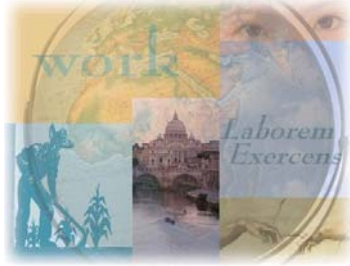


# Work as Key to the Social Question

The Great Social and Economic Transformations and the Subjective Dimension of Work



## Microcredit: A Human Development Tool

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*It is very convenient to support and develop (...) microcredit projects (...), which are at reach of everyone, and have a positive pedagogical value, globally corresponsable directed.*

John Paul II

Speech at Foundation “*Centesimus annus, pro Pontifice*”

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### ABSTRACT

The paper reviews, first of all, the Church attitude towards poverty and unemployment, through the Church Social Instruction most representative documents (*Laborem exercens*, *Gaudium et spes*, *Sollicitudo rei socialis*, *Centesimus annus*). Then, distinguish microcredit concept in developing and developed countries. The microcredit chances in poverty reduction is analysed under the financial system and poverty reduction approaches, and also is reviewed the microcredit role to fight unemployment. It is reviewed the institutional development and impact evaluation and finally, the conclusions.

### INTRODUCTION

In developing and developed countries, unemployment problems are relevant. That problems have social and individual negative consequences, from degradation to lack of self-esteem that every man and woman deserve for him and herself (cf. SRS 18). Church

reports that there are entire unemployment or subemployment groups, a phenomenon pointing out that something doesn't work, and particularly at the most critical and socially relevant points (cf. LE 18). Society must help people to get a job (cf. CA 48).

In that sense, Church draws solutions as the universal use of goods (cf. GS 70), the social conscientiousness of investments (CA 36). That needs the active role of all social entities, included unions and business forces (cf. LE 18). The key is to place the human being at the centre of every economic initiative.

Microcredit, that is, little borrowing for people lacking access to financial institutions, is a new concept of financial services for the poor and unemployed: greed is not the only economic engine, it can also have social goals.

Based in human development, microcredit aims at redesigning traditional aid schemes and approaches. It also aims at removing paternalistic thinking which in many cases help to create dependence structures. This approach core is not to create development with free grants, but to give the necessary inputs, encouraging the microcredit recipients own responsibility: helping those who want to help themselves with self-employment.

Microcredit practices are based on information systems, opposite to collateral systems, and can be offered to individuals or to groups.

### **CONCEPTUAL FRAMEWORK: SOCIAL INVESTMENT. ALTERNATIVE FINANCE. INFORMAL ECONOMY. MICROFINANCE. MICROCREDIT**

In western countries microcredit belongs to the field of social investment or alternative finance. INAISE calls social investment a type of investment that not only searches for benefit, but has as main objective the insertion of people outside the economic circuit, restoring the social network by creating of jobs and businesses.

Alternative finance is placed in front of the financial services offered by banks and usual financial institutions. These institutions, faced with small enterprises, find two kind of trouble: risk and high transactional costs (Evers). Risk comes from bankruptcy due to problems of liquidity, inadequate financial structure, bad management or simply low return of the entrepreneurial activity. This can be reduced with innovative and conscientious risk analysis and with training and enterprise support, but both methods increase transactional costs. The request of collateral has its limitations because of the high costs of liquidation of the company and the limited access to them for microentrepreneurs. An additional problem is the banking sector lack of know-how about the emerging market of enterprises operating in the third sector.

Therefore, alternative finance is outside the traditional financial circuits, tailored to new activities that find difficulties entering the banking financing. In this sense, alternative finance instruments develop more accessible banking practices, regarding the collateral and

the requirements of return. On the other hand, they usually offer training and carry out support along the life of projects. This enables the access to financial means of viable projects with low yield. This adaptation to the characteristics of its potential clients is one of the main differences between the social investment instruments or alternative finance and the conventional banking sector products and that helps to obtain smaller ratios of non-payment.

