enough to be wise. I want someone who is wise to guide me." Migration and immigration both illustrate the asymmetries of the ways in which transformation acts.

The aspect of transformation that is *generative*—where the process creates more of whatever it does and whom it involves—is the aspect on which much of the industry of charity is based. However, generativity in transformation is not a matter of marketing. Immigrants, for example, inspire others to move, and they inspire people of different social classes, economic opportunity, and social traditions. The homestead movement in the North American West well illustrates this generativity, for the pioneers did not claim that life in a sod hut in February was a fulfillment of dreams, but their efforts inspired others to try, and their redefinition of success and of neighborhood built nations.

Most of us readily recognize that transformation is empowering—participation changes an individual's sense of authority. The newly literate person or child, for example, feels able to explore the world. The newly employed immigrant feels confident that she is making her world better. It is this characteristic, however, which is frequently resisted and seen as dangerous. In a company in which silent compliance was the tradition, for example, the introduction of circles of excellence for employee input was feared by the employees and resisted by the owners as merely disruptive. In a negotiation to resolve a community conflict, holding an open town meeting was strongly resisted as "opening too many cans of worms," but it was eventually viewed by the citizens as the singular event which showed them they could express their dreams and act upon them. Hence, the fear of empowerment is every bit as important when studying transformation as are the new sense of responsibility and power that follow acceptance of change. The Imagine Movement, based on Imagine Chicago, is an excellent example of how to counter this fear of and resistance to the dangers of change.

All of these aspects can have either negative or positive results—a transformation that could lead to empowerment could cause enslavement. Any calcification of these aspects that stops the process as a whole will tend to move the impact toward negative outcomes rather than positive ones.

What is clear is that transformation takes place over time, and that relevant benchmarks regard process, not goals. I suggest that when we deal with transformation, the word *measure* is most appropriately taken as meaning meter or poetical rhythm. Musical measures serve as a means to pass on the experience beyond an immediate community and beyond a shared moment. The musician will think in multiple times and in patterns of time, and the mathematician perceives multiple times and dimensions; for our purposes, the idea of a measure is used not as a reductive tool but instead in terms of time. From this perspective, transformation can be understood as the orchestration of related, but different, aspects of a performance.[4] Replication, therefore, is neither formulaic or dependent on discrete units, as it is customarily described as being.

An Example of Transformation

To illustrate this view of transformation, I suggest we look to WORTH, a Women's Empowerment Program which was first tested in Nepal, as described by Marcia Odell, its program director, and Jeffrey Ashe of Oxfam USA.[5] WORTH is often characterized as being an example of microfinance. The project in Nepal has reached more than 100,000 women in more than six thousand saving and lending groups in just four years. The women are helped to begin saving money, so that they are not building debt to a financing institution but instead creating equity for themselves in microenterprises. At the same time that they start saving, each woman is put in contact with a literacy volunteer in their community to help them learn to read and write. Then, using simple, self-instructional materials, they go on to master working with numbers and basic accounting. The entire program is delivered through an appreciative framework, with no external subsidies—women actually pay a small fee to join the program—and is designed to build both individual and group empowerment and autonomy. The small fee is the first evidence of investment in themselves that motivates the women to change their sense of self-worth. This model is in direct contrast to traditional approaches to philanthropy, which create dependence and are episodic in their focus on a specific "problem" and its solution. In this model, there is no presumption that some external expert or institution will "solve" the individuals' problems or judge the local needs and initiatives.

When we look at WORTH as a model of transformation, what is most striking is that the participants manage to change their view of themselves within a highly unfavorable environment:

- a per capita income of $210 per year, and only half that much in rural regions;
- a hierarchical, male-dominated society which places little value on women;
- endemic domestic violence against women; and
- female literacy rates as low as 14 percent.

The comments of the women on the consequences of saving and of their participation in the group primarily center on the importance of their increased self-confidence and autonomy, the chance to learn to read, and their learning of their own rights. Savings, credit, and business development are less important than these personal changes, even though the former are often the primary focus of attention in the program. Most exciting is that the women view themselves as having the ability to give—they realize that they have knowledge and a story to tell. They are *transformed* from being defined as "the poor" or "in need" or recipients, into givers or teachers of a successful model and generative experience.

When we ask our initial questions—What are we trying to do? And what are we in fact doing?—regarding WORTH, the answers are very clear, even though they are not shaped by measures of transactions. What is attempted in WORTH is to give women the means and the literacy skills to achieve some level of economic self-reliance. The women participants themselves are now spreading WORTH village banking to other women in their communities by telling their own stories. Since the core USAID funding dried up, WORTH women have—on their own—created between eight hundred and two thousand new economic groups reaching fifteen thousand to forty thousand women. Since they are doing this on their own, no one knows accurately how far they have reached. Moreover, this has been happening in a context of profound civil struggle in Nepal. The groups are now generating revenues of approximately $20 million per year.

Expanding a Transformation

Now WORTH is rapidly expanding throughout Africa, having started in Kenya less than two years ago, and is achieving remarkable effectiveness in refugee camps. Sierra Leone, Guinea, Congo, and Mozambique are all applying the WORTH program to women's issues and to HIV/AIDS, to address the core issues of poverty and gender inequality. The Salvation Army and Project Concern International have both adopted the WORTH program and have signed agreements with the sponsoring agency, PACT, to take it into as many as 109 countries. The measures of success of this program do not conform to audits and accounting terms, particularly since women are spreading the program without sponsorship, external investment, or philanthropic outsiders. The answers to our two questions are clearly congruent: the intent to raise economic self-sufficiency through literacy and savings has been achieved, and the women and their families are empowered enough to become socially and politically active as a result.

The methods used throughout WORTH involve appreciation of the participants' abilities, and in consequence the participants appreciate the transformation of their own capacities. They say that they wish to share their discoveries of their own strengths and successes. Note that they do not want others to tell the story; they value their own voices. They dream of expanding these strengths and successes, and they know they can design ways to realize those dreams. It is particularly important here to remember that the transformation is attractive to others as well—the men of the WORTH villages want to have what the women have achieved, and they want to experience the expanded view of opportunity. However, the women do not attempt to engage the men in their groups. They can and do deliver actions and commitments to start the process and to monitor and report their progress to other women. In the areas where WORTH has been operating for several years, the women experience these changes as scalable. They want to share the program with other women, and thus far on their own they have taken it to perhaps three thousand new groups in Nepal and sixty thousand women without any external support (Odell 2002).

The theoretical implications of the results of WORTH are, I believe, of particular importance to philanthropy. Primarily through the use of existing local groups based within local traditions, the movement identifies and respects the participants' autonomy and their positive strengths within the context relevant to them. External expertise and support are seen as *enabling*, not determining or ultimately responsible. This local accountability permits experimentation, ambiguity, and redirection so that compliance or conformity no longer means that an external or monitoring institution must be created or satisfied at the expense of local adaptation.

The purpose, as well as the conduct, of the organization is transparent to all at every level. Participants feel themselves to be co-creators of the effort—women who contribute a tiny amount of savings are co-creators, as are those who take out a loan to start a microenterprise, and those who carry the message to another group. Democracy based on dialogue requires a group small enough that conversations can occur; the WORTH groups on average have less than twenty-one members each. This means that lessons learned and mutually reinforcing connections are immediate and iterative. The narrative truths of transformative experiences can be shared with the patience and rhythms of storytelling and are thus likely to be absorbed and attended to more than the abstractions or analytic reports required by external institutions.

The inherent flexibility of the model means that unanticipated and ancillary impacts can quickly be included in local actions, not only because such small, local groups are below the radar of a regulatory framework but also because the lessons learned are part of the process of continuous improvement as women share their stories in an ongoing and expansive commitment. The initial empowerment of the women results from the introduction of a new concept, which facilitates new learning and risk-taking behaviors; thus the project changes the intellectual framework first. Through participation in the project, social relationships and social horizons expand and become inclusive as a result of experienced benefit, not as a requirement by an external agency.

Replication, or the expansion to new sites or new activities, takes place according to the readiness and willingness of local participants and their own energies. There is no imposed restriction or pace that distorts the driving desires. This is the asymmetry of the process: no attempt is made to predict or to predetermine who leads the group beyond their initial achievements. The precipitating, transformative energy that moves the perception from a problem focus to positive action is the experience of direct benefit through a changed behavior. Savings of less than 50 cents per month have created an aggregate $2 million in savings in less than three years and have created businesses with $20 million in annual revenues in Nepal alone. Thus very small changes have resulted in sustainable and pervasive change with very large effects.

Autonomy, accountability, intimacy and reputation, adaptability, conceptual curiosity, inclusiveness, expansiveness and connectedness, patience, responsiveness and responsibility, transparency and constant feedback—many of these concepts are familiar in this context because they have been described by Jan Hauser and Mark Miller as part of trusted networks and trust-raising activities necessary to augmented social networks. We do not yet understand how cohesion is created within these social networks, but the concept of transformation and studies of resilience certainly lead us in that direction.

Assessing Benefits of Transformation

When we do social assessments in order to understand who will benefit from a project or intervention, we are not only creating some sort of baseline, but ideally we will be outlining the participants' conceptual maps and willingness for involvement. WORTH illustrates the value of building on existing local groups—part of this value comes from the fact that the local groups already share and invest in the common good. The current concerns with "sustainability," by contrast, often ignore the point that existing local groups are more committed to the sustainability of their own worlds than are the external experts who believe they bring an answer to issues of sustainability. It is to be hoped that the ongoing efforts to help in the recovery from the Asian tsunami will respect this local knowledge.

WORTH has also shown that it is possible to avoid the sadly common situation in which external intervention replaces one elite with another. The program averts this by ensuring that the local group keeps its own accounts, monitors individual participation, and reports on its own activities to other groups of similar purpose. Trust, reputation, and the intimacy of proximate and involved members are mutually reinforced. There is no expectation of homogeneity in WORTH in terms of results or individual investment.

The essential ambiguity and dynamics of transformation should caution us away from asserting benchmarks or fixed indicators, especially those that emphasize governance rather than participatory experience. Educators, for example, are moving toward using portfolios rather than abstractions of tests as evidence of engagement and of the learning process. For instance, when children create a personal history about their lives, there are requirements as to components but no requirements as to the style or content of each component. There is a shared language and symbolic system, but the style with which those are used is left to the child. Similarly with community transformation, there are characteristics that can be identified, but the interplay of those characteristics can neither be programmed nor judged as right or wrong. This is why I recommend that we think of measures in terms of music rather than numbers. There is in transformation a formal framework, but the details vary within that framework, just as harmonies and rhythms vary along a melodic line in music.

We saw that WORTH initiated its process by changing the women's conceptual framework of what is possible for them. Meaning may also be contained within the form. The collective imagination of social change may include a unity between action and significance because the actions are the sign that one has achieved the imagined goal. The actions themselves are the evidence of the change desired. The formal framework, or boundary conditions, may be the definition of the group, such as poor women who wish to learn how to save; or it may be the environmental limit, as in "clean up the Hudson River," but whatever it is, it serves to enhance the cohesiveness of the relationships. The form—for example, microsavings—is created by the specific savings per month by a specific individual. But what that means to her, how and why she does it, and who is impacted by her actions, will be particular to her, not predetermined by the form. Thus musical notation can be used by Beethoven or Paul McCartney—each will create music, neither in a way predetermined by the notation. An Indian raga can be performed by Ravi Shankar, sung in a village festival, or adapted by Sheila Chandra to modify a Gregorian chant—each will find meaning and melody in a different way, but each will be understandable by the others or by an audience.

Tom Munnecke, founder of GivingSpace, notes that many people experiencing transformation ask the following question: "What would happen if everyone else acted this way?" The difficulty with this question is the definition of the concept "everyone else" within a given group. We as human beings exist in relationships, and we tend to see the world in terms of the relationships of "them and us." Expanding the "us" to include everyone depends, of course, on how we perceive and identify our world.

For instance, for my parents us meant the small town where I was raised. The cities one hundred miles away, and even more the city three thousand miles away where I went as an undergraduate, were definitely not "us" but were instead viewed as strange, dangerous, and incomprehensible. The fact that I chose to leave made me a marginal person in their eyes; I was no longer of the tribe of "us," despite my roots, and was potentially just as strange and dangerous as "them." *Everyone* for my parents meant "everyone who shares the way we live and is therefore safely predictable." *Transformation* for them took place within that community, and they did not hold much optimism that the bigger world would change. Similarly, a mathematician from a small southern town was recently (in 2000) appointed to the Institute for Advanced Study in Princeton. The neighbors comforted his family because clearly anyone of talent could get a job in town, but if you did not have talent you had to go as far away as New Jersey.

One of the unanticipated results of the WORTH program in Nepal has been the effect of the women's empowerment on their own families, on the males within the family, and on the "fireside" or domestic decision-making. This is not a matter of the women wanting the men to join their group or emulate their actions; it is a consequence of the transformations experienced by the women, which change their perceptions and behavior and therefore their relationships with the rest of the community. I doubt the validity of including missionary zeal regarding "everyone else" as an intrinsic element of transformation.

The process by which we move from parochial perspectives or tribalism to inclusiveness remains a huge area of inquiry. Mary Douglas and Jane Jacobs have written about "purity and danger" and "systems of survival," and they have explored at length how group relationships are affected by participants' shared sense of fear. Isaiah Berlin has written about the two concepts of liberty: freedom "from" and freedom "for." We often think that those who do not have freedoms "from" (who have real survival needs) cannot be generous. In addition, we are often constrained to thinking of ourselves as without freedoms "for" because of the "them versus us" fears of threat and loss. Furthermore, few of us ask ourselves, let alone our adolescent children, how we will recognize freedoms "for." (I will return to this topic shortly to consider how it relates to generosity.)

Learning and Resilience in Transformation

There are other unexplored aspects of transformation visible in the WORTH experience. One is the altered sense of self the participants acquire, and another is their changed imagination regarding what is possible for them as individuals. As an appreciative process begins, “dreaming” is one of the four first steps, and that is dreaming of what might be, of possibility, of creating something different. However, in light of the women’s experiences, their dreams change—the women move on from saving to investing to building, or from saving to literacy to public health initiatives.

In learning, what we learn changes what we want to learn. The empowered women break their own cycle of dependence, and through their increased pride, they acquire new visions for their own future. This process is dynamic, just as, for example, our concept of health and fitness changes as we become healthier and more energetic. Change and learning, in other words, depend upon the sharing of information, as Noah Samara, founder of WorldSpace Corporation, put it:

> True change does not begin with declarations, legislation, and grand action. These are its effects. Great change occurs somewhat quietly, almost imperceptibly, but always first in the minds of people. . . . Information is the predicate to everything we know. It is ubiquitous. It is behind our DNA, the chair we sit on, and the building we are in. It is the wealth of nations; it explains the poverty of nations.

