Informal Finance with Some References to the Egyptian and Sudanese Cases*

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ملخص

التمويل غير المنظم فى بعض الدول النامية مع الإشارة للتجربتين المصرية والسودانية

رغم الاهتمام الرسمي بالتمويل المنظم، إلا أن التمويل غير المنظم لازال يلعب دوراً أساسياً فى تمويل الفئات الأقل دخلاً وتعليماً فى أغلب البلدان النامية. ونظراً لتعامل التمويل غير المنظم مع رأس المال العامل أساساً وبدلاً من رأس المال الثابت، ولارتباط هذا النوع من التمويل باعتبارات قانونية ودينية، فقد ساهمت هذه الاعتبارات، بالإضافة إلى اعتبارات أخرى، فى عدم انتشار الاهتمام بهذا النوع من التمويل.

ونظراً لتزايد أهمية الأنشطة غير المنظمة، والتى تستوعب ما بين ٤٠%-٦٠% من العمالة الريفية فى العديد من البلدان النامية، وتزايد الائتمان غير المنظم والذى يصل مساهمته ما بين (٣٣%-٦٧%) و ٣٨% و ٥١% من الائتمان الريفى فى بنغلاديش، والهند، وكوريا، تباعاً، فكان لابد من الاهتمام بالتمويل غير المنظم والإحاطة بأهميته فى بعض البلدان النامية ومنها العربية.

وبناء على ذلك تتضمن هذه الورقة فى قسمها الأول تعريفاً بالتمويل غير المنظم، مع الإشارة للتجربة المصرية والسودانية فى القسم الثانى. فى حين يتطرق القسم الثالث لأهم التجارب فى التمويل الصغير Microfinance (تجربة بنك جرامين فى بنغلاديش، وتجربة الصندوق الاجتماعى وجمعية رجال الأعمال بالإسكندرية فى مصر). أما القسم الرابع والخامس فيهتم بعلاقة الكبح والتحرير المالى بالتمويل غير المنظم. وأخيراً يشير القسم السادس إلى بعض الخيارات فى مجال السياسة الاقتصادية.

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INTRODUCTION

Despite official interest in formal finance, informal finance has been playing an important role in the financing of deprived, uneducated and lower income people in most developed and developing countries. Informal lenders do not always operate out of offices or display signboards. Instead, they maintain few records and often extend credit as part of their wider market transactions. Because they deal with financing working capital rather than fixed capital, informal finance is much less visible than formal finance. For religious and legal reasons, there has been a sensitivity attached to informal finance on the part of borrowers as well as lenders, which makes empirical research much more difficult.

The growing role of informal finance is derived mainly from the increasing role of informal activities, which absorb between 40-60 percent of the urban labour force in many developing countries. Moreover, the share of informal credit ranges from 33-67 percent in Bangladesh (rural), and stands at 38 percent in India (rural), 51 percent in Korea (rural), 45 percent in The Philippines (urban), and 71 percent in Sudan (urban) (ADB, 1990; Zahlan and Magar, 1986).

In order to shed some light on the state of the art of informal finance in Arab countries, this paper aims at defining this type of finance in section 1, mentioning the widely used types of informal finance in section 2, referring to the Egyptian and Sudanese experiences with this sort of finance in section 3, and citing one of the prominent microfinancing experiences in developing countries in section 4. Sections 5 and 6 present a study of financial liberalisation and its applications to informal finance, as well as providing some policy options in section 5.

1- INFORMAL SECTOR: DEFINITIONS

Since the introduction of the concept of the informal sector in the economic literature by the International Labour Office (ILO), that sector of the economy has received growing importance. Unfortunately, so far, no consensus has been reached on what is meant by informality.

The ILO mission to Kenya defines the informal sector in terms of "easy to entry, reliance on indigenous resources, family ownership of resources, small scale operation, labour incentive and adopted technology, skill acquired outside the formal school system, and unregulated and compatible markets" (ILO, 1972, p.5). This definition has been the subject of much criticism, among which is the view that most of the characteristics associated with this definition are relative and cannot be maintained collectively (OECD, 1991).

Based on Cartells and Portes contributions, Assaad (1997) argues that the nature of regulation rather than size has to be the decisive criterion in dealing with informality. In other words, the absence of regulation should not be taken as a dividing line between formality and informality. He believes that the term of regulation refers, in this respect, to the "reliance on socially-generated rules instead of legally-generated rules" (Assaad, 1997, p.2). According to Assaad's adopted definition, effort is needed to distinguish between socially and legally generated regulatory rules.

In the Arab world, no unified definition of informality has been agreed upon either. From the household survey of 1988 and the Economic Unit Survey of 1990 (ERF, 1996), it can be seen that the informal sector has been defined in Egypt with reference to registration and size criteria. Accordingly, this sector included the unregistered units employing less than five employees.

Among other references suggested in Egypt have been the lack of social security, medical insurance and other benefits, and low level of education. In contradiction to the Egyptian case, in Morocco, informal activities were characterized by family support and apprenticeship Systems, with heavy reliance on child labour. Due to the war in Lebanon, the tax system, social security, and commercial registration have not been used to identify informality there. Government registration in Lebanon does not implicitly mean registration with the Income Tax Department and Social Security Fund. Moreover, there has been a wide gap between the number of existing and registered industrial firms in that Arab country (ERF, 1996).

