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The Fight Against Poverty

Why the current strategy is failing, and what should be done differently

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By the World Bank's broad definition for poverty ($2.00 or less per day per person), there are more poor people in the world today than a quarter century ago. Nearly half the world's population, over three billion people, lives in poverty. In India alone, two-thirds of its one billion plus population is poor. Yet, the strategy for alleviating poverty across practically every developing nation has remained essentially the same for the past several decades.

There is plenty of talk about ways to increase income, reduce illiteracy and ill-health, and empower women. The increased attention given to these issues and pledges of additional financial assistance by world leaders are not matched by new and effective national initiatives that can significantly reduce poverty. So far, none of the poor countries has been able to achieve any of its key developmental targets. The emphasis is still on more funding for programs that have been in existence for many years. Yet these programs have had only marginal effect, and have not kept up with population increases.

My personal experience on developmental projects is confined to India, but the broader lessons learned there are applicable to most developing countries. What follows explains what I consider are misconceptions in the current approaches, and how the attack on global poverty can be far more successful.

International development assistance hasn't worked

The UN Millennium project[1] argues that it is the poverty trap of poor health, poor education and poor infrastructure reinforcing each other rather than bad planning, corruption, and ineffective execution that is hindering development of poor countries. The idea is that underdeveloped nations can be saved through more outside assistance and by expanding existing programs that are run mostly by governments. Those who support this notion want the World Bank and other international agencies and donors to make increased contributions to supplement domestic government resources. But there is very little evidence that foreign assistance has made much difference in overcoming the poverty trap in any country[2].

As a consequence of the financial assistance received from international agencies, national governments rely on strategies developed by planners at organizations such as the World Bank and the United Nations. There is no shortage of ideas, enthusiasm, and expectations at the planning level, but what is lacking is good execution.

Planners have no responsibility for ensuring that funded projects meet their goals in the field. Other than requiring periodic written reports and demonstration of individual cases where success has been prearranged, there is little feedback or accountability. Beneficiaries are not in a position to let their views be known, nor do they understand what is expected in the longer run.

Misuse of funds

Governments, international agencies, and donors have expended billions of dollars to address poverty. For example, in rural India, government spends significant funds on subsidies (for electricity, fertilizer, fuels, etc.), food rations, price supports, land allocation/distribution, job training, and financial assistance for initiatives in agriculture and small businesses. Loans from the World Bank and other international agencies and bilateral aid supplement domestic government resources. But who has benefited from all these programs and assistance?

The beneficiaries are usually corrupt officials who manage and distribute funds, and landlords and powerbrokers who directly or indirectly extract benefits for themselves. In India, over 90 percent of the agricultural land is owned and partly cultivated by less than 10 percent of the rural population who are termed farmers; others are mostly laborers. Governments allocate land to the poor, but they are unable to utilize it because of limited water resources, or bad soil conditions, and/or inability to secure credit. Larger subsidies benefit bigger farmers, but the poor do not gain much directly from any government programs.

The presumption that with more money, corrupt and inefficient governments and bureaucratic institutions will utilize funds efficiently and improve the deplorable conditions of the poor is an illusion. There are too many impediments to poverty reduction: bribery, political influence in the allocation of land and/or credit; diffused focus and priorities; poor execution; shortage of rural infrastructure; social inequality, among other factors. Supporters of the "more money" approach should be reminded of what the late Indian Prime Minister Rajiv Gandhi once admitted: less than 15 cents of each dollar in assistance intended for the poor finally gets to them[3]. That is not to say that assistance should not be increased. But the real focus should be on ensuring that the allocated resources reach the poor.

Corruption and misallocation of development funds are ultimately the result of failed governance. Why bad governance? Unethical and illegal practices flourish in countries without free and independent press to investigate wrongful practices. Where the press is not sufficiently strong, there is little chance of preventing the "opportunistic behavior" of individuals, businesses and officials. Corruption can be reduced by assuring press freedom and strengthening private social institutions (such as advocacy groups) that stay independent. (Surprisingly, a democracy like India does not permit private radio stations to broadcast daily news!)