Yet herein lies the rub, for just as empowerment and dreaming threaten existing power structures and excite resistance at many levels, so too does information. We who value open and appreciative explorations often forget the alarm such explorations provoke. In an experience of transformation, whether individual or social, at some point the transformed person or group becomes less attached to existing structures. Thus the newly empowered recovering alcoholic is a threat to the codependent habits within the family, just as a group of energetic village women starting their own businesses threaten the men on whom they have previously depended. Our dreams of new horizons and new adventures take us outside the safety of previously accepted comforts, and for those who fear to leave those comforts, the dreams themselves are dangerous. We must not forget the dangers, even though we dare to continue to dream.[6]

Studies of childhood and social resilience, which is another type of transformation both courageous and hopeful, show us there are four consistent aspects to resilience (Levine and Ion 2001):

- Being, a sense of self;
- Belonging, a sense of membership;
- Belief, a sense of purpose; and
- Benevolence, a sense of sharing.

Together these four aspects of resilience support an ability to transcend conditions and attitudes so that the resilient individual lives a generative and optimistic life, seeking connections, responsibility, and explorations as ways of contributing to others. Just as with the first view of the destitute women of Nepal, the first look at the conditions in which resilient individuals emerge would give an outsider little sense of possibility.

Let us look again at those earlier statistics to identify some of the possibilities and human potential they reveal:

- Two billion people live without electricity—that means, among other things, that they know how to live without that energy source, let alone dependence on wired entertainment.
- Four billion people rarely make phone calls—which means they have other means of communication and connection, and their horizons of communication are very different from our own.
- Three billion people have never seen a doctor—so among them are those who know how to stay healthy without medical intervention, and they have a different sense of what interventions are healing or necessary.
- More than 1 billion people are illiterate—which means that they have developed great resourcefulness in surviving in a world based on expectations of literacy.

Within these statistics is a world of positive deviance (Zeitlin 1990), of resilience, of transformation, which we do not understand and which we rarely explore. When considering a new literacy program, we must consider what literacy would mean to the participants and how it could change their lives. What can we learn from the so-called wretched of the earth? How can we learn from them? When considering crises such as the Asian tsunami, should we not be asking these questions before we pour "aid" into projects defined by outsiders, however well-meaning, to the region? As soon as the basic problems of survival can be met, is it not true that the local populations must guide the next steps according to their own strengths? One of the moving moments associated with rethinking philanthropy through GivingSpace occurred at the January 2002 meeting when WORTH Nepal director Usha Jha answered the question, “What do you want from GivingSpace?” by saying, “An opportunity to tell our story.”

Listening to Transformative Experience

It seems to me that the most important potential for expanding transformation is in creating the space within which people can tell their stories. The sense of benevolence, the desire to share, begins first with our personal experiences and our sense of self. Material goods or discretionary wealth tend to serve as tokens of our selves and our experiences, and we share them or give them as an extension of who we are. Similarly, the women of WORTH share their experiences with their daughters, neighbors, and other women whom they meet through their participation in the program. Thus they are donors, or givers, of wisdom, hope, and strength. They do not see themselves as recipients of some benefit at someone else’s expense or as a result of someone else’s wealth. They are generous because of a change in activity that has transformed the lens through which they saw the world, formerly through fear but now through confidence.

To understand the particularities of that generosity requires real study of the ethnology and phenomenology of their lives, not a simple categorization into donors and recipients. We know, for instance, that a shared sense of beauty, particularly through music, contributes significantly to recovery from trauma. Similarly, we need to better understand the ecologies of care and joy and generative acts.

This is not the place to consider in detail the complexity of gift giving across cultures, but it should be noted that giving is a total social phenomenon (Mauss 1999) that crosses all the dimensions of legal, economic, moral, religious, aesthetic, and psychological relations. We significantly limit our understanding of generosity if we think solely in terms of the premises of consumption.

If we are to serve responsibly Usha Jha, the women of WORTH, and others whom we see as in need, philanthropists would do well to focus on providing a forum for sharing the people’s local stories. Often the stories of transformation among the many people in need—whom we know currently merely as aggregate statistics—inform us of possibilities beyond gestures of generosity.

In our future-focused world, we lack a memory or a tradition through which to share wisdom, lessons learned, and our own tales of transformation. Sadly, we have no way to archive the real knowledge of what does work in social, educational, community, and other interventions, and no long-term cross-fertilization across the many economies—for-profit, governmental, nonprofit, and voluntary—within which we live. But we know some things:

- Dialogues can create social change.
- Trust is earned only over time and within a context of respect.
- Hope comes from uniting our needs with our passion.
- Health, whether individual or social, requires interdependent connections. Health is not something behind us but instead exists in all aspects of being, belonging, belief, and benevolence.
- Generosity beyond self-interest is an agent of vitality, of transformational energy.

Philanthropists can therefore empower a cascade of conversations which encourage life-giving relationships and responsibility through the narrative truths willingly shared. Through establishment of a forum or storytelling space, philanthropists and volunteers can reconnect participants with a sense of vocation and with personal dignity as members of a transformational community. Vocation is not the same as self-esteem, self-actualization, or an individual quest, but is instead a calling to live life within disciplines of practice, learning, and vocabulary that provides to all who experience it a transcendent sense of vitality. Given the electronic tools available, a forum of the type proposed here could use multiple methods of connectivity to link inquiry with action and establish a true redistribution of power through the knowledge gained and the lessons learned in conversations about personal fulfillment and health.

Tim Berners-Lee has written on the evolution of the World Wide Web into a semantic tool that can help us extrapolate meaning from data. We know that humans rarely know what we know until we try to share our knowledge. Therefore, what we must focus on in using information technology is the creation of means to share knowledge and to create a tradition of valuing shared knowledge, not on the model or tool the web economy provides. Although support for *community* has become fashionable in recent verbiage, there remains a significant absence of trust in the internet as a public commons, a sacred space in which those working on behalf of the public good can share, and gain, knowledge and support. Philanthropists could form such a public commons.

To quote Parker Palmer's (1999) essay on Seasons, "In the human world, abundance does not happen automatically. It is created when we have the sense to choose community, to come together to celebrate and share our common store." A storytelling forum could provide a place for just such a celebration, sharing, and exploration of "our common store." It would replicate the sense of abundance, in a scalable way, from the individual participants and their discrete projects to common concerns across all levels of activity.

The effects anticipated from giving to such a forum include the following (Ion 2001):

1. The creation of a trusted resource and a trusted space in which knowledge of effectiveness can be shared.
2. The establishment of meaningful measures that contribute to stability and long-term sustainability.
3. The establishment of collegiality and strategic partnerships across all efforts toward producing social health without dependence.
4. The creation of criteria of excellence and understanding of best practices in specific areas of community health, education, housing, and capacity building.
5. The conservation of skills, dedication, and commitment through appreciation and recognition in all levels of this work over the long term.

One of the words important in transformation, but all too rarely used, is "celebration." Organizational and community wisdom used to be celebrated in annual renewal ceremonies and cohesive rituals. With WORTH, Marcia and Mac Odell have expanded the Appreciative Inquiry process of change to include celebration as a means to reinforce accomplishment and create a tradition of transformation. Public commons, whether real or virtual, can provide an appreciative space for this tradition, and by doing so would help appease a deep hunger in our world.

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ENDNOTES

[1] These comments on accounting were greatly enhanced by input from David Burrill, founder of InAlysys and Wisdom Legacy. He is a financial analyst by training and has written in depth on understanding operational performance.

[2] The Interfaith Health Program at Emory University has allied with the Health Assets Africa project at the University of Johannesburg to understand not only the assets and resources available across all sectors of economic and social life in support of health, but also to ask questions regarding these assets in terms of vitality and resilience rather than disease.

[3] I have written elsewhere on our loss of wisdom and knowledge of what works as we lose leaders and burn out volunteers in the nonprofit world. See *The Missing Link.* [Ion 2001]

[4] Frederick Turner has written eloquently on meter and neural patterns as well as on performance dynamics, especially in *The Culture of Hope* (New York: The Free Press, 1995), 210. He has generously contributed time and helpful comments to this paper. There is also very interesting work being done on patterns and pattern languages in organizations, by Linda Rising, following the work of Richard P. Gabriel and Christopher Alexander.

[5] WORTH is already providing a model for other programs. Malcom Odell of Habitat for Humanity has been charged with developing tools for planning and evaluation to measure and increase the effects of Habitat housing initiatives. By using an approach that is both appreciative and participatory, he hopes to establish a new paradigm in which the very processes

contribute to positive and sustainable change. He draws on WORTH for his model. See Malcolm J. Odell, "'Save & Build,' Scaling-up and Reaching the Poor, A Field Trip to Explore Potential Habitat and Women's Empowerment Links," Habitat for Humanity International, February 2002.

[6] Gary Gunderson of the Institute for Public Health and Faith Collaborations at Emory and the Centers for Disease Control alerted me to the importance of this danger. We must not forget that just as change requires courage, so hope requires faith.

FOSTERING SUSTAINABLE COMPLEXITY IN THE MICROFINANCE INDUSTRY: WHICH WAY FORWARD?

Emily Chamlee-Wright

Abstract: The microfinance movement has gained tremendous popularity over the past thirty years, but it is still far from meeting its full potential. The industry stands at a crossroads between increased commercialization and increased philanthropic aid. Standard economic discourse does little to resolve the debate. F. A. Hayek's concept of the "extended order" sheds new light on how we might understand the future development of microfinance.

> *Whenever you are in doubt . . . apply the first test. Recall the face of the poorest and weakest man whom you may have seen, and ask yourself if the step you contemplate is going to be of any use to him. Will he gain anything from it? Will it restore him to a control over his own life and destiny? True development puts those first that society puts last.*
>
> —Mahatma Gandhi

> *An order in which everyone treated his neighbor as himself would be one where comparatively few could be fruitful and multiply. If we were, say, to respond to all charitable appeals that bombard us through the media, this would exact a heavy cost in distracting us from what we are most competent to do. . . . It would not provide a proper cure for misfortunes about which we are understandably concerned.*
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> —F. A. Hayek (1988, 13)

Introduction

At the close of the colonial era, the dominant thinking among economic development theorists and policymakers was that poor countries would be lifted out of poverty through top-down, state development planning efforts. Governments could create prosperity, so the thinking went, by replicating the West's industrial revolution in the developing world. Sector-wide development planning was considered the state of the art in the 1950s and 1960s, and despite abysmal results (in terms of economic decline, rampant corruption, and human rights atrocities), policies favoring heavy-handed state control of the economy persisted into the 1970s.

It was in the mid-1970s that frontline development organizations started to take notice of microenterprise[1] and the informal sector in general as the primary mechanism by which poor people sustained themselves, met their day-to-day needs, and often improved their material conditions. BancoSol in Bolivia, the Grameen Bank in Bangladesh, and Bank Rakyat Indonesia (BRI) are just a few celebrated examples of how microfinance took off in the 1980s and continues to attract attention and funding. The growth of the microfinance movement marks a profound shift in how development theorists, practitioners, and policymakers think about economic development. Gone are discussions of how the state will fill the "entrepreneurial gap." We now understand that the entrepreneurs have been there all along. What they need is an institutional environment that will allow them to play their part in the development process.

The appeal of the microfinance movement is that it seems to reverse all the mistakes of the old top-down paradigm. Rather than funneling resources through large (often corrupt) government bureaucracies that favor the political elite, microfinance offers capital-poor entrepreneurs (usually women) the small loans they need so that they can leverage their time and talent into a profitable enterprise. Furthermore, because microcredit organizations can mobilize savings among borrowers and lend at a market rate of interest, the microfinance industry has the potential to be self-sustaining, reducing dependence on foreign aid.

Since those early projects in the 1970s, microfinance has gathered steam both in the number of programs offering microfinance services and in the level of international financial support. In its 2003 annual summary, the Microcredit Summit Campaign reported that over 2,500 organizations, serving more than 67 million clients, submitted data to their campaign (Daley-Harris 2004). Though support for microfinance is still a small portion of international assistance overall, the microfinance movement has become a significant "player" in national and international politics. In 1998, the General Assembly of the United Nations adopted a resolution declaring 2005 as the International Year of Microcredit. In 2003, the United States Congress passed a law requiring all programs funded by the U.S. Agency for International Development (USAID) to use poverty assessment tools to ensure that at least 50 percent of the microcredit funds distributed by the organization reach clients living on less than US$1 per day. In 2003, more than six hundred parliamentarians from Australia, Canada, Japan, Mexico, the United States, and the United Kingdom signed a letter to the leaders of the World Bank; the Asian, African, and Inter-American Development Bank; and the United Nations Development Program (UNDP) to adopt similar measures and to double current spending on microfinance programs to US$1 billion annually.

Despite the growth of the movement to this point, however, the realities suggest that much work remains to be done. Microfinance in its current state is nowhere close to reaching its potential. Though tens of millions of clients are served through microcredit organizations, more than a billion people around the world are effectively locked out of the formal financial sector. As impressive as the record of growth has been to this point, if the industry is to serve the majority of poor people in the world, it will have to expand at much more dramatic rates.

Furthermore, with the exception of several dozen organizations, the industry is far from delivering on its promise of sustainability, if what we mean by sustainability is independence from the support of philanthropic donors. Though many organizations claim "operational sustainability," the vast majority still require donor subsidies to cover their capital costs. Between 1985 and 1996 the Grameen Bank, for example, reported "profits" of $1.5 million. But as Morduch (1999) observes, when modest adjustments are made to standardize Grameen's accounting practices and philanthropic subsidies on capital are considered, the bank is shown to have actually incurred $34 million in losses during the same period.

The point of raising these concerns is not so much to criticize the industry as to recognize that its success has brought it to a critical crossroads. The path forward will determine whether the great potential of microenterprise to serve the billion or so people who are currently locked out of the traditional financial sector can be realized.

So, the question arises: which way forward? In the microfinance community (donors, microfinance organizations, and consulting groups serving both) a general consensus prevails on two points: (1) donor support will continue to play a vital role in the future of microfinance in the foreseeable future, and (2) sustainability will continue to be a key component of the microfinance ideal. That being said, simultaneously committing to both these principles creates an ongoing tension within the microfinance community. This tension is manifest in debates about the appropriate role of donors and in the movement to link microfinance organizations to the commercial banking sector.[2] No one involved in these debates advocates one end of the spectrum to the exclusion of the other, but there is a marked difference in emphasis between what we might call (for lack of a more nuanced distinction) the "commercialization advocates" at one end and the "social mission advocates" at the other.[3]

Though the distinction runs the risk of portraying the debate as more sharply and ideologically divided than it may actually be, the difference in emphasis here is well-recognized within the microfinance community, and it is significant enough to point to two distinct possible paths for the future of the industry.[4] Will the development of microfinance in the first half of the twenty-first century be advanced most effectively by significant increases in donor support or by a massive commercialization of the industry? Though the public face of the microfinance movement denies this either/or dualism, beneath the surface a contest is heating up over which emphasis will dominate the future direction of the industry.[5]

Standard economic discourse does little to alleviate the current tensions. Nevertheless, there are forms of economic thinking that can shed light on the issues. The primary focus of this paper will be to introduce into the debate F. A. Hayek's insights regarding the nature of economic knowledge. In particular, we will consider the nature of the knowledge embedded within the social and economic networks of the poor, and we will examine how that knowledge is often disconnected from the economic development process. Finally, we will begin an exploration of how a Hayekian perspective on the debate offers fresh insight into the role donor subsidies play in either fostering or hindering effective use of that embedded knowledge.

