

Using Finance to Promote Equitable Development in the Post-Subprime World: Learning from the Grameen and South-Shore Banking Models*

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Abstract

The success of the widely-admired low-income banking models developed by the Grameen Bank of Bangladesh and the South Shore Bank of Chicago suggests that financial strategies can alleviate poverty and reignite inner-city growth. But can either model (or both together) provide the basis of an urban economic policy for low-income areas? To answer this question, this paper examines the logic of the Grameen and South Shore models in the structural economic settings in which each has flowered. Both models succeeded because they offered the right tools for overcoming specific gaps in local market structures. Because these gaps are common in many localities, both models deserve to be widely imitated. But neither model can singlehandedly provide the basis of an urban policy that will revive inner city economies or alleviate poverty. Other structural changes in inner-city economies are equally vital.

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1. Introduction ***

Most contemporary proposals for attacking poverty and renewing the inner city emphasize new incentives to induce the poor and the urban to improve their circumstances through their own efforts. In this context, financing mechanisms such as micro-enterprise funds, loan pools, and community development banking are receiving serious consideration as the basis of a new US urban policy. Two notable success stories indicate that financing-based strategies can work: the Grameen Bank in Bangladesh, which has allowed poor women with no resources to become viable borrowers and entrepreneurs, and the South Shore Bank, whose lending has revitalized a redlined Chicago neighborhood. If the Grameen model can be transplanted, much of the US urban underclass can be eliminated by its own efforts. If the South Shore model can be transplanted, urban revitalization can be conducted at a profit. Better, both strategies are budgetary bargains.

The appeal of micro-lending and community development banking is clear. However, understanding the real promise of these financing-based models requires a careful evaluation in light of the structural features of the US inner city today. This paper uses a comparative method to explore the question: under what conditions can financing-based strategies work as mechanisms for alleviating urban poverty and renewing growth in low-income communities?

We first examine the structure of poverty and credit relations in a Bangladeshi village economy; we then consider how this structure differs from that in the US inner city. Next, we explore why the Grameen Bank model has been so successful in rural Bangladeshi villages. We consider this model's prospects in the US in light of the structural differences between low-income Bangladeshi and US communities. We then turn to the South Shore Bank of Chicago, which has been offered as a prototype for US community development banking. We find that this bank differs profoundly from Grameen, and that special circumstances have contributed to its success.

Our central conclusion is that the Grameen and South Shore models can succeed given the right resource commitments and structural pre-conditions. But absent these resources and pre-conditions, neither program design on its own can work miracles. Poverty is socially relative not just because impoverished households in different societies have vastly different amounts of goods and income, but also because different societies' unique economic and social structures generate and reproduce impoverishment in very different ways.

2. Poverty and Credit in the Bangladeshi Village

Bangladesh is a largely rural society, whose principal material resource is its fertile, often-flooded soil. Land plots are usually kept in the family; so most households' economic welfare hinges on whether the yield from their land provides for their subsistence requirements. Most rural households can then be classified as poor if their average agricultural yields fall short of subsistence. A comprehensive 1989 survey found 24% of all rural households to be "chronic deficit" units of this sort, and another 50% "occasional deficit" units, with only 8.5% of all households in the "chronic surplus" category.¹ Poverty is closely, but not exclusively, linked with

*** As noted above, this draft dates from July 1996. It has been posted to facilitate advance reading by the paper's discussant. An updated draft is in preparation.

¹ This measure, developed for a 62-village survey in 1989 (see Rahman and Hossain, 1992), focuses on whether cultivated lands are adequate for household subsistence needs. A nutritional

landlessness: the landless and functionally landless (0.5 acres or less) make up 76% of all chronic deficit households (Hossain, 1992). Impoverishment is normal for both agricultural and non-agricultural wage laborers (85% and 86%, respectively), and also for tenant cultivators (79%); it falls to 53% for traders, 47% for service providers, and 20% for landowner/cultivators.

How does credit enter this picture? It is useful to distinguish between credit for household subsistence and credit which facilitates wealth accumulation. Most deficit units are engaged in subsistence activities to the exclusion of accumulation activities.² We examine these first.

Subsistence Credit in the Bangladeshi Village. Credit and banking relations are as old as cultivation in rural Bangladesh (Maloney and Ahmed, 1988; Sen, 1989). Each agricultural cycle draws on the village's labor power and its productive assets, especially during the planting and harvesting seasons. Subsistence for every household depends on its members procuring sufficient food and other goods by using their assets and labor power to survive until the next cycle. The need for subsistence credit relations arises due to three factors: the uncertain yield of the land; its unequal distribution; and the periodic nature of agricultural yields.

As a point of reference, suppose first that every household owned sufficient land, labor, and productive assets to survive autarchically, storing enough food every harvest to carry over to the next harvest. No subsistence credit relations then arise. But this limiting case is unrealistic. Many households own too little land to provide for subsistence needs, even with a bountiful harvest.