If citizens cannot rely on an impartial judicial system, there is little hope for a just and fair society. Societies that do not protect property and person from predators cannot expect to create sufficient wealth for everyone. It is the erosion of press independence and the weakness of legal system that are most troubling.

The limited role of NGOs

There are several participants in the developmental arena: national and foreign governments, international agencies, private companies, and non-governmental organizations (NGOs). The role of NGOs has gained attention in recent years as they focus on micro-issues and provide grass-roots assistance. Many have taken up projects to improve the quality of education and healthcare, while focusing on specific critical areas such as HIV/AIDS, illiteracy, and women's empowerment.

NGOs have been advocates for the poor, pointing out issues of concern and presenting ideas for improvement, often figuring out how to press through the corrupt and self-serving regulations faced by their beneficiaries. Several are involved in income generation activities, offering micro-credit or assisting with water resource management and use of indigenous technology. Some private companies have formed NGOs to attract grants from their governments and international agencies. These efforts usually complement those of governments in the implementation process.

Despite positive contributions, NGOs have not been involved in major developmental undertakings intended to create large employment and wide income generation through sustainable businesses. This is attributable to their lacking good managerial skills and organizational structure to take up business ventures. Further, donor funds are usually restricted to narrowly defined projects. Consequently, the role that NGOs are best suited to play is in support of projects funded by governments and international agencies, or those limited initiatives approved by private donors.

Unfortunately, those NGOs who actually carry out developmental work in the field are stuck within programs specified by planners in developmental agencies and donor institutions. New ideas that deviate from those already specified by planners seldom qualify for any funding. Thus project proposals are prepared to reflect the requirements set by these planners in terms of methodology and outcomes. There is little initiative from the ground up, and no real feedback. Demonstrating compliance on paper ends up more important than actually getting the job done effectively. As a result, recipients of developmental funds spend significant time preparing reports for the planners to qualify for continued funding, and less time worrying about what benefits the poor.

Micro-finance is not a panacea

The expression "social entrepreneurship" was coined to reflect corporate benevolence toward the poor. Mohamed Yunus who founded the Grameen Bank in Bangladesh in 1976 intended exactly that when he started giving poor people credit and assisting them in their local business ventures. Subsequently, many NGOs around the world started offering small loans to women who could otherwise not obtain credit from commercial banks. As different micro-credit programs sprung up in poor countries, governments, international agencies and private donors joined in with necessary capital. Several experts in these institutions termed micro-credit a revolutionary concept, and there is growing belief among many that it might be the way to solve poverty.

Today, some for-profit funds and supposedly not-for-profit organizations market micro-credit lending in developing countries, and even offer advertised returns on investment. One such micro-credit intermediary in India recently publicized that it has been charging 36 percent interest until recently when it dropped the rate to 26 percent for some borrowers by making the lending process more efficient[4]. After all, it argued, credit card companies charge as high as 28 percent interest for credit-risk customers.

The assumption is that poor people can be rescued quickly and easily with a modicum of money. (Micro-credit is intended mainly for starting or expanding small businesses run by borrowers.) The claim is that micro-credit (loans of around $100) has lifted tens of millions out of poverty in the developing world. However, assertions that more than 90 percent of the people who receive micro-credit are poor[5], that most of them succeed in businesses started with these loans, and that they repay the loans at 24 percent annual interest or higher, go unchallenged.

So far, there has not been any outcry on the high rate of interest. The poor do not have any voice in or understanding of financial markets. They are happy to get loans to meet personal emergencies (such as expenses toward surgery, marriage or dowry) or to pay off financial obligations to local money lenders who charge even higher rates. Micro-credit intermediaries claim that this is social entrepreneurship, and not living on the backs of the poor.

In my personal experience in rural India I have observed that a small number of people, mostly village leaders and their family members, operate the few shops and businesses. They are the only ones who have the support mechanisms, knowledge, and skills to make a business succeed. A great majority of the poor rural populations do not have the ability or experience to start or run businesses, with or without access to credit. To expect them to succeed in business is unrealistic. They are uneducated and labor for landowners and for the few nearby businesses. At best, they might benefit from the trickle down effect if landlords and small businesses prosper.