Incentive and Efficiency in Microfinance

When considering the intersection between programs (public or private) designed to serve the poor and the development of market institutions that may (or may not) serve the poor, standard economic discourse generally gravitates to issues of incentives and efficiency. The discourse surrounding the microfinance movement is no exception. Understanding the nature of the incentives and efficiency tradeoffs involved in microfinance provides an essential first step when grappling with the challenges facing the industry. Yet both the commercialization advocates and social mission advocates can claim economic wisdom on their side.

Social mission advocates generally point to the lack of incentives on the part of commercial banks to serve the poor. The very emergence of the microfinance movement stems from this gap. The cost of administering one thousand $100 loans far exceeds the cost of administering one $100,000 loan. In most environments, serving the poor simply isn't profitable for the commercial sector, and therefore nonprofit organizations committed to poverty alleviation often step in to play this role. While such organizations are often capitalized by a blend of philanthropic donations and commercial finance, many social mission advocates fear that rapid commercialization may create a steep price for the reduced dependence on donor support. As microfinance merges and competes with commercial banks, the argument goes, the drive for profits will force organizations to leave behind their poorer clientele in search of less risky borrowers, and lenders will move "up market" by not offering the small loans needed by the poor.[6] Social services that are often offered in connection with microcredit schemes may be cut, as bank managers attend to the bottom line. Social mission advocates argue that sustainability ought to remain an eventual goal but not at the expense of losing the movement's social mission to assist the poorest of the poor. Social mission advocates often invoke the Gandhian principle that policy decisions be guided by their effect on the poorest members of society (Padmanabhan 2001). Although it promises sustainability, commercialization strikes many working within the microfinance industry as running counter to this principle.

In addition to attending to incentives, social mission advocates point out that on efficiency grounds, too, subsidies spent on microfinance organizations are money well spent. Instead of functioning as mere transfers, donor subsidies may generate Pareto efficient outcomes when funneled through microcredit organizations (Schreiner 2003a). In a study of Grameen Bank clients, Khandker

(1998) reported a cost-benefit ratio of 0.91, meaning a net social gain of $0.09 for every dollar spent in the program (as measured by improvements in household consumption). This result is particularly impressive when compared to the cost-benefit ratios of other poverty alleviation programs in Bangladesh, such as the World Food Program's Food-for-Work, or CARE's food assistance program, with cost-benefit ratios of 1.71 and 2.62, respectively, meaning that it costs $1.71-$2.62 to deliver $1's worth or relief (Pitt & Khandker 1998). In addition, the efficiency gains of microfinance efforts are even greater when we consider that the benefits to the household extend into the future as a stream of income (Morduch 1999).

Those who advocate the social mission approach to microfinance argue that if subsidies can support programs that serve the very poor (and not just those near poverty), this is further justification for continued subsidies, because according to standard social welfare analysis a dollar in the hands of someone at 50 percent of the poverty level has greater impact than a dollar in the hands of someone at 90 percent of the poverty level (Morduch 1999). Donor subsidization, typically in the form either of outright grants or of loans provided on concessionary terms, allows microfinance organizations to offer their clients loans at subsidized rates and deepens their outreach to the very poor (Khandker 1998). Social mission advocates thus argue that while sustainability ought to remain a goal for the long term, in the short term subsidization gives development organizations a significant "bang" for the poverty alleviation "buck."

On the other side of the debate, advocates for commercialization of microfinance point to the perverse incentives associated with continued reliance on donor support. They argue that commercialization is the only means by which the interests of borrowers, lenders, and private investors can come into alignment. Access to ongoing donor support reduces the incentive for organizations to adhere to commercial standards of transparency and accountability (Christen 2001b). As long as microfinance organizations can receive donor funds at concessionary rates, there is no incentive to pay market rates for commercial sources of capital, perpetuating the dependence on donor support (CGAP 2002a). Furthermore, while microfinance organizations curry favor with the donor community for continued sources of funds, they have less incentive to attend to the real needs of their clients, who demand greater diversity of services and could play a far more significant role in providing funds for the organization's operations (CGAP 2003).

Commercialization advocates see the efficiency argument in favor of continued subsidization as premised on a static view of resource allocation. They argue that while microfinance may have efficiency advantages relative to other poverty alleviation programs, the industry should not ignore the benefits that might accrue if microfinance organizations were forced to seek out commercial sources of funding and respond more directly to client demand.

Both social mission and commercialization advocates utilize standard economic discourse, but their typical discussion gets us no closer to an answer as to which path we ought to take. Market incentives may make organizations more responsive to the economic environment, but this response may require them to move away from meeting the needs of the very poor. As Morduch (1999) points out, the counterfactual scenario of reducing donor subsidies is important to consider in that although it may result in efficiency gains, there is no guarantee that such efficiency gains will be realized.

The Informal Sector and the Extended Order

In order to advance the discussion, we may find it useful to step outside the standard economic discourse. The insights offered by Austrian economist F. A. Hayek, in particular, provide another lens through which we might search for some direction.

Hayek's Concept of the "Extended Order"

Hayek's (1988) concept of the "extended order" refers to the process by which a human society develops the capacity to cope with increasing degrees of complexity. A complex society is one in which, for example, the producers and consumers of the same good have little (if any) direct knowledge of one another. More complex still is a society in which producers at different stages of production of the same good, or financiers and entrepreneurs involved in the same project, have little or no direct knowledge of one another. This complexity of economic relations is not created for its own sake, of course, but emerges in service of greater productivity as knowledge is divided and specialized across the market.

This growing complexity is built on the foundations of social and moral rules that coordinate the disparate interests, actions, and knowledge of individuals across society. Rules of contract, property, accountancy, moral conduct, and third party enforcement are among the social institutions that save individuals from having to solve anew the coordination and moral hazard problems that arise with every repeated transaction (Hayek 1973). Given the right institutional environment, the growing complexity of economic relationships feeds on itself, generating further specialization and division of knowledge across space and time.

Echoing Adam Smith's observations, Hayek (1973, 1988) points to the unintended benefits that result from such complexity. Though the rules of the extended order increase the number of impersonal connections, the benefits that accrue to society as a whole far surpass the benefit that could have been intentionally bestowed by charitable giving, even in the most selfless communities. The point is not that human beings are not charitable enough to benefit others directly, but rather that human beings, even if we take them to be sufficiently charitable, simply aren't smart enough to design a more benevolent system, if we measure benevolence by the outcomes produced rather than the intention to do good.

This is the central contribution Hayek makes to our understanding of development processes. The extended order and the rules upon which it is based extend the reach of our cognitive abilities beyond what we know directly. When we enter into standard contractual arrangements without thinking twice (how many of us actually read the detail provided in a typical real estate transaction, for example?) we are making use of knowledge accumulated through time. We are the beneficiaries of the trials and errors made by previous generations. The knowledge embedded within social institutions such as contract and law reduces risk, lowers transaction costs, saves time, and helps us anticipate and avoid pitfalls.

Essentially, the extended order expands our cognitive reach by transforming dispersed, private, local knowledge into usable signals that guide our actions in environments that would otherwise be too confounding for us to make meaningful choices (Hayek 1948). Market prices are certainly of particular importance to this process, not just because they provide incentives and allocate resources to competing ends, but also because they serve the vital cognitive function that makes economically rational choice possible (Mises 1981 [1932]; see also Lavoie 1995). Prices summarize in relatively clear form the subjective evaluations of countless consumers and producers. They also serve as meaningful guides to action in what would otherwise be unnavigable territory.[7]

Beyond Price Signals— Tacit, Local, and Embedded Knowledge

Prices are not the only tools that extend our cognitive capabilities beyond our own direct knowledge. Although prices provide invaluable information for rational economic decision making, Hayek (1948; 1935a, 1935b, 1940) was clear that it is market prices as situated in the larger institutional context that serve as effective guides to action. Much of the knowledge that guides our behavior is tacit in nature, embedded within social networks, intimately connected to the fleeting context of time and place, dispersed across members of society, and often not easily conveyed to others. Examples of this sort of embedded knowledge (and ways to effectively send the right signals to others) abound. Members of particular religious or ethnic groups, for example, might benefit from internal bonds of kinship or "brotherhood" that make readily available a network for employment opportunities, investment, lending and borrowing, and business advice.

Consider European and immigrant Jewish communities, for example, or overseas Chinese and other ethnically homogenous groups throughout the Western and developing worlds (Kotkin 1994; Sowell 1996; Landa 1995). It was no coincidence that trade and Islamic conversion emerged simultaneously across Africa, as Islamic values gave traders, merchants, and suppliers a moral code by which to organize their financial dealings and settle disputes. By offering financial tribute to the local mosque or by making the pilgrimage to Mecca, members could signal their commitment to higher values and enhance their reputation as someone who could be trusted (Ensminger 1992).

Membership within such groups might also afford benefits in dealings with the larger society. Consider, for example, the high reputation Quaker merchants enjoyed in the eighteenth and nineteenth centuries in England and North America. Believing that the "Light of God" resided in all people regardless of their heritage or faith, Quaker merchants gained a reputation for fair business dealings (Tolles 1948; Emden 1939). Some religious and ethnically homogenous groups continue to enjoy the reputation effects of experience and expertise in particular industries (such as Amish furniture makers in the Midwest or Mennonite volunteers in disaster response). In some such cases, the distinctive manner, dress, or speech maintained primarily by an ideological commitment may also carry economic benefits by providing the right set of signals to outsiders.

If the institutional environment allows individuals to make productive use of the private and local knowledge to which they have access, that local knowledge can then feed into and advance the extended order. Immigrant groups who have enjoyed economic success in the United States, for example, illustrate how the knowledge embedded within informal social networks can be mobilized to generate economic prosperity, but only if they can connect to the larger, extended order. For instance, Korean-American communities famous for offering savings and credit services to one another have facilitated the rapid rise of a merchant class (MacDonald 1995) within that group. Today, Koreans often arrive with substantial resources already in hand, but in the 1970s new immigrants were generally capital-poor, had no credit history with Western banks, and had limited English-language skills. Compared with the formal financial sector, community members were in a much better position to engage in mutual monitoring and enforcement and were better able to offer the kinds of services newly arrived immigrants needed. As Korean-American entrepreneurs cultivated expertise within particular industries, such as the construction, restaurant, and grocery industries, the community was able to provide another source of local knowledge not necessarily available from mainstream banking institutions.

Informal networks of support are undoubtedly beneficial to young and newly arrived members of a community, but it is the community's ties to the larger, often more formal aspects of the extended order that generate a marked record of success. If no one within the Korean-American community had ever been able to hold a bank account, secure a business license, or own property, the mutual assistance afforded within the group would have transferred resources to members in need, but it would not have translated into impressive, communitywide increases in prosperity. Established members of a community serve a vital bridge function by mobilizing the knowledge embedded within the social network and connecting it to the larger, extended order in the form of property ownership and the establishment of aboveground businesses, and by linking them to the commercial financial industry.[8]

Sociologists have explored a similar linking phenomenon in the literatures known as "network analysis" and the "strength of weak ties" (Burt 1992, 2001; Granovetter 1973, 1985; Lin 2001; Wuthnow 2002). Certainly social and economic benefits can be conveyed between and among people closely linked in a tight-knit social network, but if that network is poor and if members have no way to make links beyond the local network, the group as a whole is likely to remain poor. The Hayekian version of this story would emphasize not so much the personal connections (though these are certainly important), but would instead emphasize the mechanisms by which the knowledge embedded within the social and financial networks of the poor gets trapped and cannot be effectively mobilized to generate widespread prosperity. This disconnection between the knowledge embedded within the informal sector and the larger, extended order characterizes the circumstance of much of the world's poor.

Tapping the Knowledge Embedded Within the Informal Sector

When we grope for reasons why commercial banks in the developing world fail to serve the poor, we often write it off as an aloof disregard or a remnant of colonial enculturation. But this does little to solve the mystery. Economists and industry analysts are quick to point to the high information and transaction costs of lending to informal entrepreneurs, but this only backs the question up one more level. A good deal of the world's economic history (or at least that portion that is marked by increasing prosperity) can be told as the emergence of methods and mechanisms that allow human beings to more effectively tap and make use of knowledge embedded within local contexts. Double-entry bookkeeping, insurance and credit bureau ratings, and flexible interest rates are just a few among many examples of how dispersed and otherwise inaccessible knowledge can be summarized in forms that are ready at hand (Rosenberg & Birdzell 1986). So why the persistent gap between the formal financial sector and the billion or so people who have unmet demand for financial services?

When viewing these questions from a Hayekian perspective, we can see that the task before us is to understand better the barriers that keep the informal sector and the knowledge embedded within it from connecting to the knowledge system we are calling the extended order. Just as the formal commercial sector provides financial services to middle class and wealthy segments within the developing world, the poor also have access to financial services (Chamlee-Wright 1997, 2002). Systems of saving (such as the mobile saving agents known as susu men in Ghana), credit acquisition (such as the many different variations of the rotating credit organization [ROSCAs] and informal money lenders), venture capital and business finance (often from family members already established in trade), and even insurance and pension schemes (in the form of kinship bonds, fraternal organizations, mutual assistance societies, church organizations, and intergenerational tribute) serve the poor on a daily basis.

Embedded within these systems is a wealth of local knowledge regarding individuals' saving capacity, credit worthiness, business history, and insurability. Most of the relevant knowledge, however, is in a form that remains inaccessible to anyone who does not know the savings agent personally, does not know one or more members of a trader's ROSCA, or has no direct knowledge of a trader's business and family history. Certainly schemes similar to these have served the poor throughout time. But prior experience suggests that such informal mechanisms morphed or were absorbed into the larger, extended order (Lamoreaux 1986). What keeps the same thing from happening in the developing world?