So, what do we mean by informal activities? Are they, among other things, small- sized nits mploying, or nstance, less than five employees? Or, are they units that are not registered commercially or do not pay taxes? Or, are they a combination of these and other criteria? All attempts to reach a multi-dimensional definition of informal activities have turned out to be unsuccessful and have faced a series of practical challenges (Mead and Morrisson, 1996).

Therefore, it is advisable to define informal activities using a policy-oriented approach. In other words, it is recommended to define informality in terms of labour requirements if the policy issue concerns the labour market, to define it in terms of financial considerations if the issue concerns financial markets, and to define it in terms of capital or labour intensity, if the issue concerns technological progress. Accordingly, informal activities can be defined from a financial point of view as those, which have no or limited access to formal financial markets. As a result, they approach one or more of the informal financial outlets mentioned in Table 1 below.

1-1 Informal Finance

Informal finance, or informal credit, can be seen as a proper response to the disability of formal finance to reach poor people. Among the many constraints against the latter type of finance are irrelevant collateral requirements, complex administrative procedures which require literacy, long delays in the processing of loan requests, and a lack of direct contact with the local environment. Such constraints have paved the way for the introduction of informal financial markets in most developing countries in general and in rural regions in particular, where the poverty is concentrated.

These and other negative characteristics of formal financial markets have reduced their share in the credit markets, especially in rural areas, and consequently expanded the proportion of informal financial markets. With less complex or limited administrative procedures and short delays in the processing of loan requests, full knowledge of the social environment, land little or no collateral requirements, the informal financial markets have made a remarkable effort towards narrowing the gap between demand and supply of credit in most deprived areas.

1-2 Types of Informal Finance

Historically speaking, informal financial markets have taken a variety of forms. The first one is moneylenders, who lend money, act as money changers, and finance loan trade by means of bills of exchange. They usually grant loans on a personal recommendation and guarantee to persons well known to them. Moneylenders depend, in most cases, on their own funds, but they sometimes borrow from other financial institutions when there is high demand (Iqbal, 1988). Such borrowing creates a channel through which formal funds are channeled into the informal sector.

The second form is pawnbroker. As the name suggests, this source of informal financing lends money by using marketable assets such as gold, jewelry, and household articles as collateral. The loan received against the pawned article is usually less than the value of the article. As a transaction record, a pawnticket is issued to the borrower when the repayment is made (loan plus interest), the pawned article is returned to the borrower (Bouman and Houtman, 1988).

Rotating Savings and Credit Associations (ROSCAs) represent the third form of informal financial markets. With ROSCAs, members are committed to paying a fixed sum of money into a pot each cycle of the ROSCAs life. Then, lots are drawn and the pot is randomly allocated to the members. The cycle of a ROSCA is closed when all members have received a pot. At this stage, the members have the choice to end the ROSCA or to repeat it. Members are selected by the organiser based on an ethnic, a geographical or a friendship basis. The mode of selecting winners is decided with reference to one of three approaches: first, by consensus where through a common agreement among members, the amount is given to a member who is most in need; second, by lot, where a lottery determines who gets the lump sum in a particular cycle with the winner being excluded from the subsequent lotteries; and third, by bidding, where the lump sum is bid for by the members during each cycle, with the member who wins the bidding receiving the lump sum minus the amount bid and the other members paying their contributions minus their share of the amount bid (Bouman, 1995). ROCAs are considered one of the most popular forms of informal financial markets due to its flexibility with regard to rural and urban peculiarities.

A fourth form of informal financial markets can be found in community groups. These groups are usually called upon to generate finance at a community level. The level of such groups is not unified. For instance, this level can be seen in terms of a small group of women who help each other in times of financial need, to that of requested community-level societies that offer savings and credit services to their members, and hence are linked with external groups such as non-governmental organisations (NGOs), or formal financial markets such as commercial banks.

Table 1 below summarises the main advantages and disadvantages associated with the various informal financial markets.(1)

Table (1): Main Advantages and Disadvantages of the Various Forms of Informal Financial Markets

Form of Informal Financial Market	Advantages	Disadvantages
Moneylenders	1- Provides small loans, which suit low- income groups. 2- Loans are available at the time of need. 3- Close relationship between borrower and those dispensing the need for collateral. 4- No fixed working days or hours, and therefore, loans are provided when requested.	1- No organised and lack connections with the banking system. 2- Moneylending is combined with trading and commission activities, and thus, introduces risk to their business. 3- No distinction is made between short- and long- term finance and between the purposes of loans. 4- High interest compared with those of the banking system.
Pawnbroker	1- No debt cycle is created as the loan is recovered from the pawned article(s). 2- No loan cost is involved, as the loans are less than the cost of pawned article.	1- Pawned article is not recovered in case of inability to repay the loan. 2- Pawnbroker makes extra profits when he sells off the articles not redeemed by the borrowers.

