

Feature Banking and Finance

The complex world of currency trading

by Jamal Arsalan

IN the spring of 1988 Peter F Drucker, the renowned management expert noted that the world economy has become truly global. He predicted that certain trends would be so pronounced that they would not only be visible to any analyst or theorist, but almost 'undeniable'. Classical economics is based mostly on the large scale or 'macro-economics' of a country. Today's world economy works practically contrary to the old theories. According to these conservative theories the movement of capital is based on trade, that is, goods and services. The present reality appears to be more like what Drucker foresaw: a movement of capital based on exchange rates — the function of financial institution, commercial banks, investment banks and other currency traders.

Drucker observed that year (1988) how international trade in goods was 'much larger, than it had ever been before.' Similar was the case with the 'invisible trade' in services. But that the amount of money was nothing compared to the turnover at the 'London Eurodollar market.' During each working day they deal in so much thousand million dollars that it is equal to about 25 times the world trade. In addition there are the foreign exchange transactions in the chief money centres of the globe, amounting to 12 times the international trade in goods and services. Of course, many of those yens and Swiss francs were being counted more than once.

The flow of capital and foreign exchange rate move 'quite independently of foreign trade' and often run the opposite way. Traditional economics viewed foreign exchange rates as being concerned with such factors as 'comparative labour costs and labour productivity, raw-material costs, energy costs' and transportation costs. Now the trend is being reversed. It is the foreign exchange rates which determine the costs mentioned. According to Drucker any business enterprise engaged in any form of international trade will have to keep a wary eye on 'proceeds from sales.' This includes such transactions as buying from abroad or selling as an importer or exporter; by oneself or through any medium (an agency or subsidiary).

In fact local businesses will have to watch out for many kinds of foreign competition where the exchange rates will affect the competitor and consequently the home firm itself. Protection from the state may

allow the enterprise to carry on, but the question will always be: for how long; as the country will be adversely affected in its total economic structure and function. Sooner or later the country will have to face the realities of genuine prosperity: a dependence (mutual) on world trade. So there is little to be gained by coddling enterprises that cannot either look after themselves or benefit the national economy.

Currency trading is a very complex business and full of tension. One can move millions

of dollars, marks, yens or other currency by using computers. The risk is a change in interest or some uncalculated element may cause one to lose money instead of making a profit. Once you have stuck your neck out, that is, bought up currency of a particular kind, you have to make certain your head does not get chopped off.

And there is only one way to do this: monitor the soundness of your position. The slow or sudden change in currency rates triggers warning bells. If

one does not heed them, one gets caught red handed. A central bank may issue a steady stream of statements describing as false the rumours of raising interest rates — and then goes ahead and does just that! The Bank of Japan was one of those which used this ploy in 1989, catching all those not filled with suspicion totally unaware.

There is also the fable of a team of Fuji bankers, that recently arrived in New York, USA. Content with their look at the status of the dollar they

can reap a fortune when central banks try to keep or bring a currency to a certain level. If one can guess they are falling, one can alert one's agents and plunge in for a substantial harvest. These days central banks are not having a signal success. A currency trader describes their effort as fighting a war with bamboo spears.

Currency trading has become such a force that central banks cannot do as they wish: a prerogative they enjoyed before. The Federal Reserve Bank of USA found this out the hard way in 1971 when currency trading left the US no alternative but to dump the gold exchange standard. Currency speculations may cause currency rates to possess and artificial air like the previous fixed rates, but it is only for a moment. As water seeks its own level, so do currencies rise and drop to hover at a steady point for hours, sometimes days! The central banks began their war in 1985. Five of the developed countries with a hefty economic clout agreed to knock the dollar down from as steep

Lakota Fund Inspires New Hope in Indian Reservation

by Gerald Sherman

When I started working with a group of people to start The Lakota Fund on the Pine Ridge Indian Reservation in 1985, it was to strengthen the economy of the area by starting small businesses that would provide jobs, raise family incomes, and keep the money from flowing off the reservation. But when we started lending in 1987 and began experiencing problems, we realized it wasn't going to be as easy as we thought.

Our attempt to solve the problems led us to Grameen Bank approach in 1988 when we began looking into the viability of peer group lending on an Indian reservation. Our initial studies indicated that it would address many of the problems we were experiencing that directly or indirectly affected our borrower's ability to repay their loans. However, looking at it from the standpoint of economic development didn't allow me to see the real potential of peer group lending. I didn't see it until I visited Bangladesh in 1989.

