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The Andhra Pradesh Microfinance Crisis and American Payday Lending: Two Studies in Vulnerability

By/Par **Eric Palmer**

Associate Professor of Philosophy at Allegheny College

ABSTRACT

Microcredit, a non-profit lending approach that is often championed as a source of women's inclusion and empowerment, has in the past decade been followed by microfinance, a for-profit sibling of a different temperament. Microfinance in India is now in turmoil, precipitated by legislation in the state of Andhra Pradesh, which has encouraged withholding of payment, which in turn has frozen the market. This paper considers one precipitating condition of the crisis: the remarkable, new, and developing burden of formal economic debt that poor women in the state have only recently come to hold – debt that now surpasses one year's family income, on average. The development of this lending sector follows upon innovation in lending to the poor of the global north over the past two decades, and the practices show noteworthy parallels. Both lending schemes have produced similar disproportionate burdens upon some low-status individuals within their respective economic orders, and both may exploit a vulnerability that is born of aspiration and produces great dysfunction for borrowers. This paper introduces the two lending schemes, sketches the parallels, and introduces the claim that ethical finance arrangements for the poor require attention to vulnerability, an under-utilized category in both liberal ethical theory and in finance.

Keywords: Microcredit, microfinance, vulnerability

RÉSUMÉ

Le microcrédit est une approche du prêt à but non lucratif souvent défendue comme une source d'inclusion et d'autonomisation des femmes. Il a dans la dernière décennie été suivi par la microfinance, une « sœur » à but lucratif d'un tempérament différent. La microfinance en Inde est maintenant dans la tourmente, précipitée par la législation de l'État de l'Andhra Pradesh, qui a encouragé la retenue de paiement, qui à son tour a gelé le marché. Cet article considère le déclenchement de la crise : le développement du fardeau de la dette économique formelle que les femmes pauvres dans l'état sont venus récemment à accumuler - dette qui dépasse maintenant le revenu familial d'un an, en moyenne. Le développement de ce secteur du crédit fait suite à l'innovation dans les prêts aux pauvres de l'hémisphère Nord au cours des deux dernières décennies, et les pratiques montrent des parallèles remarquables. Les deux programmes de prêts ont produit des charges disproportionnées similaires sur quelques

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personnes à faible statut. Cet article présente les deux programmes de prêts, esquisse les parallèles, et introduit l'idée que les modalités de finance éthique pour les pauvres requièrent une attention à la vulnérabilité, une catégorie sous-utilisée dans la théorie éthique libérale et en finance.

Mots clés : Microcrédit, microfinance, vulnérabilité

JEL Classification : G23

1. LENDING IN INDIA: THE MICROFINANCE CRISIS

For-profit microfinance has grown rapidly around the globe, and it has produced some results of doubtful value in development contexts, particularly of late. The problem reached a crisis point in October 2010 that may be of global as well as local significance. Subsequent to reports of suicide by desperate borrowers unable to meet their commitments, legislators in the state of Andhra Pradesh introduced "An Ordinance to protect the women Self Help Groups from exploitation by the Microfinance Institutions," which contains restrictive regulations that have played their role in generating instability in lending institutions. Even before the legislation was passed in December, re-payment of loans slowed; in December, it practically halted. Repayment appeared to be picking up toward mid-year 2011, though it was still below 20% as of April, and late in the year the repayment rate was at 10%.¹ Brief defaults due to protest have occurred in several regions of India over the past several years, including a brief pause in Andhra Pradesh in 2005 and a more pronounced one in 2006, but the state's new restrictions on loans have left many lending companies with the prospect of insolvency. Sustained failure in Andhra Pradesh is especially significant, for many microfinance institutions have better than 20% of their lending concentrated in that region. Involved institutions now face a developing crisis that may bankrupt one quarter of the microfinance institutions in the state.² A shortage of confidence could also spread, making significant impact upon the future of development globally.

¹ Vishwanath Pilla, "Six months on, loan defaults mount," *Mint* (India), April 26 2011. <http://www.livemint.com/Articles/PrintArticle.aspx?eat=tp&artid=0E6FC37C-6E42-11E0-9871-000B5DABF613>. G. Nadar Sridhar, "MFI clients in AP moot formula to repay Rs 10,000-cr loans," *The Hindu Business Line*, April 27 2011. <http://www.thehindubusinessline.com/industry-and-economy/banking/article1773971.ece?homepage=true>. Dinesh Unnikrishnan, "MFI's see sharp erosion in loans, net worth," *Live Mint*, Jun 26 2011. <http://www.livemint.com/2011/06/26223025/MFIs-see-sharp-erosion-in-loan.html?atype=tp>. N. Srinivasan, *Microfinance India: State of the Sector Report 2011* (New Delhi: Sage, 2012), 34. Annual reports in this series are cited by the year covered, e.g., "*Microfinance India 2011*."

² Yoolim Lee and George Smith Alexander, "India's Microfinance Clampdown May Trigger Failures, World Bank Aide Says," *Bloomberg News*, November 22 2010. <http://www.bloomberg.com/news/2010-11-21/india-s-smaller-micro-lenders-likely-to-fail-srinivasan-says.html>.