	3- Collateralised articles are movables in most cases. 4- Lengthy procedures to establish credit- worthiness are avoided; it is established by the value of assets pawned.	
ROSCAs	1- Offers an opportunity to save. 2- The availability of a lump sum of money allows for investment to be made earlier than that same amount can be accumulated in savings. 3- A democratic atmosphere prevails in most ROSCA operations. 4- Profits, such as bid amounts, and other returns on accumulated contributions are equally distributed. 5- Risk of default is shared by all members.	1- There is no risk of mismanagement of fraud by the organiser. 2- The timing of the receipt of money and the need for finance may not coincide. 3- Members have to wait for ROSCA meetings to make use of their surplus.
Community Groups	1- The group provides an opportunity for its members to save regardless of amount and in intervals suited to them. 2- Returns on savings are sometimes better than those available from other formal financial markets. 3- Small loans for short periods are available on terms and conditions agreed upon by the borrowers. These terms are flexible and allow for delays in repayments. 4- All benefits from any activity are equally shared. 5- Group leaders are carefully selected. They are, in many cases, trained by NGOs. 6- These groups participate in enhancing the process of community networking and sharing of resources.	1- The small amount of financial resources mobilizaed by such communities force them to cooperate with NGOs and banks sometimes. 2- Despite the collective decision-making process, these community groups are sometimes plagued by people with vested interests.

Source: Germidis et al., 1991. Pp. 146-147.

2- INFORMAL FINANCE: THE EGYPTIAN AND SUDANESE EXPERIENCES

Despite the author's attempt to contact many official departments in a number of Arab countries, no positive response was made, except in the case of Tunisia, where the information collected turned out to be on small-scale activities. Therefore, the analysis of informal finance in Arab countries will be based on the Egyptian and Sudanese experiences for which some data was found. Using the fragmentary information available on these two countries, the presentation will be based on two main issues, i.e., credit delivery and rate of interest. No records were found on any other aspects of informal finance.

2-1 Credit Delivery Systems

The forms of financing informal activities in the Arab world do not differ from those prevailing in the other developing countries. ROSCAs are one of the most common informal financial markets. Based on the survey of Baydas et al. (1995), on Egypt, Table 2 below shows the main characteristics of ROSCAs.

Table (2): Main Characteristics of Egyptian ROSCAs

Characteristic	Sample	Range
Number of ROSCAs Identified	51	NA*
Average Number of Members per Group	35	10-150
Average Number of Females per Group	55.$	0-100%
Average Number of Rotations per Cycle	31	10-150
Average Size per Contribution per Share	US$21	US$1.5-/3.0
Average Frequency of Collection per Month	1.5	1-3
Leader's Major Reasons for Initiating Group		
Savings	10%	NA
Loan	17%	NA
Help Someone	55%	NA
Group Solidarity	18%	NA
Percentage of Groups that had Default and/ or Delinquency Problems	17%	NA

NA = Not Applicable.
Source: Baydas et al., 1995, p. 654.

Among the striking features of the Egyptian case is that none of the surveyed ROSCAs had engaged in any economic activity, as was the case, for example, with the Grameen Bank. The motivations behind Egyptian ROSCAs lay mainly in collecting money to improve the standard of living.[(2)] The average amount paid for every rotation, approximately 1.5 times a month, was US$21, whereas the total amount pooled each rotation averaged US$651. As the survey's conductors indicated, if 75 percent of the survey's population of 40,000 employees participated in ROSCAs, paying an average of US$15 per month, then the total amount collected would reach about half a million US dollars (Baydas et al., 1995).

The Egyptian survey also shows another source of informal credit, i.e., trade credit, A number of employees in one of the principal specialised bank, called the Bank for Development and Agricultural Credit, were engaged in selling goods on credit. These goods included: food, jewelry, furniture, watches, household appliances, and clothing. Part of the goods' value was paid as a down payment and the rest was paid in installments. The employees may finance their trade credit activities from ROSCAs. A few of them happened to be ROS CA leaders who favoured themselves with the first interest-free loan.

In the Sudanese informal credit delivery system, a traditional system, called sheil is in place. Due to the theological problems with usury in an Islamic society such as Sudan's, a new credit system was developed. According to this system, a moneylender lends money to farmers during the growing seasons, when they are in need of cash and food. Loans are granted to farmers against the farmer's standing crops at a price which is usually less than it would be after harvest (Kevane, 1993). The farmers allegedly believe that sheil, contrary to usury, is Islamically permitted.[(3)]

One of the outstanding features of sheil is that the sheil merchant employs his extensive knowledge of the rural areas in Sudan to secure his lent money against price fluctuation, and loan default. The merchant usually establishes a direct relationship between the value of loan and the time of the sheil: the later the sheil, the higher the price of the loan. To secure himself well, the merchant also hedges against risk through his discrimination among borrowers according to, among factors, their location from sources of water, their indebtedness to others, and their reputation as a tenant.

Apart from sheil-based loans, other sources of informal credit in Sudan are available as well. These include: loans of dura (sorghum), in which the farmer repays his loan based on the cash value of his dura at the time of borrowing (no interest charge); no-interest cash loans with cash repayments; and no-interest loans in kind (dura-dura loans) (Kevane, 1993).