Our foundation[6] has studied some 17 villages and over 50 micro-credit programs in South India. Data show that less than 5 percent of those receiving micro-loans start any business of their own. One preferred activity is buying and selling sheep, hopefully at a profit equal to the wages foregone. These types of activities are unsustainable in the long run. Consequently, less than 2 percent continue beyond the first three years, and very few succeed in any such "business" with small amounts of money and little or no support, training, or skills.

Micro-credit lenders are not concerned about what the borrowers do with their loans. Loans are usually made to individuals, but guaranteed by groups that can demonstrate their capacity to repay. Most borrowers of micro-credit repay loans from income received at regular jobs, or from grants provided by governments for self-help programs. Not surprisingly, it is the intermediaries – commercial banks and loan facilitators – that gain the most from the spread between the cost of funds for the intermediaries and the loan interest charged by them. Commercial banks in India, for example, receive funds for micro-credit programs from the government-run NABARD bank at 5-6 percent. They then lend at 10 to12 percent to a micro-credit intermediary which, in turn, lends at 24 to 36 percent to the final borrower.

The assurance of loan repayment makes micro-credit popular among lenders, in addition to the high interest charged. Borrowers are motivated to repay loans because of an expectation of future monetary benefits. If one borrows and repays twice (no need to start any business, but maintain good paperwork), then he/she becomes eligible for a grant for $100 or more from a separate government program (each state offers its own variation of this facility). The free money from the government can be used to repay the third micro-loan made to that beneficiary. The government is short the amount of the grant, but the borrower is debt free, and the micro-credit middle-man is assured of capital and high returns.

Why this round about way to offer free money when there are several direct means to reduce the debt burden of the poor? The answer probably lies in the fact that this form of "hand-out" is invisible within "social entrepreneurships". Moreover, major financial institutions have become embroiled in this commercial activity. A new breed of educated and well-trained loan sharks, with bank support, is now in the micro-credit business in India. Micro-credit has become a trendy cure-all. If poverty alleviation were a matter of lending, the world could eradicate poverty easily. It would cost about $300 billion at $100 per person – a small sum in comparison to the trillions of dollars already expended over the past half a century. The present form of micro-credit, as practiced in India, results in little or no sustainable development benefit for the poor.

Importance of private sector participation

In developing countries the government bears the primary responsibility for delivering basic services for the poor. It has traditionally been the agent for healthcare, education and job training, especially due to the inability of rural populations to pay for basic services. A significant portion of the costs associated with public services will continue to be borne by the state until rural incomes rise and/or until the private sector finds it attractive to be involved in such efforts.

Government-run institutions have, for the most part, failed to offer quality services because they are unable to motivate those who carry out the tasks in the field. Those who can afford to pay for quality services rely on private providers. Even those who work for government go to private clinics for their healthcare needs, and send their children to private schools. Quality will never improve unless service providers have the incentive to serve the poor. Until then, the "haves" have markets to choose from, while the "have-nots" have bureaucrats to dictate to them.

But, lack of affordability should not prohibit private sector participation. With NGOs as project facilitators, opportunities exist for public-private partnership. Private institutions can deliver services at reduced prices, but at a profit, within a competitive and independently monitored system where the costs are subsidized or even fully paid for by the government. Such partnerships can work in a cost-effective fashion only with arrangements for independent audit and arbitration by credible third parties.

In developing countries there is no serious effort to involve private companies, though most rural areas are, in fact, ideally suited for industries in herbal products, alternate fuels, cement and tile, lumber and pulp, meat, dairy and poultry. These private industries should function in a free market with sufficient checks and balances to ensure that they operate in a socially and environmentally responsible manner. By offering job opportunities in villages, they would alleviate migration to cities for employment.