Microcredit applicants are so due to the nature of their activity, the lack of collateral or the social situation causing exclusion from the bank, or simply because they need to receive support from a microcredit institution, that goes beyond the merely financier. Many of them would belong to the category called by Letowsky "forced entrepreneurs". They are, in their majority, people without professional experience, who do not believe too much in the success of their project, and do not have beforehand the supposed abilities to create an enterprise. But, having failed in the search of a job or any way of satisfactory economic insertion, they decide to create their own enterprise.

In developing countries, microcredit is linked to the informal concept, because most of the loan users belong to the informal sector of the economy.

The term informal economy generalized in seventies to define economic activities that take place outside the common circuits for the public and private companies. We will use the Charmes definition; the activities of the informal sector are essentially those that, being at the same time fair but illegal, are developed by economic units that have not been registered by censuses or surveys, or even registered activities that can assimilate to them due to facts such as the production and marketing processes design (lack of accounting, invoicing, or contributions to the Social Security system), the small scale and the size (measured in number of workers), and the technological level (considered in the consumption of energy by worker and the professional qualifications of the labour). Nevertheless, it is necessary to underline that this is not the only approach to define the informal sector.

Buckeley points out that more than considering the informal sector being a panacea to development problems, the starting point is to consider it as a symptom of unfair development, the social result of a systematic refusal of basic rights like education, social services and civil society participation. It is possible to argue, in the best case, that microcredit can reduce this injustice, and in the worse one, will perpetuate it and will take away funds from more necessary and perhaps more appropriate interventions.

To define microfinance in developing countries we found different approaches. According to Garson, microfinance is the financial intermediation at local level. It includes not only credit but deposits, savings and other forms of financial services. It is a local procedure, based on local institutions that gather local resources and reassign them locally. The author does not distinguish between formal and informal clients, but uses the special level to define them.

Nevertheless, Gulli, rejecting the concept of credit to the production for poor microentrepreneurs considering it too narrow, understands that microfinance is the word

used to refer to small scale financial services as much credit and saving, for enterprises and families who traditionally have been marginalized from the financial system. Schreiner highlights this last aspect of the users, and defines microfinance as the efforts to improve access to saving and credit services to people of low income and low personal assets. The three authors derive microcredit from microfinance, referring just to credit.

Another microcredit definition consider that it is a very small loan, offered not to poor people, but to a microenterprise (Clark and Kays). Here the microcredit is linked to microenterprise, with different meanings according to authors and countries [1]. This definition is next to the one from Gulli, without doing the generalization of the author, being centred this time on the entrepreneurial use of the credit.

According to the Microcredit Summit, held in Washington, February 1997, with governments, multilateral organisms, NGOs and enterprise representatives, the definition of microcredit is the following: they are programs that provide small loans to very poor people for projects generating self-employment and income. This approach is centred on credit recipients, as Schreiner does.

## **MICROCREDIT AND POVERTY REDUCTION**

There is increasing evidence that economic growth and poverty alleviation come together (UNDP, 1996). Human Development Report defines poverty not only as a lack of income, but also introduces the term capacity poverty, that will be quantified by the Human Poverty Index (HPI) having a consistent relationship with the Human Development Index (HDI) (UNDP, 1997). The index reports three basic capacities: survival, knowledge and general economic supply. According to the World Bank, the access to the credit markets determines the capacity to invest the poor have and also have who are not poor but engage poor workers.

On the other hand, the World Bank notices, in the same line as Garson, that is improbable that universal recommendations as liberalization of financial markets would have the same desired effect, without taking into account the local realities. And also that the role of market liberalization to poverty reduction depends on institutional strengthening. Karim and Osada emphasize that opposed to the failure of the top-down approach of poverty fighting, microcredit, with a down-top approach has created a new hope in poverty alleviation [2].