Bangladesh was so different from Pine Ridge that I wasn't sure why I was there. Bangladesh's population density averaged about 1,800 people per square mile. Ours is about 2 people per square mile. Bangladesh is tropical, ours is dry prairie land, not suited to farming for the most part. There are many markets for almost any microenterprise a person could start in Bangladesh, but at Pine Ridge the markets are limited because of the small size of our communities and the distance between communities. But as I began to travel with Grameen staff through rural Bangladesh, I started to see something that really interested me. I saw how the lives of many women had changed drastically in what seemed a short time.

There was an extremely noticeable difference between the women who had just come into a borrowing group and the women who had been involved for some time. This is the first time it began to dawn on me that there was more involved in per group lending than developing the economy. It was changing the lives of people in poverty; people who had lived years of oppression, who had no confidence in themselves,

people who had lived hopeless lives. Because of that experience we now have peer group lending model that we call the **Circle Banking Project**. It is very similar to Grameen Bank in structure. It has been accepted very well here and all the native American communities in the United States that I have spoken to, have said that it is the best idea they have ever come across to not only make loans to the poorest people, but also to address the many problems that stem from living in poverty and oppression.

Our staff and board of directors at The Lakota Fund believe very strongly that what we have developed is one of the best methods we have ever seen that engages our poor people in a process of healing.

We are beginning to see results now with stronger borrowing groups who are more committed to salvaging their problems and making their groups successful.

Many come into the project because of their need for money. What we give them is much more. Through our orientation and on-going training we help them to build their self-esteem, their confidence, their ability to work in groups and solve problems. And as an added benefit, they have a means with which to increase their incomes and raise standard of living.

For us peer group lending has gotten off to a slow start though, because of the severe effects of years of welfare and charity; the effects of colonialism and oppression. It has taken a couple of years for us to learn how to deliver it to our people. We are beginning to see results now with stronger borrowing groups who are more committed to solving their problems and making their groups successful. We lost many of our first groups and made changes in our orientation and certification process to address the problems.

What we have now is more effective and appropriate and we are confident that it will

begin to grow. We have made over \$16,000 in loans, most of which were under \$400, to about 35 circle members. We have formed 12 circles since we started and have lost half of them. We have been successful in collecting most of the money, though. This is one thing that peer group lending does make easier. Interest is beginning to rise because of the successful circles we have and we hope to have a total of 12 circles again by the end of the summer of 1992.

Our experiences with peer group lending have shown us that there is hope for economic and social change here because of our efforts to adapt what Grameen Bank has stated. We now work for social and economic justice with the hope that one day our Lakota people will be truly sovereign once again.

Next year it will be 500 years since Christopher Columbus got lost and our Native American people found him on the east coast of what is now the United States. Our people welcomed him and what was given in return nearly destroyed our people. It was 100 years ago that the last wars between the Lakota people and the US government were fought here at Pine Ridge.

It took our people one hundred years to get to the sad condition we are now in. The language, culture, and traditions have remained strong through the years though and are getting stronger. Hope is returning once more and progress is being made. And Grameen's work in Bangladesh has contributed to that hope.

I know that many in the US are struggling to make peer group lending work for our poor people. Some have succeeded and some will continue to struggle. It is very difficult work and were it not for some of the others in this field who provide support and encouragement, I would not have lasted as long as I did.

My thanks also goes out to many of those others like Julia Vindastus of the Good Faith Fund in Arkansas and Connie Evans and her staff at The Women's Self Employment Project in Chicago. They give constant inspiration to us all and have become leaders in the field of peer lending.

— (Grameen Dialogue)



went home. Imagine their dismay on reaching home to discover the dollar had plunged in the Asian markets. The \$5 railway ticket cost their bank about \$58 million! Moral of the fable: once you have invested, you cannot even go to the toilet for long. You can relax only when you have sold out and made a 'killing'.

Simply sitting on the sidelines can be equally nerve-racking, specially if one finds and opportunity to make a tidy profit has slipped by. Often one

way in 1971 when currency trading left the US no alternative but to dump the gold exchange standard. Currency speculations may cause currency rates to possess and artificial air like the previous fixed rates, but it is only for a moment. As water seeks its own level, so do currencies rise and drop to hover at a steady point for hours, sometimes days! The central banks began their war in 1985. Five of the developed countries with a hefty economic clout agreed to knock the dollar down from as steep

The Rural Poor : Customers of Commercial Banks?

By Bertold Tritler

The Marginal and Small Farm Systems Crop Intensification Project (MSFSCIP) is a regional development project in Northern Bangladesh with the aim to slow down and reverse the marginalization process of poor farming households which is often leading to the complete loss of land.

