

Impact of Microfinance on Informal Employment: The Case of Bangladesh

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The rapid growth of urban-rural migration, characterized by environmental, economic or demographic crises, has been a topic of resolute attention in recent times in the context of Bangladesh. The inherent rural-urban wage differential, primarily, has led to a massive influx of rural migrants to the city, in hopes of better employment opportunities over the years. However, the constraints in the absorptive capacity of the rural job sector have led to the formation of a rural informal sector that hosts the excess labour. Although estimated to be about 89% of the total number of jobs in the labor market, the informal sector's contribution to the process of economic growth and national development is almost insignificant. This sector still has untapped potential which may be leveraged with the proper tools. Financial services, in the form of microfinance, to the informal sector can be a driver for job creation and substantial growth. It may, therefore, be hypothesized that the aggregate impact of microfinance on the overall informal employment is positive. Using an analytical exercise, this study finds that microfinance can effectively help alleviate informal employment. Bangladesh can thus utilize its extensive microfinance operations to achieve goals of poverty reduction, leading to greater economic development

Field of Research: Economics and Development

1. Introduction

The rural-urban migration has inherently been an issue for Bangladesh. Owing to the huge rural-urban wage differential, rural workers migrate to major cities in search of better work opportunities and a higher wage, or during environmental crises. The rural labour market of Bangladeshi cities constitutes two types of market: formal and informal. The formal market operates under a legal framework and protective labour regulations and unions. The informal sectors, however, is not characterized by these benefits and leads to underutilization of the workers. The rural to urban migration causes overcrowding and unemployment in cities as migration rates exceed urban job creation rates, with many people ending up in unproductive or underproductive employment in the informal sector. Although the informal sectors dominate the labour market in Bangladesh, they are more vulnerable to economic and social shocks.

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The size of the urban informal sector is, unfortunately, getting bigger with passing days. Although the prospects seem promising, the reality is that there is no guarantee that people migrating to the urban sector will definitely get a job. There aren't enough jobs to absorb the influx of the migrant rural workers and moreover, there is already an existing unemployed group living in the urban area. According to Michael Todaro, one urban job creation leads to three urban unemployment. This leads to a major conundrum. Most of the people migrating belong to the group have poor economic background with relatively lower level of skill. In order to utilize their untapped potential to the fullest, microfinance can be an effective vehicle. Microfinance can work as a controller to the growing 'push' factors of rural-urban migration. Microfinance can create new sectors of business in the rural area which can ultimately create decentralization, reducing the unemployment level and motivating self-employment. The success of success and recognition of Grameen Bank, both nationally and internationally, further reiterates the role of microfinance towards employment creation and ultimately, poverty alleviation. Microfinance is visible in rural and semi-urban areas.

The main objective of this study is to fill out the research gap left out by the current literature on the issue. Specifically, our objective is to answer the following research questions:

1. Does access to microfinance limit the rural to urban movement?
2. Does microfinance work as assistance in the rural area during an environmental crisis and motivate decentralization on a smaller scale?

The rural-urban migration has been a matter of concern for Bangladesh, causing an imbalance both in the rural and urban sector. Microfinance is popularly touted as a tool for empowerment and it may be implemented in this case to deal with this pressing problem. We hypothesize that the increase of microfinance can be considered as an alternative source of emergency access to finance, which can limit the flow of rural to urban migration. We want to inspect if emergency access to microfinance can curb the disproportionate flow from rural to urban area during any environmental crisis. While there have been researches assessing the impact of microfinance on informal employment, there is a dearth of studies with regard to Bangladesh.

Rest of the paper is organized as follows. Next section presents a background of the informal sector and microfinance in the context of Bangladesh. The following section presents the review of literature. The following section after includes methodology. The next section discusses the results, followed by discussions. Conclusion follows in the subsequent section with concluding remarks.

2. Background

Microfinance, pioneered by Mohammad Yunus for which he won Noble Prize in 2006, was a revolutionary approach to alleviate poverty in rural areas. Now, microfinance is implemented worldwide and has been established as a tool to benefit the low-income group. Bangladesh has one of the longest histories with microfinance. Now, Bangladesh boasts a large number of well-known microfinance institutions (MFIs) including Grameen Bank, BRAC, and the Association of Social Advancement (ASA). Simultaneously, many smaller MFIs have started operations throughout Bangladesh. Microfinance has developed in Bangladesh since the 1970s,

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and Bangladesh is one of the most advanced countries in the field of microfinance today. MFIs in Bangladesh have created innovative financial products and services to deal with various challenges and attract clients.