Garson, using the down-top approach, highlights that poor men, instead of benefiting passively from governmental grants, that never will be zero-sum games, can make profitable these same funds, offered through microcredit institutions, transforming them into biggest and more sustainable monetary flows, through productive activities generated by credits.

The role of financial systems in income poverty alleviation is probably more immediate than in capacity poverty alleviation (Von Pischke). This happens because finance is more clearly related to income generation activities. The elements of capacity poverty require generally

longer terms and strongest infrastructure requirements, specially with regard to health and education.

Two main positions have arisen on microcredit and poverty reduction: financial system approach and loans to alleviate the poverty approach (Gulli).

For financial system approach, also known as income generation approach, the goal of microcredit is to provide sustainable financial services to low income people, not necessarily the poorest, but the neglected niches of the market. There is no reason for subsidies, and it is considered that NGOs play a secondary role in microcredit markets. Financial sustainability is searched because sustainable microfinance institutions would have the chance of extending the operations in the future. Finally, for many of the defenders of this approach, credit is not the most important instrument to reduce the poverty.

According to the loans to alleviate the poverty approach, or the new minimalist approach, the core goals of microcredit must be poverty reduction and people empowerment. It is worthless to talk about financial sustainability if the services offered do not change the clients level of poverty. For the sake of the general goal, complementary services are often needed and integral approaches are adopted. Funds from donors and subsidies could be needed because fund availability is the main burden to the development of financial services to poor men. Whereas the financial system approach considers that financial services are the main objective of microfinance institutions, the loans to alleviate poverty approach considers these services a means to reach the aim of poverty reduction.

Gulli, Mahajan and Ditcher propose a contingent approach. Instead of analysing the question if microfinance is an instrument to reduce poverty, this new approach considers the way, the measures and the conditions in which microfinance can help to reduce poverty.

Garson points out two limits of credit as an instrument to reduce poverty: it is not easy to target the credit to poor men; and many people, not only the poorest, cannot use the credit because they cannot undertake an economic activity.

For Microcredit Summit conclusions, microcredit is not a panacea. It will be more effective as a poverty eradication tool if it would be complemented with interventions of infrastructures supply, water, hygiene, primary attention, alphabetisation, woman rights and microenterprise management, in the line of poverty alleviation loans approach.

## **MICROCREDIT, SELF-EMPLOYMENT AND UNEMPLOYMENT REDUCTION**

Most of the economic studies referred to international and Spanish poverty conclude that this is linked to the phenomenon of unemployment (Cantó), so the lack of employment problem feeds back the poverty problem.

About unemployment, Yunus emphasizes that unless considered correctly, wage-earning

employment does not offer guarantees of poverty reduction. This objective must be a continuous process of goods creation, in such a way that the goods of a poor family increase in each economic cycle. A poor man cannot assure a greater part of his income by his work, because its initial economic base is very small. Self-employment, supported by credit, has a greater potential to improve the initial base of goods than the wage-earning employment and thus to reduce the poverty.

The creation of enterprises as strategy to fight the economic disadvantage has tried traditionally to engage low income people, subsidies recipients, or not so poor people so that they leave other jobs free that poor can occupy. A new approach has arisen at the present time: the transfer of low income people from the dependency of the subsidy or a badly paid job towards self-employment, having this way the economic and social advantages of the property of a business (Dennis).

Self-employment has started to be considered as an important source of new jobs and an alternative to the wage-earning work. Therefore, it widens the possibilities of the potential new applicants to the labour market and of the unemployed ones. On the other hand, it is more probable that a self-employment activity would be started by an unemployed than by a wage-earner, although the ratio of enterprise failure is higher in an entrepreneur who had been before unemployed than in a previous wage-earner (Carrasco).

The creation of small companies has, therefore, an important potential to reduce unemployment by means of self-employment and the hiring of new workers. Microcredit constitutes, for many of these initiatives, the first chance to get financial resources. Once strengthened, the microenterprise would not need to continue relying on microcredit, but would be able to enter the conventional financial services.