According to the Kevane's survey of the regions in Sudan, The Blue Nile with small plots and the Butana with large plots, the four types of above mentioned loan are distinguished in Table 3 below.

Table (3): Total Value of Cash and Dura Loans

Region	Dura Loan	Sheil Loan	Cash- Cash Loan*	Dura- Dura Loan**
Blue Nile	34.079	3.805	13.4	67.0
Butana	61.257	30.786	171.8	123.7
Total	**95.336**	**34591**	**185.2**	**190.7**

*Sudanese pounds (£S) **Valued at £S150/100 kg. Sack

Source: Kevane, 1993, p.520.

Table 3 shows that the demand for credit in the less developed region, i.e., Butana, is higher than the corresponding demand in the relatively developed region, i.e., the Blue Nile. Table 3 also illustrates that sheil loans form the lowest percentage of the total loans issued, around 25 percent, in the regions concerned.

Besides the previously mentioned types of informal credit that are prevalent in the Blue Nile and Butana regions, there are other types which derive mainly from family and friendship ties.

2-2 Rate of Interest

There is almost a consensus that the interest rate on informal credit is higher than its counterpart on formal credit (Websterand Fidler, 1996). The theories which explain such difference between formal and informal interest rates can be summarised as two basic theories. The first theory departs from the opportunity cost of finance and the lender's risk premium, whereas the second adopts the view of institutional factors, which are reflected in the power relation between the lender and borrower (Saleem, 1987).

Since the Egyptian experience (i.e., with ROSCAs) mentioned in this paper, does not involve an interest rate implication, reference will be made to the Sudanese case, where a difference between issued and collected credits can be traced.

With reference to the Sudanese case, no interest is levied on the first form of cash loans, i.e., dura loans, and the interest rate is determined, for the second form of cash loan, i.e., sheil credit, through a prior agreement between borrower and lender. According to this agreement the borrower receives his loan with a pledge to the lender, that a specific amount of the standing crop will be paid at a specific price, once the crop is harvested.

Normally the lender sells the crop at the market price. Saleem (1987) attempted to measure the rate of interest paid by lenders in the Gezira region.(4) For the entire crop season, these rates varied from 174 percent for dura, to 172 percent for groundnuts, 185 percent for wheat, and 177 percent for all crops in the Gezira region. This rate of interest reached 201 percent for groundnuts in the Rahad region (Saleem, 1987).

As noted in Table 3, all the surveyed informal credit systems in Sudan were either cash loans, with and without interest, or in-kind informal credit, one without interest throughout. An in-kind loan that might be made would be, for example, two sacks of millet against three sacks at harvest time (World Bank, 1989).

The highest ratio of interest observed above can be attributed mainly to the monopolistic and powerful position of lenders compared with the weak and powerless position of borrowers. In the case that any collateral is involved, the lender, due to his upper-hand, usually undervalues the borrower's collateral (standing crop). The undervalued amount should be considered, in this case, as an implicit rate of interest (Basu, 1984).

Comparing such high rates of interest with those prevailing in formal credit, a wide gap can be easily observed. Despite the presence of the Sudanese Agricultural Bank in the regions concerned, with an interest rate of 7 percent, a mounting demand on the very high rate of interest from informal credit was in existence. One of the main reasons behind such a paradox is the lack of credit-worthiness among traditional farmers in Sudan (Ali, 1986).

The preceded findings regarding the informal rate of interest in Sudan are not unique, but rather shared by most developing countries (see, for example, the cases of Indonesia, Thailand, and Bangladesh, in: Yaron, 1992, table 10, p.29).

3 - MICROFINANCING INFORMAL FINANCE

One of the ways to overcome the problem of the high interest rates associated with informal credit is to enhance the process of formalising informal finance through microfinance institutions (MFIs). Another reason to pursue such enhancement is to restructure informal credit in favour of more productive allocations. As shown in Table 2, the Egyptian ROSCAs did not invest in any economic activity, but rather, were oriented towards improving the standard of living. MFIs provide financial services to the non-corporate sector and deal with very small deposits and loans. The main difference between informal credit and microfinance lies on the supply side. The sources of finance for informal finance are not linked with the government in terms of ownership or subsidisation, whereas the sources for microfinance are individually run or based on community arrangements, without government interference. Moreover, contrary to the situation with informal finance, MFIs are institutionally organised in terms of their records, staff monitoring systems, links with related institutions etc.

Recently, the methodologies of MFIs have been receiving special attention. This is partially because of the potential role attached to them to qualify as informal finance, to absorb more employment, and to enhance the process of integrating informal activities with rest of the economy.