The most obvious culprit may be the sheer size of the informal sector relative to the extended order in any given developing country. Unlike the example of the Korean-American community, which represents a tiny segment within a much larger population that is connected to the extended order, the poor operating within the informal sectors of the developing world represent a significant portion of any one country's population, making the search for connections beyond the informal sector that much more difficult. It is in this regard that the microfinance movement has the greatest potential benefit, in its ability to create catalysts for connecting the world's poor to the larger national and international extended order, a benefit to which we will return below.

Another critical point of disconnection is the fact that in much of the developing world, assets that belong to the poor on an informal level cannot serve as robust signals of creditworthiness and mechanisms of accountability, because their ownership rights are not well-defined. Hernando De Soto (2000) and his colleagues have provided detailed analyses of the phenomenon he calls "dead capital," in which the assets of the poor are held in ineffective forms.[9] For our present purposes, the critical point is to emphasize that well-defined ownership rights make a person a credible party in a contractual agreement. Property ownership allows a borrower, a co-signer, or an entrepreneur seeking equity investors to effectively signal that credibility to unknown outsiders. The problem of poorly defined property rights is not merely a relic of soviet-type economies, nor is it only an occasional policy debacle (such as the well-publicized confiscation of commercial farms in Zimbabwe). Poorly defined property rights are a fact of life for much of the world's poor, a condition that severs one of the most promising links that might otherwise connect the knowledge embedded within the informal sphere to the larger, extended order.

Related to the issue of poorly defined property rights is the uncertainty created by unnecessary and often arbitrarily imposed restrictions on local traders. The burden here is particularly onerous on urban market traders. Though some restrictions in the interest of safety and traffic flow may be required, the arbitrary and often violent way in which traders are removed from their selling areas imposes dramatic hardships. Confiscation of a trader's stock and destruction of fixed assets can wipe out an entrepreneur's capital overnight (Chamlee-Wright 1997). Furthermore, the expectation of governmental crackdowns on informal traders reduces the incentive to invest in fixed assets, likewise severing an essential link between the informal sector and the extended order (De Soto 1989).

Another barrier between the poor and the extended order is the tight control many governments retain over telecommunications. Even in the most formal economic environment, "word of mouth" plays an important role in conveying local knowledge across markets. Word of mouth is all the more important in the informal context in which so much of the useful knowledge of a community is embedded within tight-knit social networks. In regions where cellular technology has been able to take hold, word of mouth can travel and inform others far more widely than it otherwise could. A boy raised in a rural town has a better chance of leveraging his local social network if his uncle can use a cell phone to tell his business associates in the city about his promising nephew. Close-knit affiliations can be leveraged more effectively if the flow of communication outside of the local network is made cheaper and easier. Furthermore, cellular technology has enabled farmers and other producers distant from larger markets to connect to the knowledge flows of the extended order. For those in search of the best price for supplies and the best markets for their output, the technology often pays for itself, cutting down transportation costs by hours or even days and speeding up response times to fleeting market opportunities. Government monopoly or excessive regulation, however, makes telephone communication prohibitively expensive and cumbersome for the average entrepreneur, once again severing a powerful link between the informal sector and the extended order.

The point in raising these issues in the context of microfinance is to draw out the common theme shared among so many causes of persistent poverty. If the goal of the microfinance movement is to alleviate poverty, the key will be to find ways to connect the knowledge systems possessed by the poor to the larger, extended order. It is not for a lack of creditworthy borrowers, or a lack of people willing to save their resources, that the disconnection persists, but for the lack of ways the poor can effectively signal their demand and capacity to use financial services. In recognizing the failure of the commercial banking sector to respond adequately, the microfinance movement has stepped in, often with positive results. But it has stepped in without a clear sense of what long-term role it ought to be serving.

By emphasizing only the lack of incentives on the part of commercial banks to serve the poor, it may appear that the appropriate role for the microfinance industry is to provide an effective substitute for commercial banks, and then to compare its effectiveness against other poverty alleviation tools. If we look upon microfinance as just another policy intervention, however, the expansion of the industry will be severely limited. The resources available in the donor community are miniscule in comparison with what would be required to meet the potential demand for microfinance (CGAP 2003). Even if by some miracle donor funds available for microfinance increase by a thousand fold, the industry will remain limited unless effective links are more intentionally and more widely forged to the larger, extended order, fostering a knowledge system that is in effect far more "intelligent" (in its capacity to coordinate disparate interests, actions, and knowledge) than even the brightest minds in the donor community.

How Donor Support Can Help . . . And How It Often Gets in the Way

Utilize Risk Capital to Create Connections

Clearly, there is a positive role for the donor community to play in helping the microfinance industry to reach its full potential. Some of the most successful, financially sustainable microcredit organizations (BancoSol in Bolivia, for example) started as traditional NGOs. As Christen and Miller (2004) argue, the donor community can be particularly important in providing start-up capital to promising new programs (those that have the technical support and expertise ready to launch a successful program) but that might otherwise find it difficult to secure funding (because, for example, the target group is not yet tested). Donor support can also assist by helping to absorb some of the financial risk when established programs want to test new products and services. The guiding principle for the donor should not be primarily to provide services to a particular known group but rather to create the first, crucial connection that spontaneously generates many more connections. By assisting a promising upstart, the aim is to create a demonstration effect that inspires others to follow. By subsidizing promising innovations, the aim is to spread new ideas that reduce the cost and improve the effectiveness of microcredit services.

Improve Informatics

Another way the donor community can provide leadership is by promoting standards of transparency and accountability, helping to foster an environment in which potential investors, borrowers, savers, and other consumers of microfinance services can more easily compare various organizations' records of performance. Such transparency, in turn, would allow well-managed organizations to more effectively attract funding from a variety of private sources—sources which in the current context are reluctant to commit because of the lack of clear signals coming out of the microfinance industry. The Consultative Group to Assist the Poor (CGAP)—a consulting group serving donor members—is attempting to fill this gap by developing industry standards and best practices and distributing this information to donors and microfinance providers (CGAP 2003). The high profile the organization enjoys[10] has helped CGAP to play the role of "industry leader" and bodes well for its potential to set industry standards. In addition to improving transparency within microfinance, CGAP is attempting to push the donor community to adopt standards and practices that will reassert the centrality of financial sustainability as a core principle (and not just something that would be nice to have down the line). Many of the best practices developed and promoted by CGAP are directed at making the commitment to sustainability a credible one. As will be discussed below, however, the industry as a whole often generates pressure that undermines this commitment.

Promote Innovation and Infrastructure Development

Another important role for the donor community is in tapping embedded knowledge by facilitating the development of an information-sharing infrastructure among microfinance organizations, something akin to a credit bureau rating system. Such innovations are being tried within organizations; for example, client "scoring" that uses an organization's lending history to sort clients by known risk factors (Schreiner 2003b). As yet, however, there is no widespread use of technologies that will allow organizations to share information about specific clients with each other. This deficiency can have a disastrous effect in areas where many organizations offer microcredit. The primary disciplining mechanism in microfinance is the promise of future loans if past loans have been repaid. As more and more organizations compete in the same area, clients know that they can always borrow from another organization if they fail to repay their loan (Morduch 1999). This would not be the case if methods of information sharing across organizations emerged. In principle, this service could be provided on a commercial basis once the microfinance market matured enough to support it or by linking to consumer credit rating systems once they emerged. In the interim, donor subsidies might support initiatives that would fill this gap.

Consider Policy Reform

Perhaps the most important role the donor community might play is to use its considerable political leverage to reverse policies that effectively sever links between the poor and the extended order. By supporting reforms that formalize informally owned assets, reduce unnecessary regulations that impede trade, and demonopolize key industries such as telecommunications and transportation, the donor community can help create an environment in which the poor could more effectively signal their creditworthiness to people outside their own immediate circles.

Don't Perpetuate the Divide

Productive philanthropy connects people to systems so that beneficiaries eventually no longer need support. This is the promise the microfinance movement offers when it commits to fostering self-sustaining organizations, and, as noted above, there are ways the donor community can support the sustainable growth of microfinance. Unfortunately, however, much of the thinking in microfinance circles is nudging the industry away from this central principle. Though no one is opposed to sustainability as such, much of the donor support that is available has the unintended effect of undermining the industry's potential sustainability.

Avoid Political and Philanthropic Bandwagons

The popularity of the microfinance movement has created problems for it by forcing it onto the political stage and creating political pressure to move money even in the absence of appropriate outlets. Donor support of organizations that do not have the expertise or capacity to run an effective program creates havoc for well-run organizations operating in the same market that might otherwise be sustainable. By propping up ineffective programs, donors reduce the incentive for clients to repay their loans, and that makes it harder to attract private funding. Further, apexes (wholesale mechanisms designed to fund microfinance programs), especially those under government control, often face political pressure to fund organizations poorly suited to manage those resources. According to Levy (2002), the principal barrier impeding microfinance development is not the lack of resources but rather the lack of retail outlets capable of absorbing the resources that are available. Campaigns targeting increased funding for microfinance will have little positive effect if there is no capacity to absorb the resources at the retail level.

Adhere to the Principle of Sustainability

When it de-emphasizes the goal of sustainability, donor support can sever the link between the microfinance industry and the clients it serves. Rather than developing new products to serve poor consumers of financial services (e.g., insurance, savings, remittances, pensions, consumer credit) or finding innovative ways to deliver financial services at lower costs (e.g., rural delivery trucks, remittance services), or connecting to homegrown sources of financial services (e.g., susu men, ROSCAs), organizations can often let donors captain the ship (CGAP 2002b, 2003). Though the knowledge accumulated within the donor community can serve many purposes, donors should encourage microfinance providers to rely on their most valuable source of knowledge, that which is embedded within their client base. It is in the success of the borrower rather than the wishes of the donor where the greatest potential for sustainability lies.

Encourage Entrepreneurship

By its very nature, donor support in the form of one-way grants often shields organizations from having to think entrepreneurially and thereby delays their evolution into the next stage of microfinance development. Given that the microfinance movement emerged out of an NGO environment, it is not surprising that most of the organizations offering microcredit have a social service orientation. This “non-corporate” corporate culture is perfectly appropriate for many organizations working with the poorest clientele, many of whom lack even the most basic literacy and bookkeeping skills (Chamlee-Wright, 2005). This third-party payer system, however, is clearly not the most appropriate orientation for organizations serving experienced entrepreneurs and people with significant savings and investment capacity. Donor support can have the unintended effect of delaying this cultural transition by institutionalizing a system in which NGO directors are rewarded more for securing the next $100,000 grant than for cultivating an understanding of what products and services their clients need and for which (and how much) they are willing to pay. The result is that organizations can come to focus more on philanthropic fundraising than on the entrepreneurial business development and refinement that are at the very core of their social mission.

Conclusion

Traditional economic analysis can inform the way forward for the microfinance industry, but we need to go beyond the discussion of incentives and efficiency tradeoffs. We need to consider also how the complexity and dispersed nature of the knowledge embedded within informal economies, social networks, and indigenous methods of savings, credit, and risk management can be turned from a hindrance to an asset. A Hayekian understanding of the nature of knowledge in the extended order helps us to see the debate between social mission and commercialization in a new light. In contrast to the Gandhian approach of ensuring that the poorest members of society are directly benefited by our policies, a Hayekian reinterpretation would ask whether the policy under consideration would allow the poorest members of society to make better use of the knowledge embedded within their own social and economic networks, whether the policy would allow the poor to more effectively signal their attributes to unknown outsiders, and whether the policy is likely to inspire the spontaneous creation of new (though unknown in their details) connections between the poor and the extended order. When we consider these criteria, we see that the best way for the movement to fulfill its social mission is to pursue the path of commercialization.

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ENDNOTES

[1] The term "microenterprise" was coined by Accion International as it launched what is widely considered the first microcredit organization in Recife, Brazil.

[2] See, for example, discussions posted on the website of the Consultative Group to Assist the Poor (CGAP) at http://www.microfinancegateway.org/.; See also Morduch (2000).

[3] Alternatively, one might refer to the "BancoSol model" that promotes commercialization and the "Grameen model" that pursues continued subsidization on the grounds that it can then provide social services to clients and loans at subsidized interest rates.

[4] The language is problematic in that it might suggest that "commercialization advocates" are unconcerned with the social impact of microfinance, or that "social mission advocates" see no role for commercialization, both of which would be inaccurate.

[5] Contrast, for example, the emphasis Christopher Dunford, president of Freedom from Hunger, places on “deep outreach” (as opposed to sustainability), and the emphasis Brian Branch, vice president of the World Council of Credit Unions, places on commercialization in the Microfinance Gateway discussion on the U.S. Poverty Mandate.

[6] Empirical analysis of this question is in its infancy. See Christen and Miller (2004) and Christen (2001a) for discussions of mission drift among commercial microfinance providers. The authors point to the mixed nature of the evidence and the difficulty of drawing clear conclusions at this stage of the industry’s development.

[7] We should point out that even price signals rarely dictate an obvious and unquestionable course of action. Rather, prices need to be assessed within the context of past experience, knowledge of possible alternative courses of action, and expectations of future outcomes. Reading price signals is more an exercise of complex interpretation rather than a robotic response (Lavoie 1991, Ebeling 1986).

[8] When considering the differences among informal social networks within the industrialized context and informal sectors within the developing world, it is tempting to say that the differences in economic prosperity can simply be attributed to the fact that the former are within the context of wealth and the latter are not. But many immigrant groups within the industrialized world remain poor for generations. This is particularly true in countries where restrictive policies essentially lock immigrant groups out of the larger, extended order. See Lynch and Simon (2003).

[9] According to De Soto (2000), acquiring legal authorization to build a house in Peru is a seven-year process involving 207 legal or bureaucratic steps and 52 government agencies. Acquiring legal title to the land itself requires an additional 728 steps. In the Philippines, acquiring legal title to land involves 168 separate steps and fifty-three government agencies, and can take thirteen to thirty-five years. In Haiti, residents seeking legal title must first lease the land from the government for five years. This involves sixty-five separate steps and can take up to two years. Purchasing the property requires another 111 steps and another twelve years.

[10] The World Bank is one among many prominent members.

COMMENTS

Frederick Turner

These two fine essays, although as different in style and approach as they could be, address a shared issue. And despite their apparent contradictions, they do not basically disagree, and can be seen as different parts of a common solution.

The fundamental issue that both authors grapple with is the apparent absence, in philanthropic activity, of an Invisible Hand—of a self-organizing, polycentric, calculative process that transcends the limitations of its participants and points them all to the real needs and opportunities in the field. The price mechanism is the classic example in economics. Other areas of human activity are known as well for their marvelous ability to generate robust and subtle signals out of the local interactions of a multitude of actors even though individually such actors may be blinkered by selfishness, weakness, myopia, and unawareness of the big picture.