Controversy concerning traditional non-profit microcredit has also entered the scene of late, most notably one country over, in Bangladesh. In an interview that specifically concerned the most venerable of non-profit microcredit institutions, the Grameen Bank, Prime Minister Sheikh Hasina stated, "Micro-lenders make the people of this country their guinea pig. They are sucking blood from the poor in the name of poverty alleviation."³ *The Economist*, alongside many other sources, suggests that the Prime Minister's dogpile of metaphors was politically motivated: opportunely timed to take advantage of the Andhra Pradesh publicity, as well as overstated accusations of tax evasion that were presented in a Norwegian television documentary.⁴ In January of 2011, Grameen was placed under investigation for evading Bangladeshi tax law, and has since been cleared of any wrongdoing, but the Central Bank of Bangladesh ordered Grameen Bank founder Muhammad Yunus to step down from his position as Managing Director because he had advanced well beyond the statutory age of retirement for a Managing Director of a state institution. The board of Grameen bank protested the order, but the Bank's decision has been upheld by the Bangladesh Supreme Court.⁵

The political battles over lending continue in India. Having noted them briefly for the sake of clarity within this economic and philosophical discussion, I will now turn away from them, returning to note specific current policy developments toward the end of this article. I will instead focus particularly upon one ethically pertinent aspect of for-profit microlending, the debt burden incurred by the poor of India through two sources that are often collected together under the title "microfinance institutions" (MFIs). One source, a lending scheme singular to India, is the Self Help Group (SHG), an altered version of Grameen Bank's lending circle model, involving various Indian private banks in place of the non-profit Grameen Bank. The second source is microfinance lending directed to individuals by for-profit companies (henceforth "microfinance"), an approach to finance for the poor that has risen to significance both in India and globally only during the past decade.⁶ Accounts of both sources will be presented in the next section, where documents directed to practitioners within the financial sector are also examined. They suggest that a remarkable burden of debt has accumulated in the brief time that MFIs have been operational, and that the debt is of a kind very different than that encouraged for promoting business ventures by Grameen and other microcredit organizations. Borrowers in India now appear to hold MFI debt that is not tied in any meaningful way to business; it appears instead to be largely long-term and perhaps permanent debt, with new loans taken to liquidate previous loans as they come due,

³ "Fund transfer allegation against Prof Yunus needs inquiry: PM," *Financial Express* [Dhaka], December 6 2010. http://www.thefinancialexpress-bd.com/more.php?news_id=119351.

⁴ "Saint Under Seige," *The Economist*, Jan 5 2011. http://www.economist.com/blogs/newsbook/2011/01/microfinance_under_attack.

⁵ Grameen Bank, "Statement by Grameen Bank: Legal Challenge to Professor Yunus' 'Removal' From Grameen Bank," Grameen Bank, March 3 2011. http://www.grameen-info.org/index.php?option=com_content&task=view&id=914&Itemid=0. "Prof Yunus to remain MD until decision by GB board," *Daily Star* [Dhaka], May 7 2011.

⁶ A fine informal introduction to the early development of global microfinance lending is Connie Bruck, "Millions for millions," *The New Yorker*, October 30 2006.

in a continuous chain. Such debt now averages well over one year's income for every poor family in Andhra Pradesh, and it reflects a debt service exceeding a quarter of that income.⁷

The third section explains the history and current condition of a very different market for lending to the poor, the payday lending sector in North America. Payday loans were developed as an augmentation of the business of check cashing, a financial service specifically directed to those with limited access to formal banking. Parallels with lending as pursued in India are noteworthy: the fourth section presents comparison, showing how both credit schemes have produced burdens of debt that reflect a comparable proportion of income for at least some of the poor within their respective economic systems. The fifth section provides ethical consideration of the stories that have been sketched, introducing the concept of vulnerability into the ethics of finance. I will argue that these lending practices play into a vulnerability that is born of aspiration, and they may leave the aspirant in worse straits in the long run. Such aspiration is too common and too influential to simply ignore: it is an ethically salient feature that these credit arrangements do not sufficiently recognize and so do not successfully address.

2. THE OVERDEVELOPED MICROLENDING CULTURE OF ANDHRA PRADESH

Microfunding has been a particularly important force in Indian development, with the ubiquitous model of Women's Self Help Groups leading the way. SHGs are cooperative groups of an average of fourteen women, usually formed in rural areas. Their arrangement is inspired by the lending circle approach of Grameen Bank, in which regular meetings of a group combine education, problem-solving support, and encouragement with a three-stage financial process: accumulation of savings, followed by application and disbursement of loans, and, finally, repayment of loans. Repayment is usually followed by another round of application. In Grameen's lending circles, bank officers set up and control the lending arrangements and the circle meetings, but India's Self Help Groups, as the title suggests, are instead government-sanctioned cooperatives that are arranged by the participants themselves. SHG's contract with banks to receive their loans, and because SHG's have little continuing connection to lending officers, their members have a great deal more responsibility and latitude than do members of Grameen's lending circles.

SHGs usually meet for several months to accumulate savings that are banked in the name of the group before its first lending round. They may lend directly within their circle or within their community, but they more usually begin by saving for a deposit against a loan of two to four times the amount of deposit, contracting with a for-profit lending institution in a "bank linkage," an arrangement that, since 1993, has been sanctioned and guaranteed by the Reserve Bank of India.⁸ The SHG model has grown remarkably during the past decade: in

⁷ *Microfinance India 2011*, 6.