IT is understood that even poor farming households in the rural areas of Bangladesh do have a financial resource potential in form of savings which is not or only partly tapped for economic improvement. For instance, a study conducted in 1985 suggests that a poor farming household (with less than 0.5 acre of landholding) has been saving approximately 13% of the family's annual income in one form or another (Maloney, 1988).

However, even with the tapping of the entire savings potential of a household there is still a wide gap between the internal finance generation capacity of a family and the financial fund requirements for an economically viable investment for improved agricultural production or other income generating activities.

For a poor farmer access to external financial resources (credit) is usually restricted to friends and relatives or to the rather expensive informal moneylender market (10 to 20% interest per month). Only better off farmers with enough security (land or other assets) and a respective banking culture are usually accepted as clients by the formal banking sector.

The MSFSCIP Credit Scheme has been designed to overcome those restrictions by establishing a system where financial resources are obtained by own means (saving) and by an operational and organizational set-up which enables rural poor households to become economically viable and trustworthy partners to banks. The remaining gap between rural poor households and banks is further narrowed or even closed by the provision of a adequate credit facilities, adapted banking and loan procedures and a flexible and mobile field service.

As such, the MSFSCIP Credit Scheme represents a new and innovative linkage model between poor rural households and the formal banking sector in Bangladesh. In designing the interlinking components between rural households and the already existing bank branches of three commercial banks and

one agricultural bank (all nationalized), certain policy guidelines and principles were being following and specific terms and conditions laid down in a MSFSCIP Banking Plan as outlined below.

Participation of all Partners in the Design of the Credit Scheme

The time consuming and often tedious process of involving all partners in the design of the credit scheme helped to reap tremendous benefits for the mutual understanding of the objectives, the comprehension of the different socio-economic, professional and 'cultural' environment and background and the need for certain procedures and regulations.

Banking expertise from local bank branches and regional controlling offices, in-depth knowledge of the target group by staff members of a local NGO and expertise from the professional fields of savings and credit, agriculture, income generation, marketing, women development and training were combined in an inter-institution 'Credit Working Group' for drafting the terms and conditions of the credits scheme.

During field visits of rural households or groups of households those terms and conditions were discussed and verified and objections or request considered in further formulations.

However, cooperation and participation in the design of the credit scheme did not exist only on local level but also on national level. In Bangladesh, previous agricultural credit schemes were imposed by the government upon the nationalized banks and terms and conditions were issued by Bangladesh Bank in form of instruction letters.

In the case of MSFSCIP, the Government of Bangladesh (GOB) through the Ministry of Finance authorized Bangladesh Bank (Central Bank of Bangladesh) to come to an agreement with the so-called 'Participating Banks' for the implementation of the MSFSCIP Credit Scheme despite the fact that the scheme is primarily based on a Loan Agree-

ment between the International Fund for Agricultural Development (IFAD) and the Government of Bangladesh (GOB).

Through the facilitation of the project and based on drafts formulated by the credit working group, Bangladesh Bank and the Participating Banks discussed, agreed upon and signed a Subsidiary Loan Agreement and approved terms and conditions for the lending procedures as laid down the MSFSCIP Banking Plan.

Comprehensive Human Development Approach and Formation of Savings and Credit Groups

As in other poor countries in the world, also in Bangladesh poor households have widely demonstrated that they are able to tap their potentials and resources through self-help and self-reliance and that they can achieve improvement in their economic and social living standard if they combine their resources by forming self-help groups.

In partnership with a local, well established NGO (Rangpur Dinajpur Rural Service-RDRS) the formation of groups with members from poor rural households is encouraged with the intention of promoting self-reliance through a comprehensive socio-economic development process.

This approach of RDRS comprises the promotion of education and social organisation, health, women's development, agriculture and employment generation (rural income generation) and is supported by a rural works programme which gives assistance to improve the socio-economic infrastructure and environment of poor households.

The aim of this interaction with groups and their individual household members is directed towards self-reliance and economic and social independence and equality. Reaching maturity and graduation, the group is expected to continue without assistance to participate with a fair share in the economic life and to be a competent partner to any outside agency or institution which is providing services (like government agencies, banks etc).

In rural Bangladesh this is particularly relevant in regard of women's participation in social and economic development. Therefore, a considerable part of the efforts in group formation and training are geared toward women development 50% of the groups eligible to the credit scheme consist of female household members.

Concerning financial self-reliance, RDRS emphasizes in its human development approach the importance of capital formation or savings mobilization for the groups and for the individual member's household. Also as an indicator for group coherence and a measure of the individual members' dedication to the idea of self-help, savings contributions on a regular (weekly) basis are an important feature. It is a prime condition for becoming eligible

to the credit scheme that regular savings are deposited in a savings account with a bank for at least a period of one year.