Financial incentives like low-interest loans and tax breaks, and physical infrastructure improvements will motivate private companies to build factories in rural areas. Elimination of controls on the sale of agricultural products, and assistance in finding new markets will attract many businesses. These measures will in turn improve the demand for produce and boost commodity prices to levels that can financially sustain rural families. Further, international agencies and donors must consider equity participation in companies instead of simply channeling funds through governments or offering grants. They should provide loans at low interest rates directly to local entrepreneurs who can demonstrate an ability to run successful businesses[7]. In short, some of the available developmental funds must be used to support commercial activities in deprived communities. With more economic activity, the poor labor class can gain employment at better wages[8].

Government's role ought to be that of a catalyst. There should be no room for bribes. The focus should be to provide incentives for private (and community) participation. When private individuals and institutions find it worthwhile to take risks and invest in economically depressed areas, there will be sustainable development and poverty reduction. As incomes rise, there will be less need for government involvement in the delivery of many services currently provided.

It is not money alone but integrity and ideas that will make the real difference. A noted economist once asked me how I would go about improving the productivity of rural laborers on our farms. Creative thinking was my thought! We have instituted a program of de-worming drugs every six months, and daily iron tablets and protein-rich nutritional supplements prepared from locally available grains and nuts. Our workers wear wide hats protecting them from direct sunlight. These are simple, low cost measures, but they have contributed to a healthier and more productive labor force on our farms. For less than $10 per person a year, we have doubled their productivity!

A new model for corporate philanthropy

Contrary to the recognized activities of NGOs, our foundation has embarked on a path similar to those of private organizations: we build institutions, develop human resources and managerial skills, and undertake major commercial projects – for humanitarian reasons. One project currently underway is a 250-acre banana farm, the second largest in South India. My life-long experience in business, my convictions about free and open markets and the need to encourage an entrepreneurial spirit in the individual have helped me not to rely on donor funds alone. Instead, our foundation has invested in sustainable projects that generate "profits" as well as steady income for the poor.

Our decision to confine business activities to farming results from the fact that the rural adult population in India is generally illiterate and lacks industrial skills. It is farming that gives them opportunities to better their lives; it is what villagers have a natural affinity for; and it is an industry where large numbers can be employed.

With the goal of empowering poor women and elevating their income-generating capacity, The George Foundation set up Baldev Farms, a "learn while you earn" program. The farm uses precision agricultural tools, organic fertilizers and superior technology in drip irrigation to conserve water. Apart from the farm workers' daily wages, we set a portion of the profits generated from the sale of produce in a savings account to be used at the end of 5 years for the purchase of one third to one half acre of land for each family. Families will then cultivate their newly purchased land, sharing resources, such as wells and tractors. The foundation will remain a support organization to help address concerns and difficulties, while also offering know-how and access to markets.

Within three years of starting Baldev Farms, more than 150 villagers, mostly women, have found labor and supervisory employment in the field; hundreds of others have benefited indirectly. Most have already come out of poverty, paid off their debt, and freed themselves from bonded labor status. As the foundation expands its farming activity in high-value fruits and vegetables, it will soon generate sufficient cash flow to finance other humanitarian initiatives.

Though the final chapter on this program is not yet written, the concept of offering each poor family a piece of the land to cultivate profitable crops is proving to be sound. With the profit sharing plan in place, everyone in our farm is highly motivated, takes initiatives and works hard. It is becoming increasingly clear to us that good management and a dedicated work force are assuring profitability to empower the poor.

Admittedly, our "corporate" approach to philanthropy cannot be replicated by most NGOs. Only private for-profit companies have skill bases and resources to undertake such business ventures. But they must recognize that market opportunities can be tapped only when the purchasing power of consumers rises. Hence, for the foreseeable future, investment in the rural sector ought to be toward production as opposed to selling to the "bottom of the pyramid." In the longer run, it is competitive markets and involvement of the community in sustainable development projects that will solve poverty.