⁸ Clear explanation of the SHG model may be found in a manual that explains the groups to prospective members and is provided by the National Bank for Agricultural and Rural Development (NABARD): *A Handbook on forming self-help groups*, (Mumbai: NABARD, n.d.) <http://www.nabard.org/pdf/publications/manuals/formingshgs.pdf>. See also Frances Sinha, *Microfinance Self Help Groups in India: Living up to their promise?* (Warwickshire: Practical Action Publishing, 2009).

2002, almost a half million SHG bank linkage loans were provided, and, by 2011, the loan count had multiplied tenfold. At fourteen women per SHG, if poor women were each filling the rolls of one group only, then the groups would enlist approximately the entire number of women that the Indian government classifies as poor. Since SHGs primarily serve rural women, it is reasonable to conclude that many are enlisted in multiple groups, and it would be difficult to sustain any other conclusion for enlistment in some regions, such as Andhra Pradesh, as will be shown below. The average value of each SHG loan has also risen sharply in the past decade, from 2200 rupees (\$44) to 123,000 rupees (\$2460).⁹

The SHG model may be reaching a plateau, as its growth rate has steadily declined since 2003, when such lending experienced a 55% annual increase in the loan count.¹⁰ A rather streamlined version of the SHG, the Joint Liability Group (JLG), is also becoming common, especially for farmers raising funds for annual crop cycles. A JLG has four to ten members who do not save at the group's inception, but instead pledge joint liability to the bank that assesses their plans.¹¹ Both SHG and JLG models incorporate education, planning and vetting of loans that reflect elements of a business plan, though in the case of the SHG, the vetting of loans is done within the group. Both are arrangements overseen by the National Bank for Agriculture and Rural Development (NABARD). The JLG model, altered to include a fee that group members pay upon inception of the loan, has been adopted into urban settings by non-governmental microcredit organizations and for-profit microfinance institutions.¹²

The rising paradigm for lending is the microfinance loan placed directly with the individual by a private non-banking lender. Microfinance firms rely heavily on lending and collection officers who travel to village borrowers to transact their business. The largest of these lenders is SKS. Originally Swayam Krushi Sangam, "Self-help union," SKS ran for its first decade as a non-profit microcredit outfit. The transition to for-profit status has allowed the organization access to funds that go many fold beyond what would otherwise have been available, and so the shift also has allowed for great expansion in lending. With the expansion has come a high rate of profit as well, estimated as a 28% annual return on equity across the microfinance field in India at the brink of the Andhra Pradesh crisis.¹³

⁹ *Microfinance India 2011*, 13. Values are calculated at a constant 50 rupees/dollar exchange rate, without correction for inflation or purchasing power parity (PPP averaged 20 rupees/dollar for 2009 and 2010).

¹⁰ *Microfinance India 2007*, 36 and *2011*, 13: growth fell to 9% in the year of the crisis, and 5% in 2011.

¹¹ See "Guidelines for financing joint liability groups of tenant farmers," NABARD Circular no. 151/MCID4/2006. <http://www.sadhan.net/Adls/Microfinance/Circulars/NABARD%20Guidelines%20For%20Financing%20Joint%20Liability%20Groups%20Of%20Tenant%20Farmers.pdf>. NABARD began the program in pilot stage in 2003 and launched it across India in June 2010.

¹² See, e.g., recent introductions of Joint Liability Groups by ICICI Bank and Rang De.

¹³ Micro-Credit Ratings International Limited, "M-CRIL Microfinance Review 2010," vii. <http://www.m-cril.com>. SKS received remarkable response from investors when it presented its public stock offering in June 2010; the ardor has since cooled, and its value rests at little more than 1/10 of the closing price on the day of opening.

The broad availability of credit has produced a rather remarkable and unfortunate turn in Andhra Pradesh (AP). Well before the events of October, the state stood far out on the leading edge of microlending in India, and it became a focus of much study by both academics and lending institutions. The state has been particularly featured over the past six years in a series of very detailed financial analyses that have served as a standard annual reference work, the *Microfinance India: State of the Sector* reports.¹⁴ At the opening of the crisis, AP had more than twice the prevalence of microfinance loans and three times the outstanding debt per poor household as Tamil Nadu, the state then considered the next most advanced in these respects. The author of all recent *Microfinance India* reports, Narasimhan Srinivasan, estimated that in 2008 AP families contracted an average of 5.6 loans per poor household in the year. For the mid-2010 report, his estimate rose to 9.3, and as of late 2011, with the Andhra Pradesh market largely frozen, his estimate stood at 10.9 loans per poor household.¹⁵ The average outstanding formal sector lending debt per poor household, both SHG and microfinance debt combined, has also risen dramatically in AP: from 29,000 rupees in 2008 to 71,000 rupees in 2011.¹⁶