Those with insufficient land to subsist until the next harvest must either borrow from friends and relatives, normally accruing some informal obligations which must be settled later, or they must enter into a formal credit arrangement. The latter involves the exchange of food now for labor or other services later with a trader or rich landowner who has built up excess food stocks.³ These borrower households are doubly disadvantaged: first, they must sell their labor in advance when it brings a lower price than in the harvest season;⁴ second, borrowers' freely-owned land or other assets (that is, their collateral) must be pledged against future repayment. Borrowers who can pledge no collateral -- a situation encompassing two-fifths of informal credit-market loans (Murshid and Rahman, 1988) -- must accept even more onerous credit terms.

Many residents must sell their labor because they own too little land, and seasons of aggregate deficits occur regularly. In consequence, a labor market and a structure of credit relations are eternal accompaniments of rural village life. There are two phases of these labor/credit markets. Prior to the harvest (and after the planting), labor demand is low, and subsistence credit demand high. When the harvest comes, labor demand rises and credit demand falls, since many cultivators

measure of poverty that year found 44% of the population to be poor (Report of the Task Force, 51, 1991).

² These distinctions are not meant to suggest that low-income people lack richer households' sense of initiative, or embody a culture of poverty. Rather, some households focus on subsistence and others on accumulation because they face different constraints in accessing and using markets.

³ Sen (1992) reports, on the basis of the 62-village study conducted after Atiq Rahman's mid-1980s effort, that 43.5% of all informal credit arrangements involved friends and relatives; 11.5%, professional money lenders; 18.3%, rich landowners; 6.5%, traders; 20.2%, others.

⁴ Rahman (1992) estimates that wages fall 25% in the lean pre-harvest season, the *Mora Kartik*.

need labor and food is plentiful. So wages are low before the harvest, and adequate during it (by the same token, food prices are high prior to harvest, and low during it). A low harvest drives the wage down and food prices up, even in the harvest season. So borrowers face disadvantageous relative prices: they obtain credit for food when food prices are (seasonally) high, and repay by selling food when its price is low.

These subsistence credit mechanisms worsen asset inequality and generate ever more landless poor through one of two routes. On one hand, as Bhaduri (1983) argues, money lenders try to push borrowers into default and the surrender of their collateral. On the other hand, since borrowers seek to maintain final ownership rights to their inherited land, lenders are able to extract additional surplus through usurious interest rates (Jansen, 1983) and/or through other liens on borrowers' land and labor. Indeed, a mid-1980s study of informal credit markets found that most informal-sector loans with an explicit interest rate (about half of all loans) were made at monthly interest rates of 10% or higher (Atiq Rahman, 1989).⁵

So credit relations of various types permit a precarious balancing of the survival imperative with the pattern of resource ownership, kinship, and available food supplies. But these mechanisms lead to greater asset inequality. Bharadwaj (1992) argues that the underdeveloped market for land leads to an underdeveloped labor market. The interlinked credit and labor markets are readily manipulated by those with surplus stores of food, who can wield market power.⁶

The situation of poor women is particularly desperate. Women receive a lower share of the household consumption allotment than do men (Hamid, 1992), but they are responsible for all housework, including gardening. When women augment their incomes through cottage-industry production, they usually buy raw materials from and sell finished products to the same traders, who extract maximal profits as per Basu (1987). When women sell their labor, it is in most (64%) cases at "employers' terms," not at the market rate. Men sell at this lower rate only 12% of the time.

Accumulation Credit in the Bangladeshi Village. In contrast to subsistence-credit markets, most accumulation credit -- loans that increase the productive capacity of income-generating activities -- is supplied by formal credit institutions such as banks and authorized non-government organizations. However, this sector does a poor job of providing accumulation credit in villages, and especially to lower-income households. For one thing, formal-sector loans, which account for two thirds of all credit, are made largely to large firms in urban areas. Further, this sector's lending is riddled with inefficiency. Creditworthiness standards are lax, default provisions not enforced, bank salaries low and side-payments common. The recovery rate is less than 75%.⁷

⁵Maloney and Ahmed (1989) warn that on an actuarial basis this figure is closer to 5% per month.

⁶Basu (1983) shows that interlinked markets can be manipulated to fully extract needy agents' surplus, even if prices in one of these two markets are "fair."

⁷Sobhan and Fatmi (1990: 1) describe "a scenario in which telephone calls (and not economics or commercial principles) can dictate who gets loans and how much, where big borrowers virtually walk away with public money feeling that they have 'earned' these loans, thus shifting the onus of recovery onto the (banks) already weakened by such misplaced advances. The ripple effects are felt further on as middle order borrowers become emboldened by the trend setters."