## **SUSTAINABILITY OF MICROCREDIT INSTITUTIONS**

With respect to the sustainability of microcredit institutions there are two levels: operational and financial (United Nations. UNCDF). Operational sustainability refers when microfinance institutions cover their administrative costs and their expenses of unpaid debts with the revenue from their clients. Financial sustainability is obtained when an operationally sustainable microfinance institution can cover the costs with its funds, including the inflation. Then the MFI can turn into a true financial institution, that can obtain funds from the national financial markets and discount lines from central banks.

According to Von Pischke, and focusing on developing countries, microcredits are very popular between donors and NGOs, nevertheless, it is too soon for concluding that these efforts are sustainable. Excluding the Bank Rakyat from Indonesia, the size of microfinance institutions depends on the support of the national government and the donor of the North. It is improbable that most of the microfinance institutions become completely sustainable, although the financial viability often requires of time and a definitive judgment cannot be

emitted.

Hulme and Mosley affirm that the increasing pressures on sustainability of aid national agencies can not be the best way to reach to poorest or making work the programs. The danger to put the accent in the sustainability is that it forces the IMF to leave those people in danger as repatriated, refugees, or those financing needed in the mid term.

On the contrary, Gulli assures that it is not clear if the financial sustainability affects directly or inversely and its spirit or capacity to reach the poorest. Regardless of this relationship, the author points out that few microfinance institutions reach people who live in the extreme poverty, and many have a high percentage of clients who are not poor. Nevertheless, it notices a direct effect between the attainment of financial sustainability and the possibility of getting at many poor: the institutions well administered can reach a greater amount of poor men.

Hulme and Mosley, in this sense, emphasize one recent tendency in the greatest MFI: no longer they seem to see in the poorest its main clients. In their place, they concentrate their activities in “middle and high” poor.

To conclude with sustainability, Gulli affirms that the combination between ample focusing, understood as reaching greater number of people, and the narrow focusing, seeking to get the poorest, could be more effective to reduce poverty. Because it would give a sustainable reach on great scale and at the same time would enhance innovations to promote greater access of the poorest population sectors to financial services.

In Europe, and according to Guene, the institutions offering microcredit are loss-making structures because their credit margins surpass their costs, so they do not obtain the operational sustainability. It is not possible, therefore, to expand the activity via internal growth of capital. Only the external contributions can assure the expansion of microcredit activities (when not simply their survival).

As for the public supports, Guene considers that it is sometimes difficult to agree the exigencies of the donors with the characteristics of the microcredit institution; hybrids by nature between banks, training centres, employment centres, enterprise consultant's offices, and local development agents. This versatile character becomes a fiscal trouble, not being a lucrative activity and having to pay as being so in many European countries. In this matter, Evers states that it seems that the efficiency of the microfinance institutions increases with the distance from the public support.

The interest rates of microcredit do not need to be subsidized, and although there are institutions doing so, the rates charged can equal those of the market, or even surpass, to recover the greater cost of microcredit activities.

## **TYPES OF INSTITUTIONS OFFERING MICROCREDIT**

In general, in developing countries, we can find the following typology (Carpintero):

- NGO specialized in microcredits. Initially they had a very paternalistic approach, that resulted in subsidized interest rates and lack of searching the financial sustainability, which broke out, among other elements, in a great dependency of grants received from outside. Lately, NGO will progress towards the establishment of relations with banking institutions and even the transformation into a financial institution.
- Credit Cooperatives. They offer short term services of saving and credit to their members. To get a credit it is necessary to have some savings in the organization, so savings act as guarantee. The credits usually are granted at a lower interest rate than the market rate. They seldom offer technical assistance and training services, opposite to the NGO, that usually offers them. The Cooperatives can receive financial support from outside.
- Specialized financial microcredit institutions. Some of them have develop from a NGO. Others not necessary. The most well-known example is the Grameen Bank of Bangladesh.