These figures from the formal lending sector do not fully reflect the debt burden these households bear, and it is difficult to gain clarity, for a variety of reasons. First, the very poorest families do not participate, and microlending is also transacted among those near to but above the poverty threshold; so the overlap between lending and poverty is partial. There is also little consistency regarding characterizations of the poverty threshold in the Indian context, though one common approach sets it at a family income of 50,000 rupees/year (\$1000).¹⁷ The formal sector lending figures also do not reflect the entirety of the burden of family loans, for they do not account for informal loans, with highly varied interest rates, gained from relatives and moneylenders. Recent *Microfinance India* surveys suggest that the proportion of informal sector debt has shrunk by 1/3 in the past two years and is now approximately equal in value to formal debt.¹⁸ With these qualifications noted, the figures nevertheless suggest that poor families in Andhra Pradesh are most likely to be swimming in a pool of formal debt that is significantly greater than one year's income, at 24% interest plus fees, spread across perhaps eleven credit accounts, with collection agents attending their

¹⁴ *Microfinance India* is an authoritative annual report on the national sector produced by ACCESS India, a non-profit microfinance "advocacy" organization that receives funding and sponsorship from for-profit banks (e.g., Citibank, HSBC), intergovernmental organizations (e.g., CARE, UNDP), Indian national banks and governmental organizations (e.g., SIDBI, NABARD), and various non-governmental organizations and charities concerned with microfinance. See <http://www.microfinanceindia.org/about-microfinance-india.php>. All reports but for that of the most recent year are available at <http://www.microfinancegateway.org/p/site/m/library/>.

¹⁵ *Microfinance India 2009*, 4 and *2011*, 6.

¹⁶ *Microfinance India 2011*, 48.

¹⁷ A discussion with particular regard to Andhra Pradesh is Arnab Mukerjee, "Trends in Andhra Pradesh with a focus on poverty," University of Oxford, Young Lives Technical Note no.7, 2008. <http://economics.ouls.ox.ac.uk/13177/1/uuid2639e2a3-78de-49e5-9a98-6ed96ca9c37c-ATTACHMENT01.pdf>.

¹⁸ *Microfinance India 2011*, 53. These data do not clearly suggest a reduction in informal lending, as the 43% growth of formal sector lending during the two year comparison period may be largely the result of an absolute growth in lending, rather than a shift away from informal lending.

many payments. Srinivasan suggests that “Multiple loans help people manage money, like juggling balls.”¹⁹ Women are the recipients of about 9/10ths of these loans.²⁰

This is a new horizon in global poverty and its relation to capital and finance. Muhammad Yunus began his experiments with microcredit in 1976 because it was practically impossible for the poor of Bangladesh to gain access to formal lending sources.²¹ Whereas the poor could not find credit at that time, it has now become so ubiquitous that the poor of Andhra Pradesh had accumulated an average debt service of over ¼ of their family income, largely unpaid and mounting further, before the payment protests began. That debt is now largely frozen and is the subject of political contest, as I will indicate in the final section of this paper. The poor of Manipur state now face an even greater burden, having just edged out Andhra for the top slot in borrowing as of 2011. The rest of India is in pursuit.²²

3. THE RISE OF PAYDAY LOANS IN AMERICA

For the poor in North America the next loan is just around the corner, at the lending storefront. The unsecured loan sector sprang up in the USA, and shortly thereafter in Canada, as a product of business acumen followed by lobbying, legislation and marketing.

Loans of money are called “unsecured” if they are granted without the usual collateral that would provide a material guarantee against at least some of the loan’s value. In SHGs, unsecured loans have been stabilized through a regular pattern originally developed by the Grameen Bank: “aspiration and commitment” of women is harnessed by “groups consisting of co-opted members coming from the same background and trusting each other.” The “close monitoring of borrowers” and pressure to “do everything possible to ensure the system’s financial balance,” yield a remarkably stable system that, at Grameen, engages trained lending officers who work “with real development ethics based on rigour, creativity, understanding and respect for the rural environment.”²³ In North America, the system of unsecured loans to the poor came to be stabilized in the early 1990’s on a very different model, when non-banking institutions – check-cashing storefronts developed to provide financial services to the poor – came up with a new scheme. Check-cashers at the time were in the business of delivering funds to individuals who could not otherwise convert the checks they received, usually because the individuals were either itinerant or did not have bank accounts, which often required a significant minimum of deposit to remain on hand. The check-casher often drew a fee for this service of more than 5%.²⁴ The innovation that took

¹⁹ Lee & Alexander, n.p.

²⁰ *Microfinance India 2009*, 50. A value of 93% is indicated for India as a whole.

²¹ Muhammad Yunus, *Banker to the Poor* (USA: Public Affairs Press, 1999), 45 ff.

²² *Microfinance India 2011*, 6. (Research for this section of the article was completed April 2012.)

²³ Grameen Bank, “Method of action,” Grameen Bank. http://www.grameen-info.org/index.php?option=com_content&task=view&id=33&Itemid=107.

²⁴ For those too young to remember: well into the third quarter of the 20th century, checks from non-local banks and those cashed by individuals with residences far from the site of transaction (or no residence at all) were frequently treated with skepticism. Check cashing continues to be a business: the average rate for check cashing at present is about 2%, and customers without checking accounts also use the storefronts to handle check-writing and processing to pay bills, again with further fees

the place of collateral for check-cashers was the reasonable prospect of future repayment, a prospect presented by customers who had both a bank account and a regular source of income. Loan recipients would write a post-dated check and provide the lender with reasonably sound evidence of their ability to pay in the future, with that evidence taking the form of a recent paystub. Failed payment on a payday loan incurs substantial costs for the loan recipient, including legal responsibility for the debt and further compensatory charges, as well as fees associated with presenting a bounced check.

