

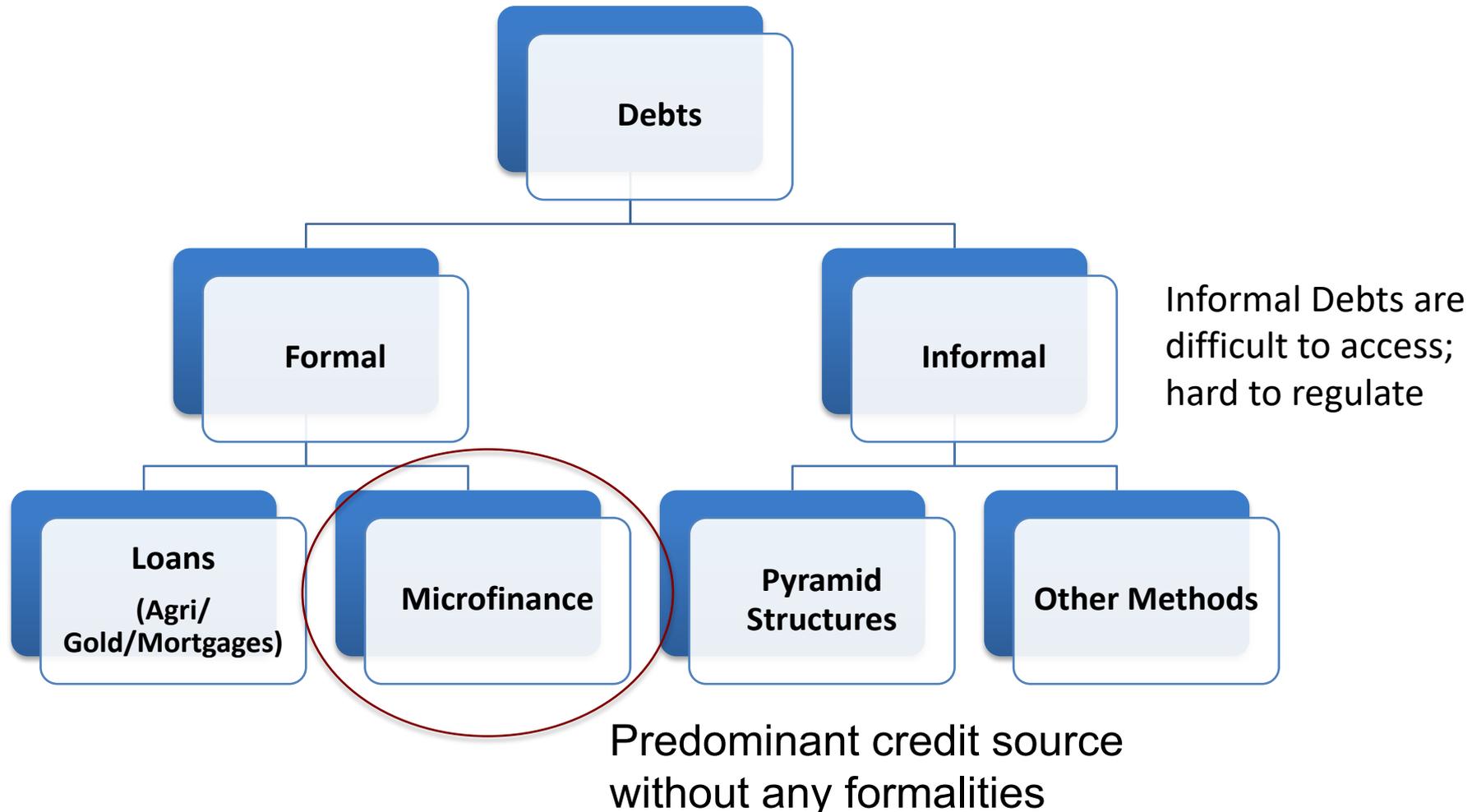
Need to Protect Poor from Growing Debt Trap: Evidence from Northern Sri Lanka

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Types of Debts at Poor households

Microfinance is a prominent & easily available form of credit to poor → Hence, our focus is on Microfinance



What is Micro Finance

- Microfinance is the provision of access to high-quality and affordable financial services to **low-income households** with an intended objective of
 - Financing income-producing activities,
 - Building assets,
 - Protecting against risks, and
 - thereby fighting against poverty

(Brau and Woller 2004:3, Duvendack et al. 2011, Robinson 2001, Yunus 1999)

Microfinance benefiting poor by eradicating poverty and results in.....