The scientist and philosopher Michael Polanyi would cite the process of normal science, in which the system of learned journals, testable hypotheses, repeatable experiments, peer review, and a currency of professional esteem combine with the rivalrous and ambitious selfishness of individual scientists to create robust knowledge. Likewise the system of legal review, in which *stare decisis* and precedent combine with appellate court discipline, constitutional principle, and legislative innovation to produce a modicum of justice, even when advocacy is, on the individual level, often unscrupulous and self-interested. Similarly, the system of separation of powers, democratic elections, free press, and limited government that the framers of the U.S. Constitution devised is a fairly successful example of an artificial Invisible Hand whereby contentious and shortsighted voters can produce coherent and sensible policy.

Flaws of Top-Down Planning

Clearly there are fields where central direction is essential—the classic examples are a ship's need for a single captain or an army's need for a commander-in-chief. The flaws of top-down planning, however, have become all too clear in recent decades—not only in government, where they are glaring, but in corporate business culture as well. The challenge facing the philanthropic voluntary sector today is that the process of giving has become essentially a top-down and arbitrary affair. The very virtues of philanthropy—the unselfishness of its central activity of giving, the benevolence of donors, the frequent universality and spirituality of its motivation—remove the nasty incentives of self-interest, competition, and myopia that, paradoxically, drive the Invisible Hand. We do not look gift horses in the mouth, for it is churlish to criticize the generous impulse of a giver who puts his money into some wasteful and ineffective but benevolent project, and in any case he is free to give his money where he pleases.

Emily Chamlee-Wright and Heather Wood Ion approach this tension and the resulting challenges in two different ways.

Chamlee-Wright finds in microfinance a way for philanthropy to piggyback, so to speak, upon the virtues of free-market economics. Using powerful economic ideas such as the establishment of legal property rights and lenders' risk assessment, she advocates the improvement and streamlining of existing systems of banking for the poor by imposing the kinds of discipline that effective conventional banks use to compete successfully with each other. She seeks ways in which philanthropic interventions in the economy need not compete with and drive out the nascent vitality of local free markets. She encourages creators of microfinance programs to put in place the feedback systems and communicative signals that ignite spontaneous nonlinearity in a system and cause it to begin to govern itself irrespective of the flaws of its individual participants.

Most important of all, Chamlee-Wright retargets the aim of conventional philanthropy, which since the Progressive period has been to hand over to government the beneficial social policy pioneered by the charitable foundation, thus supposedly assuring its sustainability. This she accurately diagnoses as the kiss of death for any program, however well-intentioned. Instead, she seeks to pass over into the arms of the free market the processes and ideas initiated and tested by charitable seed capital, which will provide a much sounder basis of sustainability.

Ion tackles the problem at a more fundamental philosophic level, looking at our basic vocabulary of philanthropic and economic concepts. What really counts, she asks, and what are we counting when we try to evaluate philanthropic or, in general, economic benefit? How do we measure benefit, and what is our measure when we do so? If we have a hammer, everything looks like a nail; if our goals are replicability and scalability—the goals of marketing, scientific theory-formation, legal principle, and democratic government alike—are we not in danger of ignoring precisely the problems and needs that charity alone is capable of addressing, which are almost always exceptional, individual, personal, unreplicable, and unscalable? In attempting to create systems that do not need human love and insight and generosity, are we not risking the loss of those self-validating values in human life? Can truly nonlinear systems be measured? Can true transformation in a society and a culture, which is required if the age-old enemies of human life are to be defeated, be easily counted or accounted for, when such transformation is by nature irreversible and unpredictable, and when it changes its own parameters and basic questions? We should be seeking not just to improve the curve on the graph but to alter the axes and the metric of it.

Ion proposes that the artistic sense of the word measure be brought in to supplement the scientific or economic meaning of it—the measures of dance, music, and poetic meter. In so doing she is by implication invoking another nonlinear system that we have not yet mentioned: the process of genre-making, reception, appreciation, and canon-formation in the arts. Though much slower and messier than the market, legal review, science, and even democratic government, it does nevertheless ensure that great works of art get created, recognized, preserved, and set up as guides and examples for future artists.

Ion cites the example of WORTH, a women's empowerment program operating in Nepal, Kenya, and other places, which combines a savings program for very low-income people, with basic literacy, health, and business education and an appreciative inquiry system in which opportunities and initiatives are proposed and tested. Certainly the program is practical, but it is also strongly imbued with human values and based on local traditions: it does not talk down to its beneficiaries, but instead charges them a small fee for their participation, so that the outside experts are in the position of having been hired by them as partners and helpers. Above all, Ion maintains, people's sense of their own life-narratives, their own stories, is all-important. Change must take place in such a way that the artistic construction of one's life through narrative coherence is encouraged rather than suppressed or replaced.

Lessons for Other Charitable Activities

Both essays are valuable in pointing the way to a sounder philanthropy. While both address microfinance, and therefore do not directly critique other areas of philanthropy such as scientific and medical research, arts patronage, higher education, disaster relief, and epidemic emergency management, they may have indirect lessons for other charitable activities. The weaknesses of Chamlee-Wright's "market" model are implicit in Ion's critique of conventional accounting measures—their failure to deal with the "tails" of the probability curve of human vicissitude, the life story of the individual, a person's unique historical or cultural double-bind, and the value commitments and developments that make human life human. The flaws of Ion's more aesthetic model are its messiness, its slowness, the difficulty in developing useful accounting approaches, and the potential for destructive competition with budding markets and other local, spontaneous movements that might have taken place instead. In addition, the arbitrariness that comes with the inequality of economic and informational power when the very rich attempt to help the very poor will always tend to distort the process, despite the most sedulous moral effort to counteract it.

These objections, however, are not fatal. For this writer the most startling effect of these two important pieces was to make me reevaluate my own field of action, which is chiefly in literature and the arts. Perhaps there is already a nascent Invisible Hand in the way that a civilization assesses its accumulating stock of poems, plays, paintings, musical compositions, architecture, and the like. Chamlee-Wright helps me to see the importance of competition in the emergence of the best work. Though in the arts such competition is usually called emulation or influence, it bears a real resemblance to the way firms try to beat each other's value for money, scientists try to disprove each other's hypotheses, lawyers try to win on appeal, and political parties campaign. Yet art is itself basically a culture of gift—the artist is very happy to prosper or at least make a living by his art, but would, driven by the love of it, make his art anyway and be glad if anyone accepted his gift. All the same, though he will usually not admit it, he is trying, however hopelessly, to outdo Shakespeare, Beethoven, and Michelangelo, and to win an audience that is presently listening to or viewing the work of his contemporaries.

Thus something akin to competition is still at work, even when the motives are not self-interested, as they are in the market or the political arena. Since it is competition that lowers prices, improves service, refines the law, and solidifies scientific theory, it can also serve the world of the arts. And if Ion is right in extending the aesthetic model to philanthropy, perhaps a competitive Invisible Hand can emerge even in the generous and morally demanding work of charity.

The implications here are quite interesting. Perhaps we need to think about instituting in philanthropy mechanisms analogous to those that make the arts work: critical reviews, exhibitions, public performances, literary and aesthetic education, historical and biographical accounts, periodicals, prizes, commissions, and so on. What would such institutions be like? How would they match the donative spirit of philanthropy as artistic institutions match the aesthetic spirit of the arts?

J. D. Von Pischke

Gandhi v. Gauss

The jarring dissonance between Gandhi's soaring plea and Hayek's quotidian observation that begins Emily Chamlee-Wright's discussion of the "extended order" has to be balanced in practice. If the last 20 percent of any march to perfection consumes 80 percent of the energy and knowledge required, surely the last single obstacle to be overcome demands an inordinate proportion of application. Depending on costs and benefits, some stopping point short of 100 percent is acceptable. Reasonable limits may be approached differently in the social world than in the physical world.

Because uncertainty is inherent in human action, a rational society finds diverse ways of dealing with "the least of these." Heroic intervention is possible and sometimes laudable, but transforming the overall human condition is inevitably a slow process. Stunning results over centuries are possible and increasingly realizable in the modern, liberal era, but the process is not widely understood, requires patience, and is fraught with unintended effects (Powelson 1994).

Large-scale interventions from on high tend to centralize power, easily slow reform, and create new problems that may dwarf those they were intended to cure. However, modest, decentralized, and competing efforts that require a commitment by the intended "beneficiaries" often do better or fail in less harmful ways. In such cases, transformation—opening up entirely new possibilities and establishing new boundaries—is likely.

As elaborated by Heather Wood Ion, microfinance is a vehicle for transformation. The most transcendent form of innovation in finance occurs when new ways of managing risk are discovered. The answer to the basic question in credit markets—"What do you think you are lending against?"—is recast through innovation (Von Pischke 1991). How else could Grameen Bank monetize the promises of poor women who had never held coins or banknotes in their hands? By rendering traditional forms of collateral no longer necessary, peer group discipline created the basis for a new market (Bornstein 1996).

The Context: A Messy Road Map

An introduction to microfinance can sketch the context for transformation through journeys into the extended order. As might be expected of a dynamic, widely dispersed activity with a range of objectives, only generalizations are possible. For example, the range of microfinance institutions' practices includes the ritualistic washing of feet, concern for household health, and hi-tech ATMs and point-of-sale transaction processing. It all began in the early 1980s with Grameen Bank in Bangladesh as a social movement centered on group credit, and with Bank Rakyat Indonesia's "village units" making individual loans on a commercial basis and collecting deposits on an incredibly large scale (Robinson 2002).

Broadly generalizing, the structure of the microfinance industry consists of two types of institutions, nonprofit NGOs and for-profit, commercial, microfinance institutions. The former are associated with group lending and modest amounts, the latter with individual lending and somewhat larger amounts. Many microfinance NGOs are changing their corporate form, becoming licensed commercial entities in order to attract deposits, increase their access to capital, and be regulated by the state as an admission ticket to broader financial markets and for better governance. NGOs often serve primarily women, tend to be concerned about social impact, and may be "maximalists," providing social services, training, and other interventions to promote the welfare of their clients. Commercial providers are often "minimalists" that provide only financial services, which simplifies and clarifies governance. Minimalists may not be concerned with impact, assuming that their clients are rational, and may be indifferent to the gender of their clients.

There may be more than ten thousand microfinance institutions worldwide. One hundred appear to be profitable, and another hundred may become profitable; these entities have a disproportionately large market share ("MicroBanking Bulletin"). Cooperatives are active in microfinance and generally conform to cooperative principles—traditional or modern—in outreach and governance.

The most popular use of microfinance is for trade, helping retailers buy more inventory to expand their businesses. Services, such as all sorts of repairs, catering, and similar enterprises are often in second place. Agriculture and manufacturing usually account for small fractions of microloans issued.

Microfinance clients are seldom the very poor or destitute—the bottom quintile of the poor—as they usually face problems that loans do not ameliorate. The working poor are those most likely to benefit from microfinance (Rutherford 2000).

How micro is micro? Donors define limits for their own purposes; lenders' definitions vary from country to country. The upper limit for micro may be $10,000 in Eastern Europe and $250 in a destitute African country.

Microfinance interest rates are "high." Annual rates greater than 50 percent are not unusual, and few commercial microfinance institutions charge less than 20 percent. These rates largely reflect the transaction costs of making tiny loans: costs of capital are usually low, even zero for grant-based lenders, and risks are generally small. These rates are attractive to borrowers because their range of choice is limited and because their total costs, consisting of transaction costs and interest charges, are lowered. Microentrepreneurs jump at this money because it is cheaper and more dependable than informal sources. Local financial markets are often dreadfully inefficient, and banks are not generally interested in this business, except possibly as consumer finance.

One major microfinance institution views a competitive microfinance market as a means of making financial markets more efficient generally (Schmidt and Zeitinger 1996). This institution targets those who have never before had access to formal credit and caters to small businesses, which create jobs for the poor. Countries with efficient financial markets fare better than those without them, other factors being equal, and more efficient financial markets benefit the poor disproportionately because of spread effects (Beck et al. 2004).

Donor agencies create sources of information, promote standardization of terms and definitions, and support "best practices." Entities associated with the World Bank include CGAP (Consultative Group to Assist the Poor) and The MIX (Microfinance Information eXchange). Several specialized microfinance rating agencies are in business, and some large microfinance institutions have been rated by one of the big three: Moody's, Standard and Poor's, and Fitch.

Impact evaluation is important to donors, and methodological problems common to social science are inherent in this quest (Dunn 2004). It is not absolutely clear from a scientific perspective whether microfinance generally fosters "development," but circumstantial evidence on the ground suggests that microfinance is a vehicle for transformation, in exactly the terms and logic specified by Ion.

Microfinance as the Frontier of Finance

The broad concept of the extended order fits nicely with the more limited scope of the microfinance revolution. The latter invades the former because microentrepreneurs—the customers of microfinance institutions—have a range of choices in how they use their loans. They may enlarge their own businesses, and some may conclude that they are in the wrong business and migrate to more remunerative opportunities.

Transformation occurs as microentrepreneurs explore the extended order. For many, their loan contracts are the first voluntary formal transactions they have undertaken, where they are willing to be held accountable to a formal institution and its procedures, where their businesses have an address, where they can exercise property rights as business owners, where they are treated as clients on an equal footing with others of similar status, and where incentives for good performance in the extended order are alive (Gonzalez-Vega 2005).

Their understanding of an extended order is nicely portrayed by one dimension of their behavior—loan repayment rates. In well-run, commercially oriented microfinance institutions that use individual lending, it is possible to achieve rates of 99 percent in southeastern Europe, 98 percent in Latin America, and 97 percent in Africa, relatively consistently (for example, see www.procredit-holding.com).

Repayment rates plus arrears rates equal 100 percent. The arrears rate commonly used in microfinance (but not by Grameen Bank—a fading star) is based on the *full outstanding amount* of any loan on which any amount that has fallen due remains unpaid for thirty days. These loans are then calculated as a percentage of the total loan portfolio. For example, $1 that is thirty-one days overdue on a loan balance of $1000 would cause the entire $1000 to be classified as being in arrears. Many microloans are installment loans, which produce information throughout the period to final maturity. These two features—installment loans and using the full loan amount outstanding to quantify arrears—constitute a rigorous test.

These arrears rates are below those of North American credit card portfolios. And when crises occur in poor countries, microloan portfolios tend to fare considerably better than those of mainstream commercial banks in both duration and intensity. Penetration into the extended order is increasingly alive, well, and positively and productively seductive for more and more millions of entrepreneurial poor people.