Currently, payday loans provide an advance of up to 50% of the value of a paycheck, with principal, interest and fees all due on the day of the next forthcoming paycheck. The value of a loan is typically about \$300.²⁵ This lending practice began with check-cashing firms introducing it not as a lending service, but as an enhanced opportunity for check-cashing (only later would the service acquire the name “payday lending”). That characterization of the practice allowed the firms to circumvent usury laws, which are upper limits for interest rate charges that have been set by states and provinces, and are frequently set below 30% per annum. Litigation and novel legislation followed the proliferation of the practice, and contestation has since settled. Payday loans are available in most states, with a fee structure that usually reflects a combined fee plus interest rate charge of about 400% per annum. Payday loans in most offerings are set for approximately a two-week period, so those loans reflect total charges of roughly 15%. Payday loan storefronts have proliferated, increasing from several hundred locations in 1990 to over 24,000 by 2007, at that time providing loans to fifteen million customers in the USA, or 5% of the population.²⁶

Payday loans are marketed in the United States as short-term solutions for debt: that is, they may serve to cover emergency financial shortfalls for individuals.²⁷ The consumer advocacy group Center for Responsible Lending promotes the argument that such lending is predatory: both dishonest in its marketing as a solution to debt, and usurious in its fee structure. The Center argues that over $\frac{3}{4}$ of payday lending is likely to be what they call “phantom demand,” conceived by the requirement of debt service on payday loans, according to their

charged. A survey of “the alternative financial sector” is provided in Michael S. Barr, “Banking the Poor,” in Luisa Anderloni, Maria Debora Braga, Emanuele Maria Carluccio, eds., *New Frontiers in Banking Services: Emerging Needs and Tailored Products for Untapped Markets* (Springer, 2007), 323-51.

²⁵ These statistics concerning the general characteristics of the industry date from 2006 and have been drawn from Katherine Samolyk, “Payday lending: Evolution, issues and evidence,” in Sumit Agarwal and Brent W. Ambrose, eds. *Household Credit Usage: Personal Debt and Mortgage* (New York: Palgrave, 2007), 175-201. Samolyk draws upon annual reporting of Stephens Inc., an investment banking firm involved in the industry. Self-reported data concerning customers collected in 2007 by the Survey for Consumer Finances of the U.S. Federal Reserve present some differences: for example, only 2.5% of Americans self-report that they use payday loans. The survey material is summarized in Amanda Logan and Christan E. Weller, “Who Borrows from Payday Lenders?” Center for American Progress, March 2009. http://www.americanprogress.org/issues/2009/03/payday_lending.html. Self-reported data is used in this paper.

²⁶ For details of this history, see Samolyk 176.

²⁷ See, for example, the website of the leading industry advocacy group, Consumer Financial Services Association of America, which provides an explanation of the product for consumers at http://www.cfsa.net/consumer_guide.html.

own recent study of public records.²⁸ Because payday loans require immediate debt cancellation at the date of the next paycheck, rather than payment of relatively small installments, they do not present the solutions that are advertised, for Center researchers find that 80% of borrowers will take out more than one payday loan per year. Among that group of borrowers, 87% of their subsequent loans will occur during the following pay period. Borrowers take nine payday loans per year on average, and about a quarter of all borrowers take twenty-one or more bi-weekly loans per year.²⁹

Like microcredit in India, payday lending in North America is not the concern of the very poorest or the itinerant, for it requires a steady income and a bank account, and at least 9% of the adult population lack the latter.³⁰ Payday loan recipients are more frequently women than men. Their individual incomes lie just 20% below the national median, on average, at about \$40,000, but their household income is likely to be substantially lower than might be expected, since the majority of loans go to unmarried persons, and so, single heads of households. The ages of loan clientele also suggest that children are likely to be resident in those households. Consequently, many families in North America, above 5% of households, occasionally set aside funds to service loans of about \$300 that may be renewed at a 400% interest rate.³¹ Some among them – a proportion difficult to pin down – are continually chaining loans that represent as much as half their paycheck, serviced at the same interest rate, representing a draw of interest of 8%, or about one month's wages per year for the half paycheck. That debt load would remain stable if the borrower does not let a payment lapse and restricts herself to a single payday loan per pay period, but there are no restrictions upon taking multiple loans. Payday loan debt is frequently coincident with credit card debt, which consumes perhaps 14% of disposable income in debt service for the average American family that maintains such debt.³²

²⁸ Leslie Parrish and Uriah King, "Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume," Center for Responsible Lending, 2009. <http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf>. The Center for Responsible Lending has links to a non-profit credit union run by its founder, Martin Eakes (see Stephanie Fitch and Matthew Woolsey, "Sub-prime's Mr. Clean," *Forbes*, March 10 2008 <http://www.forbes.com/forbes/2008/0310/042b.html>). Advocates for the payday loan sector note a possible conflict of interest in work published by the Center.