- Enhance financial inclusion
- Encourages savings (Harcourt 2012).
- Job creation
- Extending education
 - Families receiving micro financing are less likely to pull their children out of school
- Improved health and welfare
- Empowers women

But, evidence from studies on Microfinance in Asia suggests...

- Gopaldaswamy AK, Babu MS, Dash U (2015)
 - Need for Systematic review of quantitative evidence on the impact of microfinance on the poor in South Asia.
- Duvendack et al. (2011)
 - Lack of studies with robust evidence to prove strong impact of microfinance on poverty alleviation and women empowerment.
- Noreen et al. (2011)
 - Positive and significant effect of microfinance on children's education and household expenditure; However, without any significant impact on housing conditions, ownership of household.

Research Objective

- To understand the impact of excessive debt on the wellbeing of the poor in Northern Province

Research Questions

- What are the evidences on increasing level of debts within Northern Province?
- Are there any evidences to prove the benefits of credit growth to improve savings, woman empowerment, new job creation, and livelihood development ?

Depth Interviews and Secondary reports are key sources

- Qualitative Depth Interviews
 - Conducted Fieldwork in Jaffna and Kilinochchi:
 - During Sept/Oct 2015
 - Covering 20 respondents (4 DI & 2 FGD)
 - SEC D&E , Those who have taken a microfinance/debt
- Secondary Sources
 - Microfinance association
 - CBSL Report
 - CEPA Report
 - Newspaper Articles



Secondary Source Evidence on the State of Debt in North

Evidence of Debt in Northern Province

- No quantitative assessment (MFI always claims bias results)
- Former Central Bank Governor Arjuna Mahendran.
 - Indebtedness has sharply increased within the northern region as the growth of average debt per family has risen from **Rs. 52,000** to **Rs. 194,000** between a period of 4 years.
- Kathy Derore, Head of the programme unit at World Food Programme (WFP) in Sri Lanka
 - Of the 300 households interviewed over two days in Vavuniya and Mullaitivu districts in August 2013, half reported selling jewellery to cope with falling income and rising debt.
- 84% Sri Lankan including Northern people are either financially struggling or suffering



CEPA Study highlights, 84% of households receiving housing beneficiaries are in debt

Districts	Debt Amount (In LKR)
Overall	152,489
Jaffna	255,700
Kilinochi	142,536
Mulativu	117,250
Female- Headed Households	127,863
Households with at least one disable member	150,317

Source: Assessing Indebtedness & Socio-economic conditions of conflict Affected Housing Beneficiaries In Jaffna, Kilinochi & Mulativu Districts, Centre for Poverty Analysis (2014)

Key Finding from Focus group discussion

Questions on core principles of Microfinance

- Accessing Banks / Financial institution is not a problem.
 - Are there any problems to access finance in North (Particularly in Peninsula)
 - Respondents have no problems in accessing banks/financial institution (Refer Banking Density)
- Questions the need of extensive functioning of microfinance institution in the region if accessibility is not an issue.

“We don’t go searching for the finance companies, they come here to our door step, they will come with some known person and try to convince us to get credit” – Nimalaraani, Age 34, Uduvil

Often charge higher interest:

Similar to Loan sharks

- Microfinance should ideally provide better loan repayment rates
 - Microfinance tends to target women borrowers
 - Woman are statistically less likely to default
- But, woman are charged higher interest even up to the extent of 72% per annum
 - Certain loans command weekly repayments, borrowing a sum of Rs. 25,000 would lead to Rs.1,000 weekly repayments for 10 months resulting in an interest rate of 72% per annum.