With regard to the technologies used by MFIs, one can pinpoint a number of characteristics, which distinguish their progress. First, they have aimed at maximising their outreach. This last term, i.e., outreach, refers to "the extent to which financial systems and their instruments reach poor directly, increasing their participation in market processes, and, by this empowerment, in political processes" (Schneider, 1997, p 10). Second, MFIs have attempted to widen the group of those who are eligible for credit. Conventional formal, and informal, credit in rural areas is based, for example, on land collateral as a prerequisite to loans. Group guarantees have evolved in most poor countries, such as Bangladesh and Sri Lanka, to replace land collateral. Third, MFIs have paved the way for coherent financial self ustainability. hey ave ccepted the possibility of achieving a high rate of loan repayments as well as the possibility of covering part of a loan's cost. Fourth, poverty reduction has been associated, to some extent, with the spread of microfinance. Despite the controversy regarding the direct relationship between poverty reduction and MFIs, the experience of most MFIs shows that the conditions of the very poor groups have been improved through microfinance financial services.

With regard to the worldwide expenditures of MFIs, the case of the Grameen Bank, one of the oldest of such cases, has to be focussed upon and properly analysed. Herefore, the following section is devoted to presenting and evaluating this case.[(5)]

3-1 The Grameen Bank's Experience

The case of Sophia Khatoon, a 22 year old, who worked, seven days a week making chairs and stools out of bamboo, triggered the interest of Professor Muhammad Younis, the founder of the Grameen Bank, to provide an alternative to moneylenders. Khatoon was accustomed to selling her product to a moneylender who provided her with the credit to buy the raw material. The price of her products hardly covered the costs. According to 3000 percent a year. He could not understand how such a talented woman who produced such beautiful bamboo works and who created wealth at such a high rate was earning so little. Responding to such financial exploitation coupled with the famine of 1974 in Bangladesh, Professor Younis started his microfinance pilot project in 1976. The project was converted into a chartered bank in 1983 (Grameen Bank, Internet Website).

3.1.1 The Financial Mechanism

One of the main objectives of Grameen Bank is to target poverty group. These groups are defined as the landless rural poor who own less than half an acre of land initiative. Credit is provided to a self-selected groups of five persons (living in the same village with mutual confidence), who are collectively responsible for repaying each above-mentioned sense, elect a chairperson and a secretary for one year, and a meet weekly.

One of the most striking features of the Grameen Bank's microfinance mechanism is the role attached to savings as a prerequisite to lending. Group members have to make a small weekly saving of I taka (TK). Having passed a certain period of training, two members are issued a loan and observed for one to two weeks. Should the weekly payments be made and other of the Grameen Bank's rules adhered to, other loans are issued for the next two members. The group's chairperson is the last to receive a loan. The value of the loan varies between TK 2,000 and 5,000 with an upper limit of TKI0,000. The weekly repayments do not extend beyond one year. The Grameen Bank's rules stress the fact that all group members are collectively responsible for repaying the loans of each member. If one member fails to repay his loan, the group, as a whole, will not be eligible for another loan. The allocation of loans among various activities is left completely to the group members, based on a collective discussion.

By gathering five to eight groups, the Grameen Bank establishes what are called centres. As is the case with a group, a centre elects a chairperson and a secretary for one year. All members have to attend group and centre meetings. These centres function as monitoring bodies for the members' performance in terms of loan use, attendance, weekly payments, repayments, and reporting of irregularities.

On top of the weekly payment, every group member is asked to contribute 5 percent of his borrowed money to the Group Fund. The amount collected in this fund is used for other purposes agreed upon by the group members. Since 1 July 1991, a contribution of TK5 per TKI000 has been collected for loans which exceed TKl000. The levied money is channeled to the Emergency Fund, which is managed by the Grameen Bank to insure against default because of death, disability, or the like. 0 integrate as many members as possible into ownership, the Grameen Bank allows all members to purchase a Grameen Bank equity share of TKl00 (Khandker et al., 1995).

3.1.2 Evaluation

Since its establishment as a bank for the poor in 1983, the Grameen Bank has made tremendous achievements. Table 4 shows a number of indicators that reflect the performance of the Grameen Bank for 1985, 1990 and 1994.

Firstly, the Grameen Bank has succeeded in accumulating a large amount of savings, around US$125 million by the end of 1994. This figure exceeds the corresponding figures reached by the top commercial banks in Bangladesh (Schneider, 1997). Secondly, the Grameen Bank has succeeded in maintaining a high loan recovery rate, within the range of 98 percent (Jain, 1996). This high percentage can be attributed mainly to the above-mentioned innovative collateral system followed by the Grameen Bank instead of the conventional one, which is based on social coalition rather than individual guarantee. Thirdly, the interest rate adopted by the Grameen Bank has some peculiarities. Branches usually borrow from the main office at a rate of 12 percent and lend at a rate of 20 percent. By adding this source of finance to the earnings from the deposits of Group Fund and individual savings, the Grameen Bank's branches enjoy varied sources of funds, although they are not financially independent. The rate of interest levied by the Grameen Bank is not considered in comparison with other microfinance institutions, i.e., and moneylenders. Fourthly, with regard to the Grameen Bank's financial performance as reflected in Table 4, it is obvious that the Grameen Bank has achieved a remarkable financial position. This can be shown with reference to the following:

- Despite the relatively high profit of the Grameen Bank (except for the years 1991 and 1992 due to the government's increases in the salaries of employees in 1990), which reached about TK21 in 1994, this profit does not remain the same if we exclude the non-operational revenues, which represent about 17 percent of the total revenues in 1994. This percentage represents: income on fixed deposits, three-month government treasury bills, and other income such as grants from the head office for monitoring, evaluation and training expenses.