²⁹ Parrish & King, 3-6; Uriah King and Leslie Parrish, "Springing the debt trap," Center for Responsible Lending, 2007, 3. <http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf>.

³⁰ William C. Apgar and Christopher E. Herbert, "Subprime lending and alternative service providers," United States Department of Housing and Urban Development, February 2006, xii. <http://www.huduser.org/Publications/pdf/sublending.pdf>. Estimates regarding demographics of payday loan recipients and of the unbanked vary widely; the government's figure of 9% for the unbanked is the lowest I have found; Barr places the figure at 22% in "Banking the poor," 323.

³¹ Calculated using aggregate data from many sources gathered over the past decade and reported in "Payday Demographic Summary," Maryland Consumers, at <http://www.marylandconsumers.org/LinkClick.aspx?fileticket=vs6DjMctIt0%3D&tabid=104>.

³² Joint Economic Committee of the Congress of the United States of America, "Vicious Cycle: How Unfair Credit Card Company Practices Are Squeezing Consumers and Undermining the Recovery," U.S. Congress, May 2009, 3. http://jec.senate.gov/public/?a=Files.Serve&File_id=42840b23-fed8-447b-a029-e977c0a25544.

4. COMPARISON

The two situations may hardly appear to be comparable at first glance: Indian rural families living on several dollars a day (or perhaps eight, at purchasing power parity), and American urban families living on \$120 a day. Yet their relation to debt puts both groups in very difficult circumstances that are similar in some respects. The former are in debt by over a year's income, losing a quarter of it continually to debt service; the latter may be in debt to payday lenders and credit card companies to a similar extent, paying a similar debt service, at 22% of family income. This debt service is usually combined with heavy costs for housing and transportation to work, in the American context.

The lending conditions in Canada and the USA that support burdensome payday loans are sustainable from the perspectives of most legislators. Some are trapped, but they are few, and poor, and they have little political voice. In India, the proportion in poverty and the characteristics of politics are quite different. The legislation in Andhra Pradesh proposed in October 2010 was passed two months later. It institutionalizes a new registering authority for MFIs, and presents the following further requirements. First, new lending restrictions are in force. Individual persons may be members of one SHG alone.³³ Two loans in total are the maximum that a SHG may receive from a banking institution, and the second loan requires a prior government review process. Loans are not to be secured by pledge or pawn of property of any kind. Second, consequent upon news reports of abusive practices, restrictions on the interaction of lending agents with borrowers have been made explicit. Agents may not recover loans by using coercive practices, which include intimidation, following clients about in public, and making efforts to transact business at their homes, beyond providing or requesting information. The legislation requires that SHG payments are to be transacted at the local Gram Panchayat office. Finally, the legislation states that all MFI loans within the state that have effectively yielded to lenders the repayment of principal plus another 100% in combined interest and fees are considered fulfilled, or cancelled.

The combination of repayment protests and the last of these provisions – which amounts to the cancellation of many delinquent loans – has frozen the lending market in Andhra Pradesh and has led to political efforts to marginalize and alter the state's position. The Asian Development Bank responded by providing a fund to guarantee microfinance loans within

³³ Legislature of Andhra Pradesh, "Andhra Pradesh Microfinance Institutions (regulation of money lending) Ordinance, 2010 [Original title: An Ordinance to protect the women Self Help Groups from exploitation by the Micro Finance Institutions in the State of Andhra Pradesh]." Proposed 15 October 2010; passed 14 December 2010. Available at <http://indiamicrofinance.com/download-andhra-microfinance-ordinance-908172.html>. The original ordinance, which referred to "women," was clarified by a published statement of the Panchayat Raj and Rural Development Department in February 2011. It applies also to men involved in SHGs, and is intended to cover lending activities and fees described in terms other than "interest." See http://www.rd.ap.gov.in/MFI/GOMSNO_53_MFI_DT_260211.pdf.

India, with the exception of Andhra Pradesh.³⁴ A Reserve Bank of India committee, headed by the director of the Bank's central board, Y. H. Malegam, released recommendations regarding guidelines for microfinance institution practices in what amounted to an effort to mediate among parties and re-settle the conditions in the microfinance sector. The Malegam committee's recommendations have lately been postponed by one year, to an implementation date of April 2013, partly due to continuing opposition at the state level in Andhra Pradesh. Those recommendations include that $\frac{3}{4}$ of microfinance loans be extended "for income generating purposes," and that a maximum interest of 24% plus fees be set, for loans not to exceed a sum total of 25,000 Rupees when loans are directed to families below the income line of 50,000 per annum. ³⁵ If the new regulations are fully implemented, they may provide a brake to overdevelopment in lending to the poor of India.