Right after Bangladesh's independence war in 1971 the country was in severe destitution. The newly formed government couldn't cope up so NGOs emerged to help out. And the focus on development started. Microfinance emerged as a tool among poor come out of extreme poverty and it proved to be a success around.

The microfinance sector was well established with Grameen Bank, ASA, BRAC and Proshika and a multiplicity of small and very small NGO-MFIs, most of them pursuing the standard Bangladeshi plan: group credits, with an emphasis on women, and weekly group meetings and repayment modalities.

By the end of the 1990's the microfinance sector got into a repayment crisis which was due to the unstable growth of the NGOs which led to over lending-multiple memberships and thus overlapping of their borrowers with more than one MFI, and it was increased by the nationwide floods in 1998 and by the tailing off of donor grants. This led Grameen to alter its position and was a key moment in product development of microfinance in Bangladesh. Not only did Grameen get rid of some rigidity, but other MFIs tagged along.

These days, MFIs cover some 32 million clients and lend out more than \$7.2 billion every year. Commercial banks and international funds aid in MFIs instead of relying on the savings of borrowers. Modern microfinance in Bangladesh has shifted from home-based activities and self-employment to include savings and insurance, microenterprises, and productive employment.

Household income grew over the study period, driven by rising non-farm income and helped to diversify borrowers' economic activities, boosting incomes in the process. For households venturing into non-farming activities has positively improved their income conditions especially extreme poor to moderate poor households. Better access to credit was found to be a key factor in promoting this shift.

Debate maintains over whether such packages truly benefit the poor. Proponents emphasize the need for modern ways to offer poverty ridden populations get entry to economic access. Critics argue any successes can be transient because microfinance applications require training and entrepreneurship talents, which many poor populations lack. Similarly, some fear that beneficiaries can be charged excessive interest costs or come to be depending on MFIs, borrowing greater than they can pay again and becoming similarly trapped in poverty. The informal sector is a very significant area of the economy and employment in Bangladesh specially in the city area, particularly for the less skilled people. The dearth of rights and social protection of the workers is the major problem involved in it. Informal workers are less likely to receive pension, social protection, and a notice of job leaving compared to formal workers.

Common places of informal work are on farms, markets, bazaar stalls and trade fairs. Self-employed workers were most likely in single regardless of legal status. These activities are usually conducted without proper recognition from the authorities. The labour market in Bangladesh constitutes three types of market:

formal, rural informal and urban informal. The formal market functions under the legal framework that follows the presence of contractual employment relationships, labour laws and regulations and union. Protective labour regulations and unions do not cover the informal sectors, which dominate the labour market in Bangladesh. Workers under informal employment arrangements or those working in informal enterprises are more vulnerable to economic and social shocks. One of the principal development challenges for Bangladesh is the creation of employment for new entrants into the labour force which is growing, at almost twice the rate of population growth. The provision of education, training and skills development of the labour force can increase the labour productivity; economic growth and the increase in wages of the labors are inter-linked to each other. The present state of the informal sector in Bangladesh highly demands education, training and skills for decent work in the informal sector. The urban informal sector also shows lower productivity. Data on the following issues should have been determined for policy planning on the best utilization of the informal sector:

- (i) The number employed in the informal sector,
- (ii) The prevalence of workers in the informal sector compared with the formal sector,
- (iii) Socio-economic profile of the workers engaged in the informal sector and
- (iv) present skill & skill needs to develop them as a formal sector.

The informal sector is often a reaction to requirements not appropriately met by the formal sector.