- On top of non-operational revenues, the Grameen Bank still receives two types of foreign grants for financing training, research and monitoring, and for on-lending. The percentage of foreign grants of income declined from 20 to 3.8 percent between 1989 and 1994 (Schneider, 1997).

- In evaluating the financial viability of the Grameen Bank, the issue of subsidy is usually brought up (Al-Ahram El-Ektesadi,1998). Since the subsidies received by the Grameen

Bank are not spelled out in its financial statement, Yaron (1992) attempted to measure the subsidies by using the Subsidy Dependence Index (SDI).(6) This index refers to increases required in the interest rate needed to compensate for the subsidies received. The SDI value decreased from 170 percent to 21 percent between 1986 and 1994 (Schneider, 1997). This indicates that the dependency of the Grameen Bank on subsidies had been reduced to a great extent.

To conclude, the Grameen Bank had a positive impact on reaching the poor through having lent to more than a million borrowers by the end of 1994, with a steady dissemination of borrowers in most of the three million villages. Such achievements are coupled with low credit costs, as compared with the higher interest rates in conventional financial institutions, and lower default rates.

3 – 1 – 3 Arab Microfinance

Apart from the Social Fund for Development, which is oriented toward encouraging small-scale industries, Egypt has no well founded MFIs except the Alexandria Business Association(7). Until 30 June 1998, the Alexandria Business Association had made 92,790 loans totaling US$79.73 million. These loans have created about 68,600 jobs in the Alexandria governorate alone. The corresponding figures for the Kafr EI-Sheikh governorate were as follows: 2,210 total loans with a total amount ofUS$791,000.

Table (4): The Trends of the Main Variable of the Grameen Bank, 1985, 1990 and 1994

Parameter		1985	1990	1994
Number of Branches		226	781	1045
Number of Groups		34325	173911	412145
Number of Centers		7210	34206	59921
Number of Employees		2777	11964	10861
Loan Disbursement By Activity (%)	Agriculture and Forestry	2.20*	4.4	34.9
	Livestock and Fisheries	45.7*	42.4	26.10
	Manufacturing	25.0*	30.30	15.50
	Services	2.6*	1.80	1.00
	Trade	17.3*	15.60	16.80
	Other	7.20*	5.50	5.70
Savings	Group Savings	71.4	6496	31474
	Emergency Savings	12.7	1288	2226
	Other Savings	30.8	9087	55991
	Total	114.9	16871	89692
Income	Interest Income	8959	33535	191286
	Total Income	65	7855	10572
Expenditure	Interest Expenses	3102	10257	79194
	Non- Interest Expenses	5886	30111	120490
	Total Expenditure	8988	40368	199684
Net Profit		**36**	**1023**	**2174**

NB: All amounts are given in taka (TK). * 1986 figures.

Source: Khandker, et al., 1995.

To deepen the trend of informalising informal finance, the Alexandria Business Association has proposed an attractive package. The client receives his loan 15 days after submitting an application. The period is reduced to 72 hours for repeat borrowers. The repayment period ranges between 4 and 18 months.

In its attempt to insure that repayments are made on schedule, the Alexandria Business Association counts deeply on its 100 loan officers. These officers are considered as intermediaries between the Alexandria Business Association and the borrowers, in regards to completing application forms, appraising barriers and financial needs, or maintaining the high rate of repayments. Loan officers can increase their salaries sometimes sixfold if they succeed in attracting new borrowers.

Until mid-1995, almost 70 percent of the issued loans went to manufacturing activities, such as apparel, leather goods, and furniture. Trade activities absorbed about a fifth of all loans, whereas services had taken the rest of the loans (ABA Internet Website). As for collateral, the Alexandria Business Association protected itself against default by asking the borrowers to sign post-dated cheques in the amount of the installments, i.e., the loan's principle plus interest. The cheques were deposited by the loan officers as the payments came due. Legal action is taken in cases of insufficient funds in the borrower's current account.

Finally, despite the success of the Alexandria Business Association, especially in its very low default rate of around 1 percent at the end of 1998, and in its role as an intermediary between formal commercial banks and poor borrowers, it is still using a commercial interest rate of around 17 percent.

4 - FINANCIAL REPRESSION AND LIBERALISATION

Most, if not all, developing countries have been liberalising their economies to reach a certain degree of stabilisation and to enhance their competitiveness, mainly abroad. International financing agencies and the World Trade Organisation advise these countries to finalise their policies towards liberalisation before any economic gain can be realised. The financial sector is one of the most distorted sectors in developing countries; therefore, special attention is paid to eliminating most government interventions, which might discourage financial performance. Such government interventions in financial activities are usually referred to a financial repression (McKinnon, 1988).

Informal finance, like the rest of the economy, is affected by financial liberalisation. Before an assessment is made on how informal finance is influenced, a brief introduction of the mechanism of financial liberalisation is made.