5. CONCLUSION: ASPIRATION AND DEBT

In "Aspiration Paradox in Indian Microfinance," Wendy Olsen explores women's self-help groups in Andhra Pradesh and finds that the efforts of many rural women to gain and keep a cow through installment lending can lead their families to financial loss. The cow, which may not survive the loan period, generates a stream of income at about the same level as the cost of keeping the same cow during the nearly two year period of repayment for the SHG cow loan. Roughly ten days per month that might have been spent by the woman in earning cash through labor are occupied in tending the cow, and in some areas local overgrazing and increased water demand for cattle also leads to environmental degradation for all. The group interactions and self-education that support these cow loans within the Self Help Group organizations, as well as the increases in social status and self-esteem that come with tending the cow, are considerable rewards that the women discover. But, Olsen argues, frantic re-borrowing to pay the demanding SHG loans, and increased suffering for the woman and her family frequently attend these rewards.³⁶

Pierre Bourdieu's sociological account of French petit-bourgeois aspiration in *The Social Structures of the Economy* inspires Olsen to introduce the term "aspiration paradox" to

³⁴ Somasroy Chakraborty, "ADB refuses to back loans to Andhra MFIs," *Business Standard*, March 24, 2011. <http://www.business-standard.com/india/news/adb-refuses-to-back-loans-to-andhra-mfis/429583/>.

³⁵ The Malegam report is accessible through an article that summarizes its findings, "Malegam Committee Report on issues facing the Microfinance Sector released by RBI," *India Microfinance Business News*, January 19 2011. <http://indiamicrofinance.com/malegam-committee-report-microfinance-sector-issues-rbi.html>. The recommendations of the report were accepted by the Board for implementation on May 2 2011, and are currently set to be effective April 1 2013: "RBI extends deadline for MFI provisioning norms to April 2013," *Moneylife*, March 21 2012. <http://www.moneylife.in/article/rbi-extends-deadline-for-mfi-provisioning-norms-to-april-2013/24416.html>.

³⁶ Wendy Olsen, "Aspiration Paradox in Indian Micro-Finance: A Difficulty and an Opportunity for Debate," University of Manchester Brooks World Poverty Institute, BWPI Working Paper 42, 2008 2-5. <http://www.bwpi.manchester.ac.uk/resources/Working-Papers/bwpi-wp-4208.pdf>. And see Jamie Morgan & Wendy Olsen, "Aspiration Problems for the Indian Rural Poor: Research on self-help groups and micro-finance," *Capital and Class* 35(2) 2011, 189-212.

characterize cases such as those examined in her own research, wherein “a borrower's status aspirations may contribute to a situation in which their borrowings exceed their capacity to repay.”³⁷ The overextended homebuyer, the family that takes vacations on credit, and the entrepreneur who strives, fails and falls back into worse circumstances than before the effort – these are examples of failed aspiration that pertain to Bourdieu’s study of the French context. Olsen helpfully extends the analysis in her application of it to a case study among the poor of India.

Aspiration paradox is also a plausible outcome for the poor in the United States, where a great proportion of the population, including the poor, maintain that they are better situated financially than the evidence suggests. They also harbor unrealistic expectations concerning their future economic position.³⁸ I do not intend to suggest, given the evidence I have gathered, that aspirational efforts represent the greatest, or even a great proportion of the balance of borrowing among the poor in India and America. The opportunity for such spending has increased greatly with the recent development of both MFIs and payday loans, however, and along with such borrowing, the opportunity to voluntarily shoulder paralyzing debt has also increased.

Recent experiences with credit in the housing market of the United States also indicate that a great proportion of the population whose finances indicate middle class status show limited ability at successfully managing financial risk under the lending conditions that prevail there. Study by economists presents analysis of this weakness and indicates that a good proportion of households are quite vulnerable to the demands imposed by emergencies. One credible survey indicates that half of all American adults would agree that they definitely or probably could not come up with \$2,000 to meet an emergency within the space of a month.³⁹ The poor of the globe are adept at maintaining complex financial arrangements, and their finances have never been simple. To manage their businesses, save money along different time scales, and ensure funds for emergency, they themselves have devised a broad variety of strategies.⁴⁰ Those who are naïve in particular financial practices that are well designed to capture their attention and that only partially address their needs, however, are likely to find themselves at a disadvantage. This holds true in the developing and developed world, for middle class and poor.

The rise of debt service and default among these varied populations suggests the importance of reconsidering the ethics of such lending practices. The sudden rise of MFI debt in India suggests urgency as well, but the case of India is not singular: similar crises have visited

³⁷ Pierre Bourdieu, *The Social Structures of the Economy* (USA: Polity Press, 2005) 185 (Olsen, p.9).

³⁸ Thomas Diprete, “Is This a Great Country? Upward Mobility and the Chance for Riches in Contemporary America,” *Research in Social Stratification and Mobility* 25 2007 89-95.

³⁹ Annamaria Lusardi, Peter Tufano. “Debt Literacy, Financial Experiences, and Overindebtedness,” National Bureau of Economic Research Working Paper No. 14808 (March 2009). Available at: <http://www.nber.org/papers/w14808>.

Annamaria Lusardi, Daniel Schneider and Peter Tufano, “Financially Fragile Households: Evidence and Implications,” National Bureau of Economic Research Working Paper No. 17072 (March 2011). Available at: <http://www.nber.org/papers/w17072>.