Microcredit in western countries is generally managed by alternative finance institutions or by social investment institutions that in Europe would be the following:

- Non governmental organizations (NGOs) of different types and location.
- Credit Cooperatives of microenterprises that would grant credit to their members.
- Specialized microcredit institutions of initiative and public support.
- Ethical bank. The “ethical label” is because they invest according to the convictions of his depositors, generally in environmental and social development projects.
- Investment clubs of private initiative and generally local scope, where the members join their savings to invest in microenterprise projects.
- Others.

We will say that microcredits can also be granted by a traditional bank, with the support of some above institution. This support can be any type of collateral or technical support, training and enterprise management. The microcredit goal in the North is exclusively enterprise activities, unlike it is in the South, where microcredit can be used for consumption.

## **MICROCREDIT IMPACT. DOES IT ALLEVIATE POVERTY AND UNEMPLOYMENT?**

Research on microcredit evaluation in terms of poverty alleviation are focused in the income poverty approach, but they do not consider the ample concept of capacity poverty.

Johnson and Rogaly recognize that in spite of the methodological difficulties in the measurement of the increase of resulting income of the credit provision, studies have demonstrated that the provision of credit to microenterprises can have positive effects. Nevertheless, Hulme and Mosley have proved that the less poor is the borrower, the greater is the income increase caused by a credit; people having resources and abilities can make better use of the credit. Poorest have less possibilities of assuming risks or of using the credit to income increase.

Johnson and Rogaly admit that microcredit improves economic security; this approach prefers income protection instead increase, as a first step in poverty reduction. In that sense, the World Bank considers microfinance as one of the seven tools to increase the economic and social security of the poorest homes. Thus, microfinance programs have helped not-so-poor homes to smooth the fluctuations in one of the components of the income: consumption and that fact has increased their economic security; nevertheless it notices that the size of the loans and the sequence of the payments would have to be more flexible so that these programs reach the poorest homes.

Gulli emphasizes that income increase is an indirect effect and not always the main purpose of a loan. She suggests to carry out evaluations of direct effects of microfinance, such as improvement of money management. At the same time, it would be due to examine the link between clients and services and financial strength of the microfinance institutions.

The impact refers to the effect of microfinance in subsistence means and in the well-being of clients (Gulli). The evaluation of the impact is important when the credit is subsidized. Many studies of credit impact have been carried out almost entirely focused on the beneficiaries of the subsidy, who are the borrowers who receive credits under the program or project or the institution who grant the funds for the loans. Nevertheless, for Carpintero the number of general studies on this matter is little and the impact evaluations of microenterprise support programs are also few.

Buckley shows microcredit experiences with supposed successful results in terms of reach and rates of return.

Making an evaluation according to the contingent approach, there is no consensus on the measurement, the form and the moment at which poverty can be reduced by microfinance (Gulli). Due to the enormous methodological problems in the analysis of impact of the credit, it is not possible to state categorically that credit alleviates poverty, or to what extent it can contribute to alleviate it. It can be affirmed that the money has an impact in those who

spend it, but it is difficult to discover what changes of conduct are induced in the margin (Von Pischke). Gulli, like Stallings, is a little more optimist, when affirming the potential of microfinance to reduce poverty, but she warns that it is a partial instrument to reduce it.

Guene highlights the methodological difficulty of microcredit evaluation of employment in Europe. The European Commission affirms that research into the evaluation of the use is still heterogeneous and disperse. This is partly due to disagreement on what it is due to measure and partly because it is too far from political decisions.

Guene, doing certain methodological reservations, compares the cost of created job thanks to different financial instruments with social character, among them is microcredit, with the cost of average unemployment subsidy in the European Union. The annual average cost of unemployment subsidies is of 9000 ECUs of 1995. 70% of the studied financial instruments make investments by job below 9000 ECUs.