As just mentioned, when the government intervenes in financial markets, in terms of taxes, which take the form of interest rate controls and direct credit allocation programmes, then these markets are financially repressed. Imposing controls on nominal interest rates, which apply to deposits and lending, usually results in maintaining lending rates to encourage investment. It follows that deposit rates can be increased if the government is willing to subsidise the financial intermediary. As a consequence of a low nominal interest rate, especially when the inflation rate is high, the real interest rate takes a negative value.

When the government intervenes, using credit allocation programmes, banks are no longer free to allocate credit the way they choose. The forms of these programmes can range from refining schemes, development finance institutions, and compulsory loans at preferential interest rates, to lending requirements imposed on banks. According to the World Bank, these types of intervention would lead to an inefficient allocation of financial resources (World Bank, 1989). Interest rate controls and credit allocation programmes may have negative implications, such as making bank deposits unattractive to real assets, reducing the role of financial intermediaries and accordingly reducing the demand for broad money, and reducing savings, investment and growth (Gibson and Tsakalotos, 1994).

Recently, most developing countries including many Arab ones have taken steps toward eliminating repression of financial markets through financial liberalisation. This sort of liberalisation involves moving toward a more market-oriented system. The interest rate plays the central role in this system. As mentioned earlier, low interest rates on savings will repress the quantity of investment and in turn, growth. Financial liberalisation suggests increasing the interest rate on savings, which subsequently encourages investment. The crucial assumption here is that investment in developing countries is constrained mainly by a lack of saving (Yaqub, 1998).

Moreover, fixing the interest rate decreases the quality of investment. By fixing the interest rate below the level corresponding to the conventional supply-demand framework, an excess demand for credit is created. This entails, under low interest rate on borrowing, a reduction in the returns to project proposed for finance. Once financial intermediaries are not in a position to increase the interest rate on lending, these intermediaries will finance a large number of low-return projects, and hence lower the quality of investment. The constraint of allocative credit programmes lower, as well, the quality of investment. This is true because intermediaries have no choice in the allocation of their finance to the most productive sectors. According to the doctrine of financial liberalisation, by liberalising interest rates and eliminating allocative credit programmes, the performance of financial intermediaries can be improved, and a better loan allocation mechanism can be achieved.

5 - INFORMAL FINANCE AND FINANCIAL LIBERALISATION

Repression policies are seen as the main cause of financial fragmentation, whereby domestic financial markets emerge (formal and informal). The domestic market is characterised by uncontrolled interest rates in response to an unsatisfied demand for money (Sikorski, 1996). Therefore, financial liberalisation is expected to expand formal finance, and hence, degrade the need for informal finance. Now, the legitimate question is: has financial liberalisation succeeded in formalising informal finance through the provision of cheap credit? In other words, has financial liberalisation contributed positively to the financing of projects submitted by the rural poor even if they are riskier?

Unfortunately, empirical Arab studies able to answer these questions are not available at present. Alternatively, a conceptual approach and some evidence gathered from other developing countries are used instead. In the African experience (i.e., Ghana, Nigeria, Malawi, and Tanzania), liberalisation has had little influence on deepening formal finance and reducing informal finance. Following financial liberalisation, formal banks started closing their rural branches and hence restricted access for the poor, whereas the agents of informal finance reacted positively in accommodating access to the demand for money. The African experience shows that liberalising repressed financial markets is a necessary condition but not sufficient. A consistent package of institutional, financial, economic, and social policies is needed to harmonise relations between formal and informal finance (Steel et al., 1997). In their survey on financial liberalisation in developing countries, Gibson and Tsakalotos (1994) make it clear that the empirical debate is far from conclusive. For instance, while a financial liberalisation policy predicts that savings should increase with real high interest rates, the empirical results demonstrate that the interest elasticity of savings does not increase (Gibson and Tsakalotos, 1994).

In contrast to the financial liberalisation mechanism, the neostructuralists have their own view. They maintain that official banks (formal finance) are less efficient than other financial sectors, such as informal financial markets. They do believe, as well, that official banks are interested mainly in absorbing funds for reserve requirements, whereas informal financial markets provide complete intermediation. Accordingly, they argue that high interest rates may stimulate portfolio shifts to bank deposits more from assets in informal financial markets than from currency or inflation hedges. This indicates that higher interest rates would reduce the amount of credit, and then depress the growth of the economy (Taylor, 1983).

Overall, the views expressed by financial liberalisation and the neostructuralists indicate that on the formal and informal financial markets interdependence can barely be substantiated. The difficulty of reaching a clear conclusion may be explained by many factors. First is the difference in the efficiency of official banks, formal financial markets, and informal financial markets. The view of financial liberalisation sees the informal financial markets as fragmented, and hence they are not properly channeling household savings to sectoral investment. Neostructuralists, on the other hand, look at informal finance as very competitive, while reserve requirements detect financial intermediation through commercial banks. Therefore, these banks cannot intermediate credit as efficiently as informal financial markets, which are fully liberalised.(8)

Second are the econometric-based studies used to prove the financial liberalisation thoery, and third are the advocates of financial liberalisation who see it as "the only game in town" (McKinnon, 1988). This belief is too broad and misleading. Different developing (and developed) countries face different forms of repression, and to include them all under a single concept of financial repression is simplistic. The role of different financial institutions (formal-informal, public-private, etc.) should be analysed thoroughly before any final policy can be reached. Experiences show that the success (at least up to the late 1990s) of Asian countries reflects a role for governments in terms of credit allocation. Financial strategies should be combined with institutional consideration and the economic pecularities of the developing country in question.