Commercial Practice Will Grow Faster Than Charitable Endeavors

Chamlee-Wright asks which way forward, and evidence suggests that the best way is increasingly commercial: commercial funds—the world's capital markets—are enormous and dynamic (Goodman 2006; Pouliot 2006), whereas donor funding is limited and constrained (Ivatury and Abrams 2006). As Chamlee-Wright suggests, an increasingly productive symbiosis consists of donor grants to establish microfinance institutions, donor loans to provide start-up assistance, and "patient" donor investment in the stock of commercial microfinance institutions. As commercial scale is reached, private capital and deposits take over. Donor loans are repaid, usually within five or ten years. Donor stock will be retired more slowly. This arrangement accelerates access: limited state funds leverage enormous volumes of private capital (Brugger 2006). Private money is increasingly available in the form of private equity/venture capital. Commercial microfinance debt and equity are included in pension fund portfolios, and within a decade retail investors are likely to be attracted to microfinance (de Sousa-Shields 2006; Pouliot 2006).

Microfinance institutions that offer savings facilities tend to attract more funds than they can lend, especially in poor countries where there are few safe places to save. In addition, the number of clients who are savers only is usually larger than the subset that only borrow or who have both savings accounts and loan accounts (Robinson 2002). This suggests that these institutions are achieving large gains in trust, longer time horizons, and changes in cautionary behavior and in creative capacity—all of which are attributes of the extended order and of transformation.

The core of the commercial formula is secure. Micro will become increasingly mainstream, moving money into the bottom end of the market through increased experience, efficiency, and new ways of viewing risk, such as by credit scoring. Continued probing of the frontiers of finance, supported partly by donors, is producing a current that is increasingly navigable.

Official donors and others in a charitable mood or mode will continue to be active in trying to help "the least of these." Social mission advocates, using grants, will continue to achieve political victories for their own programs and organizations, as in the case of the microfinance institutions serving the $1 per day clients that by law consume half of USAID's microfinance funding. This should ensure that microfinance does not succumb to "mission drift" away from programs that serve the very poor, such as the one in Nepal described by Ion.

Donors in particular are becoming impatient with approaches that build one microfinance institution at a time. Why has it not been possible to achieve massive breakthroughs, especially in large countries with large retail financial institutions? What new types of services could attract the majority of poor people to the microfinance revolution? Possibilities include "connectivity" that reduces sellers' transaction costs through shared electronic infrastructure, "plastic" cards that provide low-cost access for the poor, and "proxy" applications of credit scoring that use large databases rather than detailed credit analysis to determine loan size and repayment probabilities (Schreiner, forthcoming).

Outlook

Experience with the extended order gained through microfinance is likely to promote better definition of property rights, stronger basic civil rights, and better lives for very large numbers of people. While the early promotion of microfinance exhibited breathless enthusiasm and a low regard for commercial performance at the level of individual microfinance institutions, a commercial approach to microfinance is now commonly viewed as a commitment to sustainability. But some nonprofit NGOs that require continued injections of subsidy will also survive as effective providers of microfinance at the very small end of the market (Von Pischke 2002).

Hayek's extended order characterizes all facets of the spectacular growth of microfinance. Poor borrowers find greater opportunities and become comfortable in a greater variety of roles and situations. Their action changes the extended order, as does that of the microfinance institutions that serve them. Donors, investors, and regulators are also part of this universe. Transformation continues with the constant quantitative soundings that are the daily routine of finance (Pattillo 2006).

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Alejandro Chafuen

Heather Wood Ion begins her paper by citing insights from Peter Drucker and Edward Deming, two very knowledgeable management experts. Drucker stated that "95 percent of what matters in an organization cannot be counted"; Deming, that "95 percent of the time within an organization is spent on measuring." I will add to these insights that of another management guru, Michael Porter, who has claimed that "billions are wasted on ineffective philanthropy" and that "philanthropy is decades behind business in applying rigorous thinking to the use of money." Those who want to improve the theory and practice of philanthropy need to be aware of both challenges: the need for rigorous thinking and the need to acknowledge that many important things can't be measured.

Although Ion's paper focuses more on the topic of measuring success at nonprofits than Emily Chamlee-Wright's contribution does, both wrestle with the same questions: How can we know how much good we are doing in nonprofit, microfinance endeavors? How can we improve the sector? The insights of both authors have value for the entire nonprofit sector.

Economists know that having more of any scarce and useful product is a positive thing. Abundance becomes detrimental only after passing a level of saturation. Just as too much water in soil can damage certain plants or lead to flooding, too many resources flowing into microfinance initiatives could lead to negative outcomes for the field. As long as it is not subsidized, the more microcredit the better, but if it is subsidized, with grants or with donated time, we should begin to take consideration of tradeoffs.

Knowledge Through Prices

In understanding the economic allocation of resources, one of the key questions we ask is, "How do we know we are using scarce resources in a manner that, in satisfying one need we do not leave another, more urgent, need unsatisfied?" Thanks to private property, markets, and the evolution of money, in the profit economy we have price signals which help us determine economic efficiency. Property, markets, and money arose from, and helped expand, the division of labor among participants unknown to one another (the

Hayekian "extended order" mentioned by Chamlee-Wright). By comparing prices, people who do not know each other can nevertheless learn from the results of social cooperation. After they sell their harvest, farmers who have an adequate knowledge of the price of new seeds, fertilizers, and other factors of production can assess whether they helped create or destroy wealth. The entire farming exercise may have been spiritually rewarding for the farmer; it may even have been a helpful and long-term positive professional experience, but unless the farmer finds a way to produce more than what his activities consume, as measured by the market process, his material well-being will plummet. If one generalizes this situation, we end up with a farm community consuming more than it produces, yielding a poverty-generating sector.

The assessment of whether a particular economic activity generates or dissipates wealth is possible only because of the existence of market prices. Prices are signals that reflect the relative scarcity of a product and thereby signal to entrepreneurs what activities are most likely to generate wealth. Philanthropies operating in a market economy likewise can use price signals to operate, but as their products or services are not sold, or are sold below market prices, we can't arrive at a conclusion as certain as the one at which we arrived in the example of farming. Those of us who work in the philanthropic sector place a high, even ethereal, price on the goods and services we provide, and that satisfies us that we are adding value.

Early economists among the late medieval scholars proposed a category of human action called "mixed donation." The term describes the practice of willingly selling a good at below the market price to help another person or organization. It also applies to those activities that we perform which, apart from increasing the value of our assets or creating some income, might help others and give us a spiritual reward. Planting trees to prevent soil erosion, while getting a small government subsidy or tax rebate in return, is an example. By contrast, it is often the belief that true, "pure" philanthropy is that which is given without expecting to receive something tangible in return.

The need for a concept such as mixed donation points to the complexity of evaluating philanthropic activities. Ion's paper likewise demonstrates that assessing the value of some of the most important aspects of philanthropic activity is difficult and that there are some outcomes that can't be measured at all. Nevertheless, as most philanthropic products have some competition in the for-profit sector, there are many areas where it is possible to measure results or at least have an approximation of effectiveness. The more the product of a nonprofit resembles the product of for-profit organizations, the easier it is to measure its effectiveness. Comparing results of a for-profit high school or university against a nonprofit entity can produce very relevant results. If we see a growth in the for-profit microfinance business, philanthropies working in the sector will be able to compare their cost of delivering a loan with that of their competition. If they neglect such self-evaluation, other not-for-profit or for-profit outfits will step in and do the job more efficiently. Microrate.com, a rating agency dedicated to the evaluation of microfinance institutions, is one example of this process.

Structures for Empowerment

To make her point, Ion focuses on the work of WORTH, a Women's Empowerment Program in Nepal. The women are encouraged and trained to save money which is then invested in their microenterprise. Each woman, writes Ion, "is put in contact with a literacy volunteer" and then goes on to learn how to work with numbers and basic accounting practices. To take part in the program, which provides no subsidies, the women pay a small fee. They are encouraged to be creative and not dependent on gifts. The structure of the program, according to Ion, "is in direct contrast to traditional approaches to philanthropy, which create dependence and are episodic in their focus on a specific 'problem' and its solution."

The major focus on helping women increase their personal skills and perception of self-worth creates a personal change which Ion regards as the most important contribution of this philanthropic effort. These women "are *transformed* from being defined as 'the poor' or 'in need' or recipients, into givers or teachers."

This great potentiality of human persons when there is an increase in respect for their dignity was also brought to the surface by the research conducted since the 1980s by Hernando de Soto and the Institute for Liberty and Democracy in Peru. The studies, originally published in de Soto's book, *The Other Path*, showed that the major barriers that the poor were confronting were the burden of governments' economic interventionism and over-regulation. Despite these hurdles, the poor working outside the formal economic sector were able to produce and accumulate an enormous amount of assets. In de Soto's *The Mystery of Capital*, a sequel to *The Other Path*, he further quantifies the wealth created by the poor, a wealth which yields only a small fraction of its potential fruits because of the weak rule of law and lack of respect for private property in the society.

I recall that almost twenty years ago, at the "Oxford Conference of Christian Faith and Economics," an outstanding Christian scholar from India, Vinaj Samuel, remarked during a keynote speech, "for years we have seen the poor as the victims or the necessary destinaries of our paternalism. *The Other Path* has shown us that the poor are a great source of wealth and creativity." De Soto's effort to quantify the number of days, steps, and bribes that it would take to register a simple business, and then, in his second bestselling book, to measure the amount of assets created by these informal endeavors, was essential in helping us begin to recognize the potential for wealth creation among the poor and to identify ways to unleash it. Unlike De Soto, Ion seems unaware of the key role played by the sense of ownership, be it private, familial, or even communal, in this process of change.

In addition to omitting discussions of the role of property rights, Ion may leave measurement too far behind. The fact that there are efforts that are not measured appropriately does not invalidate the need for measurement. Ion tells us that after major funding from USAID dried up, the WORTH project continued on its own and created between eight hundred and two thousand new economic groups reaching fiftenn thousand to forty thousand women, and points out that "since they are doing this on their own, no one knows accurately how far they have reached." The fact that there are efforts that are not measured appropriately does not invalidate the need for measurement. The statement by Ion would carry much less strength if instead of providing a rough estimate she had stated that WORTH has created many groups, reaching many women. Although Ion states that "the measures of success of this program do not conform to audits and accounting terms," she nevertheless acknowledges that those who run WORTH seem meticulous in trying to measure as much as they can for each aspect of their work and impact, even if much is unaccounted for and indeed unaccountable.

The Value of Traditions

Ion is correct, I believe, in stating that one of the most important lessons for philanthropy is the value of working primarily "through the use of existing local traditions" in ways that respect "the participants' autonomy and their positive strengths within the context relevant to them." In the line of business I am most familiar with, policy and educational think tanks, that has also proved to be the best strategy. There are, however, certain basic principles, rooted in human nature that seem to work everywhere: notions of trust, respecting commitments, timeliness, etc. During a workshop for nonprofit think tanks I once attended in Cairo, an expert from the World Bank likened these principles of human nature to a Japanese bonsai tree: if one respects the rules of how to grow those trees, they can survive and prosper anywhere.

My views are slightly different. I believe that successful think tanks, and this can be generalized to successful nonprofits, are more like vines for wine. To produce good grapes, they need to be a variety that adapts well to the local terrain. Even then, it usually takes many years to produce the first good wine. The vines need to plant deep roots in the local soil. Principles of sound management, including leadership, measurement, and accountability, work everywhere, but they need to be adapted to local contexts. Those of us who try to help philanthropies from outside, as Ion observes, need to respect local traditions and work as enablers more than as the actors ultimately responsible for the success of the effort.

From the importance of "dreaming" to her discussion of how change and learning depend on the sharing of information, there are many insights in Ion's paper that I see confirmed time after time in the nonprofit arena. One of the authors she quotes states that great change occurs "first in the minds of people," and hence information is "the wealth of nations; it explains the poverty of nations." Yet, someone has to use this information, has to have the proper incentives to act upon it. It is in this aspect of the use and the incentives to use information that I find Chamlee-Wright's paper to be a good complement to Ion's. Market incentives do matter.

The Value of Market Incentives

Chamlee-Wright analyzes microfinance, but she focuses more on the knowledge generated by social interaction and the market process. She asks, "Will the development of microfinance in the first half of the twenty-first century be advanced most effectively by significant increases in donor support, or by a massive commercialization of the industry?"

The path of commercialization, which Chamlee-Wright sees as the road which can best help reveal the knowledge existing in social networks, is really a path of ownership and better definition of property rights. She correctly names property and contract as two of the social and moral institutions which allow the extended order of the market to disseminate knowledge. Market prices, as she states, "are certainly of particular importance to this process, not just because they provide incentives and allocate resources to competing ends, but also because they serve the vital cognitive function that makes economically rational choice possible."

Chamlee-Wright also describes some of the dangers that might take place with increased commercialization. "Market incentives may make organizations more responsive to the economic environment, but this response may require them to move away from meeting the needs of the very poor." Current dynamics are moving organizations to focus on efforts that, as she suggests, are more helpful for their fundraising than for "the entrepreneurial business development and refinement that are at the very core of their social mission."

The answer to these tensions between fundraising and mission activity might be a process where some of the activity in the microfinance market continues to move toward commercialization and bigger clients while other efforts enter the market to serve the poor. Within the nonprofit groups, we might see them develop a two-tier product line: one to attract larger donor grants and keep building capacity, and another to continue serving the neediest candidates. In such cases we would begin to see how interdependent commercial and philanthropic action can be.

The Importance of Design

Chamlee-Wright's major point, the need to connect the poor to the extended network of the market order, takes me to my last topic for discussion. Ion, at least in her paper, tends to pay little attention to the importance, in economic development, of market incentives and a rule of law based on respect for people and their belongings. Chamlee-Wright takes these institutions into account but does not focus much on how this network or rule of law comes about. There are simplistic notions of spontaneous orders based on a dogmatic bias against human design. As so many social institutions essential for the free society evolved through time without having a single architect, some of us, Chamlee-Wright included, are sympathetic to the notion of spontaneous orders. But the fact that many human designs do not produce the intended consequences and need constant adaptation does not negate the importance of human actions intended to improve institutions. In the same way that one can plan one's charitable activities, one can and should "plan for freedom" or for institutions that make freedom possible.

I have no doubt that new demands for rule of law, rights to free trade, and property titles would come out of the many new participants producing and trading through projects such as those studied by the authors of these papers. But these demands can easily be squelched by authoritarian regimes regardless of their ideological bent or structure. Maoists, monarchists, and illiberal "democrats" continue to manipulate public opinion and close the doors to freedom against microentrepreneurs in large regions of the world. In addition, many of those benefiting from microfinance have no knowledge of the importance of the extended order and might seldom act on their own to protect private property or rule of law for their neighbors. In order to change that, we need new kinds of efforts, and these too might belong to the nonprofits rather than the for-profit sector.