⁴⁰ See Daryl Collins, Jonathan Morduch, Studart Rutherford and Orlanda Ruthven, *Portfolios of the Poor* (Princeton, N.J.: Princeton, 2009); Abhijit K. Banerjee and Esther Duflo, *Poor Economics* (New York: Public Affairs, 2011).

other shores. Consider the recent U.S. financial crisis, with its partial basis in a misalignment of interest and incentive exhibited in home mortgage lending markets. One of the key causes of that financial collapse was a lending system structured so that the personal interests of loan officers were decoupled from the economic interests of those who would eventually come to hold the paper and attempt to collect on the loans. The overwhelming incentive for housing loan officers was to place loans with clients, and their efforts were rewarded on the basis of the volume of lending they generated. Loan officers held very little financial interest, and consequently very little concern for the likelihood of default, because the loan officers also held no responsibility for collecting on the loans. Consequently, they held little regard for the long-term success or failure of those loans. The U.S. lending market ballooned under those circumstances, as loan officers accepted at face value the recipients' claims about their ability to pay regular installments. In some cases, the officers also encouraged them to lie about their finances, and so, about their ability to repay loans over the long term. Recipients who could not service the loans received them anyway, and when they defaulted it was no matter to the loan officers, who had no financial stake in the paper that would not be paid off. Some loan officers would also re-structure the loans creatively to allow recipients a bit more time, generating another loan booked, to the advantage of the loan officer. Defaults, already common, overwhelmed the system when property prices did fall, because the free flow of credit had previously ballooned the property prices.⁴¹

For-profit microlending appears to be well advanced within a similar boom phase, one perhaps generated by a similar troubling pattern of decoupling the lending agent's interest to generate loans from their regard for the ability of borrowers to repay such loans.⁴² What can be done? The lender's position is crucial in producing a stable market in both USA and India, since the lending agent regulates traffic at the relevant crossroads, directing available capital to some borrowers and denying it to others. To return the discussion from the economic and social-psychological language of interests to the vocabulary of ethics: What must be done? The lender's position must be re-considered, and with an eye to ethical values and the results of their application.

The lending agent should not hold to a strictly libertarian and market based ethic and should not focus upon providing general access to funds in a fashion that promotes an egalitarian ideal, either. Each conception is manifestly insufficient as a guide to ethical action in this applied context, since each produces manifestly unjust results: unsustainable burdens on the one hand, and aspiration paradox on the other. Neither framework presents a just basis for action, yet both reflect legitimate concerns: concerns for freedom and fairness that lending agents justly promote as they also consider matters of economics (that is, as they consider the client's apparent capacity to repay the loan and interest). Alongside these concerns, I suggest, lenders should introduce another dimension of consideration. That dimension might be called vulnerability.

⁴¹ See Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (USA: Government Printing Office, 2011) 104-111. A popular treatment that highlights this aspect of the financial crisis is Gary Rivlin, *Broke USA* (USA: Harper Collins, 2010).

⁴² *Microfinance India* 2009, p. 55; *Forbes* (India). "The microfinance lending machine." 5 November, 2010. <http://business.in.com/printcontent/18502>.

Vulnerability is a concept introduced into development ethics by Denis Goulet forty years ago; it has since become a standard tool in the kit of development ethicists, but it has received surprisingly little attention in other areas of applied ethics and in the mainstream of ethical theory.⁴³ Vulnerability concerns sensitivity to shock, or the inability to rally in the face of setbacks: it may pertain to financial resources, but also to health, to access to information and to understanding. The vulnerability of the economically strapped worker might be a good example of the first; the vulnerability of the newborn, as well as the middle-aged and elderly, to health shocks highlights the second; and the vulnerability of children and the mentally disabled illustrates the final pair. One's reserves are frequently reduced in these cases, and they are reduced further to the degree that these factors are compounded.

In financial law in North America and Europe, some protections against vulnerability have been present for middle class investors for most of a century. Emerging companies solicit funds from a class known to many as "angel investors," for example, but speaking more exactly, they are prohibited from collecting funds from any apart from those "accredited investors" who are specifically characterized within securities law. In the USA, accredited investors include individuals with net worth of \$1 million or more beyond investment in their principal residence, or \$200,000 per year in income.⁴⁴ In Europe, the criteria for accredited investors include explicit indications of understanding, such as one's familiarity with stock markets or professional status as a financier. These protections illustrate ways in which vulnerability can be accorded regard in law. Some such protections for borrowers also remain in payday lending, even following the relaxation of usury laws that occurred in North America in the late 20th century. 400% interest rate caps, for example, may be thought of as protection, albeit perhaps inadequate protection. More protection might reasonably be returned. In MFI lending in India, the recently proposed but currently stalled Malegam Commission recommendations may provide regulation that does not freeze the lending market, as the legislation presented by Andhra Pradesh has done.

Protection against vulnerability belongs as an ethical consideration in banking. It also requires further support, in the form analysis in economics and protection in law and social policy. This paper has focused primarily on the economic aspect, examining circumstances in two contexts in which financial vulnerability is quite apparent.

⁴³ Denis Goulet, *The Cruel Choice: A New Concept in the Theory of Development*. New York: Atheneum, 1971 38ff. Luis Camacho, "Goulet on Vulnerability as a Key Concept in Development Ethics." In *New Directions in Development Ethics: Essays in Honor of Denis Goulet*, by Charles K. Wilber and Amitava Krishna Dutt, 142-154. Notre Dame, Indiana: University of Notre Dame, 2010.

⁴⁴ United States Securities and Exchange Commission, "Accredited Investor," October 17, 2011. <http://www.sec.gov/answers/accred.htm>.