He also says that the jobs created with this kind of instruments would not have been created in their absence. Microcredit acts in market niches not covered by traditional financial instruments. In certain way, the support in the enterprise management replaces the collateral demanded by the bank.

Anyway, Letowsky recognizes that the number of created jobs is small, considering the number of financed companies and the number of financial intermediaries who participate.

Finally, for Stallings the efficiency of the market does not substitute the personal attention in the fight against poverty. The success of microcredit is based so much on the collaboration as in the personal understanding of the needs of poor men. Johnson and Rogaly plead for interventions in the microfinance field that answer the demands of the poor: these can play an important role in poverty reduction.

## **CONCLUSIONS**

The Church, worried about poverty and unemployment, suggests a vision of the economy centred on the man, as a first step in the solution of these problems.

The definition of microcredit is not the same for the North and the South. In addition, inside these economic areas different approaches can be meet. Even so, we found two common elements in microcredit of the North and the South: its small quantity (micro) and the sense of exclusion of its users. In western countries, microcredit is linked to the social investment or the alternative finance and its goal are entrepreneurial activities; in developing countries it is tied to the informal economy and can also be used for non-entrepreneurial aims as consumption or education.

Literature revision reveals that microcredit effect on poverty is studied mainly in developing countries, and the effect on unemployment in developed countries, although unemployment

can trigger poverty situations.

Microcredit is able to alleviate so much the income poverty as capacity poverty, but its results are more immediate in the first option. The financial system approach is centred on the microfinance institution, whereas the loans to alleviate the poverty approach seeks to alleviate the level of poverty of the borrowers, in the scopes of capacity and income poverty.

The financial system approach seems to follow the ruling economic theories, and loans to alleviate the poverty approach appears to follow another paradigm, more person-centred, more humanist. Both approaches appear most of the time as non complementary but substitutes, and most of the reviewed authors, referring to empirical studies, affirm that microfinance institutions do not obtain together sustainability and poorest reaching.

As for unemployment reduction, the approaches based on self employment enjoy greater diffusion. Microcredit can suppose the first step to get financial instruments for this type of activities.

The typology of microfinance institutions is parallel in the North and the South, having a greater amplitude in the North.

As far as the evaluation of microcredit, the reviewed authors warn of the methodological difficulties of this task. In any case, microcredit can have positive effects in terms of income increase, although it is more agreed that it can increase the economic security, that is to say, to protect the income, more than to increase it, as a first step to reduce the poverty. And most of the authors agree that microcredit must be combined with another type of instruments to improve effectiveness.

With regard to the possibilities of microcredit to reduce unemployment, making some methodological reservations, it is said that jobs created with this instrument would not have been created otherwise, and a research reveals the smaller cost of the concession of microcredit compared with the unemployment subsidy.

To conclude, we think that microcredit can be centred on itself or be centred on the person: it is this approach the one that has biggest possibilities it in the fight against poverty.

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## **GLOSSARY**

CA: Centesimus annus

GS: Gaudium et spes

HDI: Human Development Index

MFI: Microfinance Institutions

INAISE: International Association of Investors in the Social Economy

HPI: Human Poverty Index

LE: Laborem exercens

NGO: Non Governmental Organization

SRS: Sollicitudo rei socialis

## NOTES

[1] For these authors a microenterprise is an enterprise with less than five employees, being the most common the ones which only engages the owner.

The European Commission (European Commission, 1996) consider a microenterprise with less than ten employees. Next group, little enterprise, engages up to fifty employees.

Carpintero considers that informal sector economic activities can be divided into survival activities and microenterprise activities. These last go beyond survival, but it is difficult to draw a line in the case of individual microenterprises. For the author, a microenterprise has less than ten workers.

[2] For the top-down approach it is important the national economic growth: the profit of it will also reach the poorest, and this way national poverty level will be reduced.

The down-top approach aims directly to the poorest: it considers than growth should start at micro level, which finally will help to growing at macro level.