3. Literature Review

Our literature review consists of several cases, articles and papers on microfinance and informal sector around the world. In line with urban-rural migration theory, many migrants migrate from the rural regions to the cities to engage in self-employment or work in the circle of relatives-owned while firms the usage of hard work-extensive generation. but often times however jobs are not formally pronounced and accounted for and it performs an imperative position in emerging economies — employs a massive fraction of urban population personnel on this area normally have low education, are usually unskilled and shortage access to monetary and that they paintings normally for survival but earning in the casual sector are on average higher than rural earning; additionally, perhaps better opportunities for upward mobility. most migrated labor cannot work or register a business in the urban area because of government policies and rules in registering formal businesses and additionally access to credit score while those are poor people without a collateral.

The following section presents case studies of different region or countries which have implemented microfinance and its impact on the informal sector.

Ethiopia

Ethiopia is listed as the second most populated country in Africa with an estimation of annual increase in inhabitation by 2 million. The main source of national income in Ethiopia is agriculture for which a large portion of the population lives in the rural area where they can find perfect land and weather for cultivation. This poverty-stricken economy mostly depends on the revenue made from the agriculture sector.

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The high rate of urbanization, as well as unemployment in Ethiopia, has concluded with small-scale economic activity in the informal sector for many people living near around. The country is observing rapid growth in the informal sector.

The Ethiopian Microfinance Institutes are currently operating in is a barrier for the potential growth and improvement of the finance industry, consequently affecting the development of the informal sector as well. In order to better serve the informal sector in order to realize its full potential, the microfinance legislation hence needs to be reformed as to deal with the new dynamics found in the microfinance industry.

The major barriers for the Ethiopian microfinance industry in developing the informal sector are a weak microfinance legislation, a clear under-representation of particularly Muslims and women, lack of specially tailored services and products to societal minority groups. One of the overarching barriers is the lack of funds. This thus calls for adequate funding from various sources, possibly from external financial sources and nominal shareholders.

However, there is a different viewpoint of the people involved in the informal sector. The major obstacles they identified were high interest rates, too small loan sizes, lack of training (in areas such as marketing and skills advancement) and delays in handing loans

This study does not indicate the limitation of the rural to urban migration due to the provision of microfinance because of various constraints. Moreover, access to microfinance does not help the rural people during the time of environmental crisis as per indication. However, microfinance does motivate small scale decentralization.

The West Bank, Palestine

The West Bank is a landlocked territory near the Mediterranean territory, under the joint Israeli-Palestinian Authority. Since 2000, the average income of the Palestinian population has declined by 30 percent and 50 percent of the population lived under the poverty line of \$2 a day, which increased to 70 percent by 2006. The unemployment rate range was estimated to be in between 30 percent to 50 percent. Since then the economy witnessed citizens get involved in the informal sector which is mainly due to political, economic and military unrest.

In the West Bank, there is above 13 semi-formal and formal institution providing microfinance assistance throughout the region. Among them, the United Nations Relief and Work Agency (UNRWA) and FATEN are the two largest Microfinance Institutes (MFIs) representing about 54 percent of the total clients.

This study tried to find whether the provision of microfinance allows businesses to move away from the informal sector towards the formal sector. The evidence and researches do not find any significant effect of microfinance activities in influencing the economy towards the formal sector.

This case study has figured out the correlation between the microfinance provision and informal sector engagement at the West Bank of the Middle East. The informal sector is a way or second chance of survival for many from the West Bank and with the help of the provision of microfinance. A persistent increase in self-employment is

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observed as well. Microfinance is used as a crisis management tool in the informal business sector of the region. Microfinance clients are less vulnerable in average in terms of job creation.

Along with the provision of microfinance, the reason behind the flourishing of the informal sector in the West Bank is due to the economic necessity of the poor, flexible character of the informal business sector form, government institution and tolerance.

This study does tell us that microfinance is limiting the rural to urban movements in the West Bank and also it does not convince people for formalization. Moreover, the provision of microfinance did help people during environmental crises. Though this provision does not motivate the people in the West Bank for small-scale decentralization.

Bangladesh

Bangladesh is situated in Southeast Asia and is considered as a low lying land. Since its independence in 1971, Bangladesh faced a high level of unemployment. This unemployed workforce is usually low skilled with little or no education.

Bangladesh is considered as the pioneer of the microfinance movement and is the home of the largest microfinance operation in the world. Microfinance Institutes (MFIs) in Bangladesh have been providing financial assistance, including both savings and credits, to the poor especially women. With the expectation of social benefits, the government, as well as donors, has been contributing to this sector ever since its inception. Microfinance has proved itself to be one instrument for poverty reduction in Bangladesh.