Loan is used for consumption rather than income producing activities

- 16 out of 20 respondents we spoke to did not have any regular income generating activity.
 - *“I bought a motor bike for my son with the microfinance loan that I obtained. The agents is living around our neighborhood so I got it easily”*
- They took it because it was easily available at the time of difficulty or someone persuading me (group loans)
 - *“I mentioned to the agent that I need loan to start my own tailoring business to get the money and used it to meet my family’s daily needs and expenses”.*

Difficulty in repayment , results in more debt to solve debt

- Most of them do not have a fixed earning or means to repay. However as the repayment is a small denomination, they expressed confidence in repaying somehow.

“Mortgaged my three-wheel and obtained a sum of Rs.200,000. Rs.90,000 was paid to settle installment and interest. The remaining Rs.110,000 so I settled the balance by pawning family jewelries.”

- Saving is heavily affected after the loan was obtained
 - *“Main motive was to buy the vehicle believing that I could earn and somehow repay the loan. However, it is impractical and companies seize the vehicle instead. If one month’s repayment is missed it gets even more difficult to repay.”*

Any impact to the Local
Economy ?

In 2009 the branch density was 9.9 and it has increased by 118% to 21.66 in 2014; even higher than Western Province

Branch Density* by Province				
Province	2008		November 2014	
	Density	Rank	Density	Rank
Western	17.75	1	21.18	2
Southern	12.24	2	16.62	4
Sabaragamuwa	10.89	6	13.66	8
North Western	10.45	7	13.12	9
Central	11.04	5	14.49	7
Uva	11.40	4	14.70	6
North Central	11.90	3	16.14	5
Eastern	8.38	8	16.82	3
Northern	7.39	9	21.66	1
Sri Lanka	12.58		16.90	

* Bank branches per 100,000 population

Evidence of High Unemployment rates in Northern Province

- Development Economist Dr. Muttukrishna Sarvananthan
 - Scale of the problem is worse as the Government used a low threshold to calculate unemployment rates [Included 10 Yrs. old and those working only one hour a week]. With stringent parameters [Eligibility age of 15] the national unemployment would be at 18% instead of the 4% reported currently, **and with 32.8% unemployment rate in the Northern Province.** (Irinnews, 2014)
- Swiss Labour Organisation, 2014
 - Youth unemployment is one of the region's top challenges, with around **60% unemployment** in main towns in the North including Mullaitivu, Jaffna and Kilinochi

GDP remains somewhat constant with slight fluctuations within both North & East.

Provincial GDP Share	North	East
2011	3.7%	5.8%
2012	3.7%	6.3%
2013	3.4%	5.7%
2014	3.3%	5.8%
2015	3.5%	6.0%

Source: Department of Census and Statistics (2015)

Abuse and Marginalization instead of Women Empowerment

- Verbal abuse, sometimes they are even threatened
 - *“If the money isn’t ready every month as the agent arrives to collect we are subjected to insults, and humiliation. So in order to avoid that embarrassment we borrow from neighbors and friends to repay our monthly payments”*
- Loans are offered despite knowing the true intentions
 - *“I mentioned to the agent, (Lives near my house) that I need loan to start my own tailoring business to obtain the money and used it to meet our daily needs and expenses”.*
- Everyone in the society is considered as entrepreneurs
 - *“Even if we have any self employment activity (poultry, farming) we can obtain loan, they will initially give small values, once you pay we can obtain in larger values.*

Ultimately Who is benefitting ?

Unethical Practices of MFI

1. Door-door aggressive sales/marketing of the microfinance loans
2. Employing women to increase customers, without payment
3. Inadequate documentation, the sales personnel refuses to provide any document/contracts
4. Lack of understanding and awareness about the total cost that they eventually need to incur. Overcharges are included.
5. Deceptive advertisements and complicated terms
6. Consumers don't have a proper channel to complain about the issues and errors faced, majority doesn't even know that they have the right to complain
7. Subject to insult, abuse and humiliation when the staff arrives at their homes every

Policy Implication

- Financial Consumer Protection
 - Lack of crucial and proper regulations
 - General consumer protection law available in Sri Lanka without any explicit reference to financial services.
 - Financial Ombudsman is controlled by the financial institutions
 - Improve consistent and detailed reporting of microfinance interventions
- Create financial awareness among the lower socio-economic groups
 - Financial literacy needs to be developed amongst people
 - Promote Micro-savings , a better model than microcredit
 - Comprehensive and in-depth research could be undertaken (quantitative assessment)

Thank you