6 - SOME POLICY OPTIONS

Despite the existence of literature on the economic policies relating to formal financial markets in developing and Arab countries alike, such literature is very limited concerning informal financial markets. The growing importance of informality in such markets makes it urgent for policy makers concerned with the Arab world to formalise a proper package of macroeconomic policies in general, and financial policies in particular, to tackle the repercussions of the changes occurring in informal financial markets on the rest of the economy. A few remarks are cited below, regarding a number of policy issues.

- Among the delivery systems pointed out in this paper, i.e., ROSCAs, trade credit, and sheil, ROSCAs continues to be the most popular in Egypt. Despite their popularity, ROSCA loans are still issued for consumption purposes (Mohieldin and Wright, 1994), whereas sheil-based informal loans are steered toward production in Sudan.

- A growing concern has been reported on the way informal finance is channeled between production, consumption, and other outlets. It is alleged that such forms of allocation are dampening monitory policy (ADB, 1990; OECD, 1991). Before reaching a final verdict on this type of allocation, there is a need to take a disaggregated view of consumption credit. Some of these credits are no less essential or productive than credit that finances investments. Therefore, it is advisable to categorise consumption lending into: subsistence and emergencies, i.e., medical expenditures and other essential purposes; housing, education and immigration, which are in essence productive consumption; the purchase of consumer durables; and conspicuous consumption. Such a classification may help achieve a much more reliable definition of productive and unproductive informal finance.

- Among the policy tools available to bridge the gap between formal and informal financial markets in order to make use of monitory policy is the introduction of village banks. These banks aim at meeting the needs of lower-income and less-educated clients, often living in remote areas. As one form of microfinance, village banks help reduce the ceiling for interest rates, which tend to be very high in most types of informal finance. Reducing interest rates can be achieved through cutting down administrative costs, decentralising management and developing a new guarantee system.(9)

- The formal and informal financial dualism associated with structural adjustment policies has become a central issue in the financial reforms debate in most developing and Arab countries (see, for example, Kapur, 1992; Gupta, 1997; Agenor et al., 1993). It is suggested that financial reforms and adjustments through interest rates, reserve requirements, and portfolio allocations, have little influence on informal finance markets. The influence is rather exercised on those who engage in both formal and informal financial markets and who have ready access to the laffer (Christensen, 1993). In this view, factors other than monetary policy are believed to affect informal financial markets, such as increasing transaction costs, high-income risk, and a lack of suitable collateral and default risks.

- According to Kapur (1992), both markets have complementary rules to perform in a fully reformed financial system. He maintains that asset holders prefer to deal with both markets since the formal financial market offers greater liquidity and the informal financial market offers higher returns (Kapur, 1992). To reach a conclusion on proper financial policies regarding the formal-informal finance dichotomy, a deep macroeconomic analysis is required for different Arab countries.

NOTES

(1) For other kinds of informal finance, see Rutherford (1996, pp.6-27).

(2) Several studies have refuted the unproductive nature of most informally financed activities. An informal loan for subsistence consumption can afford a household the opportunity for future production (Informal Sector Newsletter, 1991).

(3) Among the versions of *sheil,* the one which prevails in West Sudan is that in which animals are pledged as collateral. A moneylender buys the farmer's animal during the peak demand for cash, and resells it to the farmer at a higher price when the farmer gets the money (Zahlan and Magar, 1986).

(4) Denoting harvest price by p^n and sheil price by p^S, interest rate, r, is calculated (Saleem, 1987) as $r = (p^n / p^S) - 1$.

(5) Among other worldwide IMF experiences are Credit Rural (Guinea), Village Banks (Senegal) and the Banco Solidario (Bolivia).

(6) This index is calculated as the inverse of self-sustainability, which refers to the return on equity, or the net of any subsidy received that equals or exceeds the opportunity cost of the equity funds (Yaron, 1992).

(7) Originally, the Alexandria Business Association was, in 1988, a private, nonprofit, NGO; its name was changed to the Alexandria Business Association only in 1994. On top of the subscriptions of 300 large businessmen, the Alexandria Business Association received subsidies from the USAID and local banks. The Alexandria Business Association initiated a microfinance programme starting in January 1990. By January 1992, the Alexandria Business Association had achieved operational self-sufficiency.

(8) It follows that neostructuralists advocate repressing official banks in developing countries to maintain more funds flowing via a liberalised and efficient informal financial markets.

(9) Experiences have shown that a few informal borrowers from village banks have graduated to become new clients of formal financial systems, and a long road still lies ahead before the gap is bridged fully between formal and informal financial institutions (Johnson and Rogaly, 1997).

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