In Bangladesh, the number of female borrower of microfinance is much higher than male borrower. These women use this money for small home startups which falls under the informal sector. In this region, microfinance plays a huge role and it matters a lot to the poor for increasing per head consumption. There is an increase in the probability of people accessing to microfinance in Bangladesh eventually leads a better life by involving themselves in self-employment in small scale. Microfinance, in Bangladesh, helped to reduce extreme poverty.

Thus, this study concludes that microfinance played a vital role in Bangladesh to improve life of many unemployed and unfortunate. It included a lot of female in the informal workforce. The overall informal sector gained a lot from the microfinance assistance as it helped a lot of people to start a new life. However, microfinance provision could not limit the rural to urban migration in Bangladesh but microfinance did assist a lot of people during the time of environmental crisis. Moreover, the provision of microfinance does not motivate small scale decentralization in this region.

4. Methodology

This paper is based on secondary data and discussions. The study is basically conducted by collecting and analyzing data from published literatures and journals. For the purpose of analysis, we chose Palestine, Ethiopia, which somewhat

resembled Bangladesh's conditions. We have tried to find out variables which affected movement from rural to urban areas and lead to the creation of jobs in the informal sector in the rural area. The correlation between informal employment and microfinance was evaluated and trends were studied and later policy implications were suggested to leverage most out of the informal sector.

5. Results and Discussion

The cases we analyzed showed that microfinance does limit rural to urban migration, assist people during environmental crises but do not always motivate small scale decentralization. The cases we studied were from Bangladesh, the West Bank and Ethiopia. The regions have similar economic conditions and are developing countries. In case of Bangladesh, microfinance provision did not limit rural to urban migration. But this hypothesis needs to be empirically tested to be confirmed. This study has not been previously done, specifically in case of Bangladesh.

Microfinance has undoubtedly been a revolutionary idea and a breakthrough in alleviating poverty around the world, especially in developing countries. It has successfully been implemented over and over again especially in terms of women empowerment in various part of the world. In the studies conducted we can see that microfinance has been used as a crisis management tool e.g. the West Bank and used as a tool to fight poverty e.g. Bangladesh. Microfinance has been instrumental in leveraging the extreme bottom line of the population to use as a mean for self-employment and generate income. But it has only been working in extreme condition. It is seen that micro financing alone cannot help poor people to come out of poverty, they need a certain amount of skill and training to have full access to the opportunity. This access to microfinance can be a vital tool to limit migration from rural to urban area as most rural people migrant in hopes for looking for jobs due to a dearth of jobs in the rural area. This will decentralize cities in the country while also it may be an emergency tool to combat crisis. Bangladesh has a record of being hit by natural disasters. When natural disasters hit, people lose their home and everything and thus are compelled to migrate to urban area moving into the informal sector. The informal sector on the other hand is very low productive sector, it comes with very low wage and bad working conditions. But access to microcredit can help these migrants stay in their area and diversify into different areas.

6. Conclusion

Microfinance has proven to be instrumental in alleviating poverty of destitute and has been successfully implemented in and around the globe and thus it can be an important leverage in decentralizing urban areas where rural people migrate to in hopes of better jobs but usually get absorbed into the informal sector which is of low productivity. Access to microfinance for such people can keep them in the rural area and give them a better life and a more productive life. Several cases and articles and research papers have been studied in light of this and have been concluded that access to microcredit can reduce urban migration and work as a crisis manager during disaster management.

Limitation of this research paper would primarily be that it is based on only a few selected case studies. Similar studies have not been done in case of Bangladesh. Studies are based on specific areas only. Primary survey and empirical analysis are

needed to check the hypothesis. Further studies can be conducted to check the hypothesis on a more regional basis. Further research will reveal what ways microfinance can be used as a tool for disaster management. This paper may help policymakers realize the impact and implication of microfinance in the informal sector. Several studies have seen that credit cannot help poor entirely, if they do not possess the necessary skills and leverage and marketing opportunities. Credit alone is not enough to boost productivity, sustain increasing incomes and reduce poverty.

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