Application of a Group Loan System

Individual poor farmers usually have only limited or no assets available as security for the banks. Moreover, procedures in regard of providing collateral appear to be very cumbersome and sometimes expensive for unaccustomed



The promotion of other income generating activities helps the farming household to increase the family income and to become more independent from the risks of agricultural production.

farmer. To overcome those limitations, the group members agree to be jointly and severally liable for the repayment of loans under the condition that all loans are administered by the group through a group loan system.

Under this group loan system the partner to the bank for the loan contract is the self-help group. By resolution the group decides to take up a bank loan either for the purpose of a group activity or to finance an economic productive activity of a group member. By appointing office bearers through a 'Power of Attorney' declaration and the signing of a 'Joint Promissory Note', the self-help groups act as a kind of intermediary between the bank and the rural farmer.

As such the group loan system facilitates the access of the farmers to the bank, provides adequate security for the bank and enables bank branches to deal only with one partner but reaching up to 20 customers.

The proper investment and enduse of the loan and the timely repayment of instalments is under the control of the group. The weekly meeting exert peer pressure on office bearers and individual group members who are awaiting their turn to receive loans. If one loan of the group is in arrears, no further loans will be granted by the bank.

As a kind of an 'Insurance Scheme' each group establishes a 'Group Savings Guarantee Fund' which can be used for loan repayment of overdues in very extraordinary cases only.

This contractual (compulsory) saving (4% additionally to the 16% bank interest) enhances also capital accumulation within the group and encourages investments from own resources, since savings exceeding 10% of the total group loan volume can be used by the group for further internal lending and/or investments e.g. for consumption purposes.

short-term 'Seasonal agricultural Credit' in order to finance inputs for agricultural production for up to three seasons.

Medium-term loans in the form of 'Agricultural Investment Credit' and 'Non Agricultural Investment Credit' (for any economic productive activity outside the agricultural sector) provide funds for investments in equipment, tools, machinery, etc inclusive of necessary working capital.

Agricultural or non-agricultural activities that are financed can be undertaken by all group members together as a joint activity or by one group member alone as an individual activity. In all cases, a production or investment plan must be prepared in line with the established cropping patterns and credit norms.

Loan applications for consumption or for social purposes (e.g. marriage) are not permissible under the credit scheme, but it is up to the group's decisions to use their own funds for internal lending.

Banks hold full Sanctioning Authority and Responsibility for Loans

In Bangladesh credit disbursements of various credit schemes are channelled through nationalized commercial banks, but sanctioning powers are assigned to local credit committees and/or government or project agencies. Low performance level of banks are attributed inter alia to such interference of outside forces in the running of bank and credit operations.

The MSFSCIP Credit Scheme assigns full sanctioning authority and responsibility for appraisal, disbursement and recovery to the participating banks, whereby project agencies like the Agriculture Extension Service and the NGO involved in group formation assist in the cooperation of the bank with the groups.

Despite the fact that loan applications are usually sanctioned on the merit of providing adequate collateral, the extremely low recovery rate (in Kurigram district presently only 7%) indicates that the banks have not been very successful with their present col-

lateral system and the applied appraisal procedure.

Unfortunately, many poor rural households in Bangladesh do have a negative annual family budget, which severely limits the loanee's capacity to repay. Therefore, in appraising loan applications special attention is given to the assessment of the loan repayment capacity of individual members and/or the entire group.

In the past the supervisory role of bank field staff consisted mainly in assignments to recover overdues or to deal with bad debts in preparation for certificate case.

The supervised credit system under MSFSCIP covers three different level procedure and hierarchy. In order to prevent loans to become overdue, the supervised credit system starts already with the loan application and accompanies the loanee/bank relationship until the loan is repaid.

Before loan sanctioning, it is important for the bank field staff to establish contact and to familiarize with the group. Interaction with members and office bearers during group meetings for the follow-up of disbursed loans, the end-use control and repayment control guarantees the bank and high recovery rate.

This policy requires and improved staffing ratio and investments in staff mobility but will prove more profitable in the end than to make huge provisions for bad debts.

A major area of supervised credit concerns the bank's internal, hierarchical control and supervision of operational loan procedures, like timely loan processing, overdue control and categorization and gives special emphasis in improving accuracy in accounting, ledger keeping, recording and reporting.

Therefore, the training programme of the MSFSCIP Credit Scheme concentrates on training of the self-help groups in credit discipline and management, training of bank field staff in the interaction with the self-help groups, and supports bank staff in training on bank and credit administration, accounting etc.

— Asia-Pacific Rural Finance.