While those who are engaged in microenterprise and receive the benefits of microfinance can truly be defined as entrepreneurs, those who are promoting microfinance schemes or WORTH-type solutions can be defined as social entrepreneurs—people who see a need for a social solution and are able and willing to attract resources and allocate them to satisfy that need. Something absent in these papers but needed in my opinion for the microenterprise movement to reach its full potential, is a new kind of actor: *intellectual* entrepreneurs with accurate understandings of the institutions needed for prosperity. I define intellectual entrepreneurs as those who discover a need for an intellectual or policy change and are able and willing to attract resources and allocate them to satisfy that need. It is people like that who help create legal frameworks conducive to prosperity.

Intellectual entrepreneurs also have their weaknesses, and a principal one is that they tend to become so enamored of their own ideas that they seldom make an effort to test them against reality. While social entrepreneurs and their sponsors often fall to the temptation of neglecting the battle for ideas, intellectual entrepreneurs, on the other hand, tend to neglect the personal battle of helping people actually improve their lot, instead focusing purely on indirect means of personal and social improvement. Although I am biased toward the importance of indirect means of alleviating poverty, I am convinced that more collaborative efforts between social and intellectual entrepreneurs would create the conditions for improved, measurable results in the world of microenterprise and many other nonprofit fields. Perhaps these conversations can help us move in that direction.

Claire Morgan

The relationships between microfinance and philanthropy are diverse and complicated, as these two thoughtful papers reveal. Over the past few decades there have been multiple experiments in microfinance, and perhaps one of its attractions as a policy for alleviating poverty is that it may be adapted to suit varying needs of different individuals and groups. At the same time, there is no question that there are many challenges to instituting a viable model. Moreover, the subsequent goal of "graduating" (Daley and Sautet 2005) individuals from microfinance schemes to the world of standard finance is, or ought to be, the ultimate objective, but it also remains the chief practical challenge. The role of philanthropy in achieving these things, as these two papers show, may be either enabling or limiting. How should we decide which it will be?

Both Heather Wood Ion's paper and Emily Chamlee-Wright's raise many important points concerning the promise and problems associated with the philanthropy of microfinance. They provide two contrasting but in some ways complementary visions of it. One is extremely optimistic—indeed celebratory. The other is chastened and ambivalent. Partly, this has to do with the respective scope of each paper. Ion highlights a single case of a highly successful microfinance savings program and suggests ways in which philanthropy can be employed to finance the promotion of the ideas supporting it to replicate that single successful model. Chamlee-Wright's analysis takes a broad view of the microfinance world, a world composed of many models of savings and loans which have achieved differing levels of success. For the most part, she focuses on standard programs that employ NGO models of lending, where donors provide credit to the poor as an initial investment, or as the only investment, to finance the programs.

In one author's vision, philanthropy provides support for the dissemination of information and knowledge. In the other's account, it provides financial resources for loans or subsidized lending rates. Each account encourages us to think through the components of this institution and its application, and each serves to raise questions about the prospects for successful, strategic investment in the future. Together, they help to reveal some of the conditions necessary for a successful model of microfinance, and they suggest how philanthropy might be used appropriately to create them. Crucially, the papers also point to cautionary lessons for philanthropists engaged in microfinance programs.

Seeking Transformations

Ion's paper, like the institution she describes, is creative and perceptive. She raises the perennial concern of many nonprofits, namely how to measure success, but more importantly she asks what constitutes success. What is or ought to be the goal of a successful nonprofit program? Going beyond the usual easy-to-measure (but ultimately unhelpful) "inputs and outputs" model of transactions, Ion notes that what is most important and exciting about some of the work she cites is its dynamic (hence the dancing metaphor) *transformative* quality. Moving from illiteracy to literacy, from poverty to prosperity, or at least to some measure of self-sufficiency, involves a total change that takes place at the level of the individual's very identity. Participants in the WORTH program in Nepal, she notes, learn how to be (or to become) different kinds of individuals. She says:

> When we look at WORTH as a model of transformation, what is most striking is that the participants manage to change their view of themselves within a highly unfavorable environment. . . . Most exciting is that the women view themselves as having the ability to give—they realize that they have knowledge and a story to tell. They are *transformed* from being defined as "the poor" or "in need" or recipients, into givers or teachers of a successful model and generative experience.

This personal transformation is realized through entrepreneurial business activity in the first place, and only secondarily and indirectly through philanthropy. Note that in Ion's model, philanthropy helps promote the storytelling of successful entrepreneurs in an effort to spread the good word, to encourage others to follow suit. The philanthropic end is to replicate the model across the world's poor as members of successful programs present themselves as examples for emulation to other poor, uninitiated potential entrepreneurs. Philanthropy here seems to be concerned less with investing to provide resources for funding entrepreneurial projects than with promoting broad transformation. Funding for WORTH programs comes from savings made by the participants themselves, so the project is self-financing. (Ion mentions a couple of people who have overseen the project, but it is unclear whether they have offered advice or seed capital or simply reported on the project.) Participants in the program do not see themselves as recipients of any sort. As Ion emphasizes,

> This model is in direct contrast to traditional approaches to philanthropy, which create dependence and are episodic in their focus on a specific "problem" and its solution. In this model, there is no presumption that some external expert or institution will "solve" the individuals' problems or judge the local needs and initiatives.

Ion thus begins to point us toward the importance of local initiative, a need echoed throughout Chamlee-Wright's piece. As C. K. Prahalad explains in his book, *The Fortune at the Bottom of the Pyramid* (2005, 292-294, especially 294), most of the problems in microfinance have to do with the institutions' focus on credit, which sets up all the wrong sorts of incentives and attitudes, such as those Chamlee-Wright describes. By contrast, the WORTH program is a savings program, a kind of self-help group that members actually buy into. For any microfinance program to work, Prahalad says, at a minimum there "must be some level of saving (preceding credit) to avoid donor dependency (ibid) 294)." Incentives matter. Thus, the WORTH program is established by a group of people who already share a common set of commercial values from the start. They are not grateful recipients of outside investment by some philanthropic entity. They are accountable to no one but themselves. More importantly, they do not need to be liberated from a set of circumstances and a mindset that promotes dependency. Through the WORTH system they come to understand and appreciate the workings of the commercial banking system that their program works within. What matters in the end is local knowledge and local accountability.

Reaching the Poorest

Conversely, Chamlee-Wright tells us about a number of groups of individuals who lack money and such a perspective. They have neither autonomy nor the kind of knowledge that would be needed to participate within the larger commercial network of institutions. What's more, they are unlikely to acquire these because the donors approach the recipients with a type of "social services mission" that helps to propagate the client's dependency. Oftentimes such limitations are further reinforced by an inhospitable institutional environment (e.g., over-regulation, insecure or no property rights backing loans or investments). Chamlee-Wright mentions some recipients who are too poor to contribute to any sort of savings program. These are the poorest of the poor, the kinds of people Prahalad refers to as being at the "bottom of the pyramid." They have been recipients of much aid in the form of unsecured loans because there is a moral belief (as a matter of fairness) among the donor community that if one is to help the poor, the poorest of the poor must be the guiding standard by which help is given. Moreover, as a standard of efficacy, as Chamlee-Wright says, there is the belief that this is where donors can get the biggest bang for their buck. As Chamlee-Wright explains:

> Given that the microfinance movement emerged out of an NGO environment, it is not surprising that most of the organizations offering microcredit have a social service orientation. This non-corporate corporate culture is perfectly appropriate for many organizations working with the poorest clientele, many of whom lack even the most basic literacy and bookkeeping skills. This third-party system, however, is clearly not the most appropriate orientation for organizations serving experienced entrepreneurs and people with significant savings and investment capacity.

Giving microcredit to the very poor may be the only way to help them, in one sense, because they lack any capacity to save. However, the implications of the analyses presented in these papers appear to call into question whether philanthropic microfinance credit programs are a useful tool for the world's very poor if the goal genuinely is to alleviate poverty. They may not be. Instead, other kinds of programs may be more suitable, and further analysis needs to be done to answer this question definitively.

As compared with Ion's, Chamlee-Wright's account is one that focuses more on the institutional environment and the economic incentives that flow out of microfinance programs, and less on the kinds of characters that successful and unsuccessful microfinance schemes produce. But in the end, Ion and Chamlee-Wright agree on what is needed from philanthropy. Chamlee-Wright says,

> The guiding principle for the donor should not be primarily to provide

> services to a particular known group but rather to create the first, crucial connection that spontaneously generates many more connections. By assisting a promising startup, the aim is to create a demonstration effect that inspires others to follow. By subsidizing promising innovations, the aim is to spread new ideas that reduce the cost and improve the effectiveness of microcredit services.

Moreover, the donor community can help to secure the institutional environment by providing a secure political-legal system, one that is transparent, avoids corruption, and secures private property rights so that investors will feel confident about their investments. But if the donors go beyond these things, they will probably do more harm than good. At the very least they will squander the opportunities that ventures such as the WORTH program are providing the poor.

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David Ellerman

Much of the subtlety in development assistance and in many other helping relationships lies in the contrast between transactions and transformations. There are the outward behaviors and indicators that are measured in transactions, and there are the inward, subjective transformations on the part of the doers that are the ultimate goals in a helper-doer relationship (e.g., in education, counseling, management, organizing, and so forth). Organizational rationality will tend to focus on what can be counted, measured, or accounted for in an 'objective' manner, while the original purpose of the various forms of assistance lies in the invisible, subjective transformations on the part of those being taught, counseled, managed, or otherwise helped.

Heather Wood Ion has given us a wise and subtle discourse on transformations and transactions, taking as a positive example the WORTH program which combines microfinance and literacy development. I have no disagreement with her arguments or conclusions, but I think it may help to elucidate and triangulate her points if I approach the matter from a couple of different directions.

I think these matters are subtle for a good reason: there is a fundamental conundrum at the heart of any helping relationship. The old cliché "helping people help themselves" (Ellerman 2005) captures a little bit of this conundrum. If the external helper is 'helping people' in any direct and substantial way, then the people probably are not much 'helping themselves.' And if people are truly helping themselves, then any external help would be more indirect and limited. Direct assistance (as recorded by 'transactions') is 'outside in' while genuine self-help ('transformation') is 'inside out.' (The 'outside-in/inside-out' terms are from Ezra Taft Benson and were popularized by Stephen Covey in 1990).

Pursuing Measurable Results

This helping-self-help conundrum is perhaps clearest in education, where the helper-doer relationship is between teacher and learner.

> If we ask how the teacher-learner roles differ from those of master and slave, the answer is that the proper aim of teaching is precisely to affect those inner processes that, as Hegel (and the Stoic philosophers before him) made clear, cannot in principle be made subject to external

> control, for they are just, in essence, the processes germane to independence, to autonomy, to self-control (Hawkins 2000, 44).

Yet the organizational rationality of educational administrators will lead them to focus on what they can count, measure, and record; for example, on 'transactions' such as passing a test. Thus even if a teacher is fully aware of the difficulties in fostering inside-out transformation, the administrative pressures are to use carrots and sticks to 'show results' in a quick and uniform manner that can be replicated. Hence the educational process tends to be reduced to a form ('teach to the test') that will reliably produce the necessary transactions.

While this pattern is perhaps best known from the schools, it is a common organizational pattern in institutions dedicated to fostering some form of transformation. In the first instance, it is devilishly difficult to train teachers, managers, counselors, organizers, and social workers in the subtleties of indirect assistance to the doers' transformational processes. But then even the best training may be subverted by an organizational environment that more or less forces the helpers to 'take responsibility' for 'producing results,' which in turn implies reducing the interactions with the doers to a set of unhelpful transactions that can be monitored by the organization.

In particular, this organizational sequence is very evident in development assistance agencies. Judith Tendler has likened the situation to that of a company that needs quality inputs from a supplier. Aid agencies need high-quality projects that are fundable. If the agency doesn't 'take charge' then the quantity and quality of the 'deal flow' may be insufficient to justify the mission of the agency itself. Hence the agency is pushed by its own organizational imperatives to take over more and more control in the process of working with 'clients' to generate fundable projects:

> This taking over of project generation by development assistance institutions is like the backward vertical integration of firms in the private sector. The organization expands "backward" into the task environment and starts to "manufacture" project applications itself. It thereby lessens the high degree of uncertainty of the environment from which it must get its inputs, assuring itself of a more reliable source of supply (Tendler 1975, 103).

These organizational realities greatly complicate the issues about transformations and transactions.

Another angle of approach in understanding the tensions between transformational and transactional help is the question of motivation and incentives. Economics enjoys great prestige today at the pinnacle of the social sciences. It is said, "If economists understand anything, it is incentives." But there is at least one dimension where this understanding is tragically flawed. Ion notes Isaiah Berlin's distinction between positive and negative freedoms. To contrast freedom with oppression, Berlin makes a crucial point about the difference it makes whether the source of some constraint is a human will or a natural cause:

> "The nature of things does not madden us, only ill will does," said Rousseau. The criterion of oppression is the part that I believe to be played by other human beings, directly or indirectly, with or without the intention of doing so, in frustrating my wishes (Berlin 1969, 123).

Friedrich Hayek makes a similar point in his analysis of liberty or freedom in contrast to coercion:

> In this sense "freedom" refers solely to a relation of men to other men, and the only infringement of it is coercion by men. This means, in particular, that the range of physical possibilities from which a person can choose at a given moment has no direct relevance to freedom (Hayek 1960, 12).

Hayek's last point is directed against the tendency in conventional economics to interpret freedom in terms of the breadth of choice rather than the role of human will in determining the constraints on choice. Robinson Crusoe may have had few choices and endured much hardship, but none of it was a result of coercion or oppression.

Concentrating on Incentives

The same point may be made concerning the economic analysis of incentives. That analysis tends to neglect the important question of the source of the incentive. Is the incentive sourced in an external human will that wants to manipulate my actions, or is the incentive my own, so that acting in response to it is an exercise of autonomy? This question is neglected in an economic model that only records such and such a benefit if the person undertakes such and such action.

For some time, the mantra in the large development assistance agencies has been to 'get the incentives right.' If the clients are not 'doing the right thing' then it must be because the agencies did not 'get the incentives right'—as if the appropriate outward behavior to fulfill the 'right incentives' was the same thing as an inward transformation (which could only come from internally sourced motivation). 'Getting the incentives right' can buy some seemingly virtuous behavior (the 'right transactions'), but it cannot buy virtue in the sense of transformation.

Albert Hirschman, perhaps the most acute observer of the economic development process in our time, has noted these problems in trying to 'buy virtue.' If development policies were not adopted by the government independently of the aid, then such policies would tend to be adopted by aid-hungry governments in spite of continuing doubts of the policy makers themselves, resistance from some quarters within the government, onslaught against the 'deal' from the opposition, and general distaste for the whole procedure.

> Naturally, doubts and reservations are not voiced at the moment of the aid compact; hence the delusion on the part of the donor that there has been a full meeting of minds. But soon after virtue has been 'bought' through aid under these conditions, the reservations and resistances will find some expression—for example, through half-hearted implementation or sabotage of the agreed-to policies—and relations between donor and recipient will promptly deteriorate as a result (Hirschman and Bird 1971, 205).