As long as significant poverty exists around the world, and the disparity between the rich and the poor widens, private companies in developing countries need to make a contribution to solving the problem. A dialogue must begin between and among business leaders on devising rules for business conduct in deprived communities. The model must consider how poor people can be brought into the mainstream of consumers with sufficient purchasing power within a reasonable time period. Those who work must earn enough to be able to come out of poverty. Minimum wages and benefits must be adequate to meet at least basic human needs, and farmers must be able to sell their crops at prices that assure a fair net gain. Economic success and social justice must go hand in hand.

There is serious concern in many circles, and rightly so, about whether the private sector can be trusted to operate fairly in communities that are poor. The fear is that free markets mean exploitation, citing what they call the "Wal-Mart Syndrome" of forcing suppliers, especially those from poor countries, to offer products at prices that leave little gain for workers.

Troubling issues like this one will always exist. But they can be addressed through effective enforcement of laws and regulations concerning minimum wages, worker safety and benefits, non-competitive practices, and environmental protection. Private companies must resist the temptation to extract government funds for their business activities in the name of social entrepreneurship. They must recognize that it is in their long term interest to win the support of the communities where they operate. Repressive local norms in compensation and treatment of labor must be replaced with fair practices that assist the poor in adequately caring for their families. Market forces of supply and demand and competition for gaining a dedicated labor force and loyal consumers are powerful factors in motivating good behavior on the part of corporations.

Concluding remarks

There are no easy answers. Poverty, in large part, can be solved if the poor gain new skills and if more jobs will become available in the rural sector. For some, the solution lies in ownership of a permanent income generating asset: land. The poor need to have the opportunity to own and develop land, and grow profitable crops that can be sold in a competitive market.

More money is not a prerequisite for success; proper use of available funds is. There is no substitute for good planning, effective organization, and execution with accountability. Only those who bear financial risk can be expected to perform effectively.

Handouts will not solve poverty; neither will it be solved by grand government projects, or by piecemeal interventions of NGOs. Instead, poverty will be solved with vibrant economic activity driven mostly by the private sector. The hundreds of millions of new jobs that are needed each year will come mainly from corporate business ventures in rural areas. The developmental strategy to address poverty must embrace this reality.

A market-based approach to poverty reduction will result in income and wealth creation, and lay the groundwork for the next generation to avail of a wider range of opportunities with enhanced resources.

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1. *Investing in Development*, UN Millennium Projects Reports, September 2000, commissioned by the UN Secretary-General and sponsored by the United Nations Development Programme on behalf of the UN Development Group. The report is an independent publication.

2. Considerable evidence on whether foreign aid has been effective in reducing poverty in poor countries is provided in *The White Man's Burden*, William Easterly, The Penguin Press, New York, 2006.

3. Unscrupulous politicians and bureaucrats in developing countries have perfected schemes for siphoning off funds allocated for poverty eradication in their national and state budgets. It is not uncommon that additional funds are assigned by governments for projects that have already failed, with the assertion that more money will solve the problems.

4. "Entrepreneur Gets Big Banks to Back Very Small Loans," *Wall Street Journal*, May 15, 2006.

5. The question on who are the beneficiaries is answered by a recent study of one of the largest micro-finance intermediary in India that has shown that most borrowers use the funds to finance the purchase of a new motorbike, pay the family doctor, and/or to meet other needs that are way above what poor people can afford. *Tyler Cowen, "*Micro-loans May Work, but There Is Dispute in India Over Who Will Make Them", *New York Times*, August 13, 2006.

6. The George Foundation is engaged in several poverty alleviation projects in rural Tamil Nadu, India, focusing on income generation activities, education, healthcare, and community development (see www.tgfworld.org).

7. Examples of equity participation in and loans to small businesses to promote development can be seen in projects funded by the International Finance Corporation (an agency of the World Bank) and Acumen Funds. However, currently such allocations of funds by international agencies and donors are very limited.

8. The argument that villagers can lift themselves out of poverty much faster by getting a job in a successful business enterprise, instead of trying to start businesses of their own, is beginning to gain some attention. "Shopping for a Nobel," op-ed, *New York Times*, New York, October 17, 2006.