The debate about conditionalities required to 'get the incentives right' is thus ill-posed. In psychological terms, the question is for example, how best to indirectly foster the government's internally sourced motivation for reforms, as opposed to the question, posed by economics, of how best to impose carrots and sticks (externally sourced motivation) to ensure the government 'does the right thing' (in terms of observed transactions).

My goal has been to complement Ion's discourse by noting the complications raised by the organizational imperatives in development agencies and by the quality of the 'just get the incentives right' advice given by the best and brightest of the conventional economics profession. The public is constantly being harangued by development agency leaders and various academic economists (not to mention assorted celebrities): "This is not rocket science—we just need to put in enough resources along with properly structured incentives and monitoring to get the job done." But this model of development aid as one big social engineering project is the model that has failed over the past half-century (Easterly 2001, 2006; Dichter 2003). The leaders of failed agencies and the purveyors of flawed theories have become more a part of the problem than of the solution. Perhaps understanding the subtleties of transformation is in fact more like rocket science than they think.

Strengthening Autonomy

This brings me to Professor Chamlee-Wright's paper on the microfinance industry. Here were a number of 'dogs that didn't bark.' The problems were not in her excellent review of the state of microfinance or with Hayek's concept of extended order. But any discussion of the way forward for microfinance with an emphasis on sustainability surely has to look at the difference between savings-based microfinance and the lending-led programs. Perhaps 'microfinance' is coming to mean lending-led programs that can be 'installed' by development organizations using seemingly off-the-shelf models and donor finance (see Johnson and Rogaly 1997; Dichter 2005b). Thus 'sustainability' is indeed an issue. In fact, there is an issue as to whether or not that sort of development assistance should be sustained. Is that the sort of assistance that builds self-reliance rather than dependency, that builds capacity rather than prolongs incapacity?

Another dog that didn't bark was the whole notion of a 'cooperative.' Part of the extended order is the array of organizations and informal institutions that poor people have from time to time developed (with whatever names) to address their needs and meet their challenges. Historically, the cooperative movement has flourished during hard times (for example, during the Great Depression in the United States). There have been savings-based credit cooperatives (including but not limited to rotating credit societies), consumer cooperatives to hold down costs, producer cooperatives to help farms and small businesses, adult education associations to promote advancement through learning, and, yes, even labor unions. It might be recalled that the early labor unions of the 19th century were not exclusively (if at all) organized for collective bargaining but for more civic-republican ideals of getting out of the wage relationship to become independent operators of businesses, trades, or farms. They were allied with worker education associations such as the mechanics institutes in Glasgow and London (now Birkbeck College, the adult education unit of the University of London).

By definition, the poor do not individually have wealth but they do have numbers, and through the social organization of those numbers they can acquire the social, economic, and political influence to address their own needs. Thus the first question might be, "Does the program help poor people to organize what they do have—their numbers—to better address their own needs?" The historical cooperative and labor movements as well as the Civil Rights movement over the last half century are examples of that sort of self-organized extended order wherein poor or disempowered people played an active role as the agents of their own betterment, not as the 'customers' or clients of well-meaning organizations who want to 'help' them.

But today much has changed. In the developing world (and in the depressed parts of the developed world), social organization often comes in the form of donor-funded organizations that are thick upon the ground to 'help the poor' (Dichter 2005a). Instead of really helping the poor to become the agents or doers of their own development, the poor are seen as the clients and customers of the multitude of externally funded organizations with the ostensible purpose of delivering services—such as microfinance lending services—to the poor.

Chamlee-Wright poses the question of whether the microfinance industry should have more of a social mission orientation (with the resulting dependence on continued donor funding) or move toward a commercial model that might be self-sustaining but which, for all the usual reasons, would tend to leave the poor behind. I think this line of questioning misses the point that neither of these options promotes the forms of extended order and self-organization by which poor people have historically improved their lot. There are other forks in the road.

In contrast to the microfinance programs discussed by Chamlee-Wright, a savings-based credit cooperative (or 'credit union,' as another type of union) is an organizational form by which large numbers of people, each with small savings, can pool their savings together to finance nontrivial business opportunities (in addition to some consumption-oriented lending). In one sense, cooperatives are commercial (for example, in using corporate forms and accounting standards). But cooperatives are not commercial in the sense of being footloose or free-floating such that they can leave the poor behind. A certain identifiable group of poor people are the members of the cooperative, and their savings are being put at risk, so they have the natural incentive to monitor and control the activities.

If this third, 'savings-led' option is the way forward, there are many ways that donors can subtly help catalyze and facilitate the development of savings-based credit cooperatives. For instance, one way is to foster and partially fund upstream organizations whose missions are to catalyze and help organize savings cooperatives and to help those cooperatives learn on a peer-to-peer basis from each other about meeting the many obstacles they face. As Chamlee-Wright put it wisely, “The guiding principle for the donor should not be primarily to provide services to a particular known group but rather to create the first, crucial connection that spontaneously generates many more connections.”

In taking the service-provision approach, by contrast, donors often provide what might be called ‘unhelpful help’—‘help’ that tends to crowd out budding attempts at self-organization, ‘help’ that tends to reward need rather than initiative, and ‘help’ that tends to create dependence rather than build the capacity for independence (Ellerman 2005).

There are interesting analogies with the contrast between ‘fast food’ and ‘slow food.’ Genuine development assistance, where the helpers do not crowd out and undercut the agency of the doers, is a slow, subtle, and painstaking process. Yet various leaders of development assistance agencies, assorted well-meaning celebrities, and a few publicity-seeking academics are constantly badgering the public, political leaders, and donors to ‘do more’ to help the poor and to ‘do it quickly’ because ‘things are getting worse.’ Thus donors and the organizations they fund are ‘in a rush to do good’—which accounts for much of the popularity and ‘success’ of installing off-the-shelf, loan-led microfinance programs. But that is rarely how good is done, and the rush to produce ‘fast food’ results often disrupts ‘slow food’ approaches that may be more productive in the long run.

Put yourself in the shoes of a community organizer working in a village, town, or city trying to get people to overcome the many differences that have kept the poor ‘divided and conquered’ and to exercise the self-discipline to join together and start a savings-based credit cooperative. What would be the effect of then having a loan-led microfinance organization enter the scene offering low-cost, donor-subsidized individual loans with no savings required?

Finding the Truth

Clear thinking about microfinance also requires getting beyond the carefully selected, stylized stories told by the microfinance industry. The activities of microfinance organizations are described as funding ‘entrepreneurship’ by the poor, when the bulk of loans seem to fall into a category that is better described as ‘consumption smoothing.’ This includes bulk consumption expenditures on things that cannot otherwise be purchased on credit, as well as the various family crises that might otherwise force a family into the hands of the village moneylender. The point is not that these goals are unworthy but that they bear no relationship to the story-line of funding entrepreneurship by the poor.

In the minority of cases where some business activity is being individually funded, it will often be an activity with little or no barriers to entry, so many micro-borrowers may simply end up in cutthroat competition with each other. For instance, one type of nanobusiness is to buy a spice or staple in some bulk and then repackage it in small amounts so that other poor people can afford it. Such microbusinesses are easily imitated, have little if any potential for growth and diversification, and do not address the more fundamental obstacle to nontrivial entrepreneurship, namely, the inability of people in the community to cooperate together to do what they cannot do individually.

It is now a commonplace that donations of food surpluses from the North (developed countries) to 'feed the poor' in the South (developing countries) may well end up undercutting the struggling farmers in the South so that the South becomes even less able to feed itself. In a similar manner, donations of used clothing may undercut local tailors and local cottage industries. It is perhaps less appreciated that an 'entrepreneurial activity' funded by subsidized microlending, namely shuttle trading (where the individual trader shuttles back and forth between the suppliers and her marketplace), has created a micro-version of the 'Wal-Mart effect' on unsubsidized local merchants, not to mention local producers. Moreover, it is often small and medium-sized businesses that have the real development potential to engage in the extended order of the market, but their financing needs seem to be crowded out by the quick fix to alleviate the symptoms of poverty. Thus the rush to do good with prepackaged and easily installed microfinance programs may well be another form of unhelpful help that has untoward longer-term effects on the supposed beneficiaries.

I am sympathetic to Chamlee-Wright's arguments for commercialization of microfinance—or at least a cooperative-based version of it. But I have also argued that the microfinance industry has very deep problems of unhelpful help quite apart from the decision about whether the way forward will be to move down the path of subsidies or the path of commercialization.

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NOTE

A SAVINGS-LED ALTERNATIVE TO FINANCIAL INSTITUTION BUILDING

Jeffrey Ashe

The cost of reaching the rural poor with microfinance can be prohibitive for microfinance institutions (MFIs), credit unions, and banks. But small, savings-led, often informal Member-Owned Financial Institutions (MFIs) have shown promise in reaching clients living in areas with poor infrastructure, low population density, and low levels of economic activity, especially in Africa and Asia.

For the entrepreneurial poor and people in densely populated areas, a good part of the unmet demand for financial services can be met by simply extending the reach of microfinance institutions, banks, and credit unions. Technological advances and two decades of on-the-ground experience show that this market can be reached efficiently and even profitably by well-managed financial institutions.

An entirely different approach is called for to reach the much larger number of people whose savings and borrowing capacity is on the order of tens rather than hundreds of dollars, who often need a safe place to save rather than take on debt, and who live far from towns and cities. The key is to train many thousands of small groups to deliver basic savings and lending services by building on what villagers already understand—their *tontines, susus, chit funds, money-go-rounds*, and *tandas*.

These "modernized ROSCAs" (revolving savings and credit associations) add lending at interest and simple record keeping to traditional systems, with interest from loans building the group fund. Since savings are pooled rather than given to members in turn, several group members can take out a loan at the same time; clients see this as a major advantage. Adjusting savings to the highly variable cash flow in villages adds flexibility to the model, and charging an interest rate of between 2 and 10 percent per month quickly builds the group's fund along with the trust that ensures compliance in their ROSCA and creates demand for a high level of accountability. After all, it is their own money that they are managing. Villagers quickly grasp the idea that it is better to pay interest to themselves and reap the benefits than to pay an external credit provider, be it a money lender, a bank, or an MFI.

Self-Management Crucial

"Savings-led" programs rely on the capacity of groups to manage their own accounts. Groups typically receive three months of weekly training through local (NGOs), and then progressively less frequent monitoring until they can operate on their own. Graduating trained groups quickly, and encouraging "spontaneous replication" where group leaders train new groups, are the keys to this highly decentralized model.

Groups are trained through [nongovernmental organizations] NGOs carrying out a range of projects in poor rural villages, rather than specialized MFIs. Since there is no external loan fund to administer, the NGO "animators" focus their entire effort on training groups and on education. The limited scope of the intervention keeps the costs low.

Whereas mainstream microfinance defines sustainability as covering operational and financial costs, this savings-led model defines sustainability as savings and lending groups being able to operate successfully on their own and self-replicating as group leaders train new groups on their own. Minimizing the training and support costs per group is an important measuring rod. Periodic monitoring and training after graduation ensures portfolio quality.

Challenges Remain

Notwithstanding the promise behind these programs, there are several challenges:

- *Maintaining group quality.* Group quality suffers if the "animators" are not well trained and supervised.
- *Graduating quality groups quickly to keep costs in check.* Animators tend to visit groups long after they can operate on their own, unless there is a clear, time-limited, training protocol and good early supervision.
- *Introducing simple record keeping to guarantee transparency.* These programs bog down if the record keeping system is complicated and animators keep the records rather than teaching the groups to keep records themselves.

- *Ensuring equal access to loans for all members.* Unless there is good training and monitoring, the better-off within an MFI tend to monopolize the group fund.
- *Avoiding the takeover of the groups by local elites.* Here, too, good training is required, to enable groups to stand up to local leaders who ask for a loan and never pay it back.

Showing how quickly these programs can reach scale, Oxfam America and Freedom from Hunger trained twenty-one “animators” through two Malian NGOs in February 2005 as they launched Oxfam’s “Saving for Change” initiative. One year later the animators had organized 340 all-women groups and the group leaders had trained an additional 176 groups on their own. Altogether, these groups had more than eleven thousand members. At last count, 74 percent of group members had received loans, none of the groups had failed, and late payment on the nearly five thousand outstanding loans that averaged $10 each was one half of one percent. The women were also trained in malaria prevention and treatment, through a curriculum developed by Freedom from Hunger. Based on this experience, the Community Finance unit at Oxfam America has developed a simple formula for financing the mass expansion of Saving for Change in the poorest African countries. One million dollars will finance the expansion of Saving for Change to fifty thousand women organized into 2,500 groups in more than six hundred villages in less than four years. The expected outcomes are increased income, greater solidarity, more social capital, and increased knowledge, at a cost of $20 per group member (or $3.50 per family member), including Oxfam’s costs for recruiting, training, and supervising the local partners and for systems development, evaluation, and advocacy. Ten million dollars would cover the majority of the unmet need for improved financial services in a country the size of Mali.

Demonstrated Growth Is Impressive

Showing the impressive potential for these saving and lending group initiatives to achieve scale, in just three years Pact’s Women’s Empowerment Program (WEP) in Nepal trained 6,500 groups using 225 local organizations for village-level organizing and follow-up. Eighteen months after all financial and technical support was withdrawn, the net number of groups had actually increased as the group leaders trained more groups than the small percentage that disbanded, while the size of the average group fund doubled. In Africa the local (CARE) staff in eighteen countries trained "Village Saving and Lending" groups with 437,000 women members, with the largest programs achieving most of their growth in five years. In India, the partners of Catholic Relief Service trained groups with more than 785,000 members, adding disaster preparedness, micro watershed management, and literacy to the basic saving and lending package, with most of this growth occurring over four years. In India, since the late 1980s at least three million self-help groups trained by thousands of NGOs and government programs have been providing basic savings and lending services. A total of 1.4 million of these groups topped off their internally managed savings with loans from local banks facilitated by the National Bank for Agriculture and Rural Development (NABARD). By acting as a facilitator of a vast, decentralized network of NGOs and rural banks, NABARD has become the largest and fastest-growing microfinance initiative in the world.

Among U.S.-based institutions, CARE, Catholic Relief Services, Pact, and Oxfam America have embraced the "savings-led" approach and have launched locally adapted versions of the model in multiple countries. They recognize that while their local partners are unlikely to become the next Grameen Bank, ASA, or Banco Sol, they can become the trailblazers for a highly effective approach to microfinance that builds on what they are good at—grassroots organizing and training. An important part of the hardest-to-reach market for savings and lending services may be best met through the savings-led model. This is truly "microfinance for the rest of us."

NOTES

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