Most institutional credit that does flow to rural areas is channeled to large and medium landowners; it is often relent by urban credit recipients, at higher rates than in urban areas.⁸ The absence of collateral prevents formal markets for accumulation credit from opening for the poor. While the poor often own farmland, it is frequently pledged in subsistence credit arrangements; and anyway, since it is infrequently bought and sold at arms' length, it does not qualify as proper collateral. And while *urban* artisans, traders, and other producers commonly obtain start-up and working capital from informal lenders (Rahman, 1989), this is not the case in the countryside.

Thus investment funds are available in the villages mainly to those already in a position to extract surplus. Deficit households can use the banking structure only to meet consumption needs, at the risk of pledging their wealth assets and their future labor power. This banking structure, in which land is pledged against consumption deficits but not against investment capital, leads over time to further polarization between the landless and the rich.⁹

3. Poverty and Credit in the US Inner City

We now consider impoverished urban communities in the US by considering some of the key differences between their economic and credit-market relations and those in the Bangladeshi village. We first contrast overall economic structure, and then turn to credit relations per se. The discussion that follows draws heavily on Boston (1988) and on my research with John Veitch.

Bangladeshi villages can be thought of as relatively self-contained circles encompassing productive assets (farmland), labor (cultivation, housework, and home production), and output (food). While exploitation exists, long-standing ('traditional') cultural practices undergird all economic practices, so that there is substantial continuity to the fabric of the social whole despite the use of market exchanges to allocate many goods and services. By contrast, in US cities economic practices delimit the space for cultural traditions, not vice versa (Logan and Molotch, 1987). US inner-city communities have never been self-reproducing circles in any sense.

US inner-city communities are recent creations -- they are the legacy of the urban migrations spurred by the periods of forced industrialization from World War I to World War II. In most cities, areas occupied by white residents of mixed income levels turned, in the 1950s, into communities of racial minorities of mixed income levels. While some minority workers held industrial jobs producing goods and services, many found work as domestics or in the service sector. These workers' jobs were seldom secure: 'last hired, first fired' was the operative principle for most industrial jobs. In the 1950's and 1960's, these communities were "internal colonies" (Tabb 1970, Barrera, 1985) which exported their labor power in exchange for goods produced elsewhere. The colony's labor was often remunerated at lower rates than elsewhere; its goods cost more and were lower in quality. In practice, some of these communities' largely blue-

⁸In BIDS' 62-village study, medium and large landowners received half of all institutional credit and a quarter of all noninstitutional credit; these landowners comprised about 18% of all households.

⁹ According to BIDS' 62-village study, a third of the landless in 1989-90 have lost the land they inherited. The land situation of 60% of the functionally landless has remained stable, while 27% of this group have less than 90% of the land they inherited. Marginal landowners show more downward than upward mobility in land ownership; but half of all large landowners have increased their holdings by more than 10% (Sen, 1992).

collar and service-sector workforce were located within the community; for example, Watts was home to several steel mills. The ghetto and the barrio were exploited for their labor; survival there depended on the return inward flow of goods and services.

The 1970s and 1980s saw a 'hollowing out' of the US industrial structure, which hit inner-city communities with particular force. What Bluestone and Harrison (1988) have termed the 'great U-turn' involved two interrelated trends: 'deindustrialization', in which many production facilities were relocated to remote locations, eliminating many union blue-collar jobs; and a 'low-income reindustrialization' which created more low-wage, variable-hour service-sector and manufacturing jobs. In consequence, many more workers, even full-time workers -- and a disproportionate number of inner-city workers -- earn less than poverty-level wages (Ong, 1989).¹⁰

Reduced levels of employment discrimination and residential segregation in the wake of the 1964 Civil Rights Act (as amended) also created opportunities for many middle-income families to leave for the suburbs. This exodus, combined with the loss of stable blue-collar jobs, has left inner-city communities with what Wilson has called an 'underclass':¹¹

individuals who lack training and skills and either experience long-term unemployment or are not members of the labor force, individuals who are engaged in street crime and other forms of aberrant behavior, and families that experience long-term spells of poverty and/or welfare dependency (1987: 8).

In sum, economic and social forces have made US inner cities into low-income, minority communities over the past 40 years.¹² In consequence, US inner-city communities today are profoundly separated, in spatial, racial, and resource terms, from the suburban and exurban communities that surround them (Goldsmith and Blakely 1992). A separation of this sort has not occurred in Bangladesh.¹³ Further, US inner cities have no equivalent of agricultural cultivation -- that is, no residual source of nourishment, no opportunity for self-provisioning (apart from crime). The connection of most residents in Bangladeshi villages to the ownership and cultivation of agricultural land creates a circle of exploitation which permits survival for most. But no asset appropriate for this purpose exists in US inner cities -- to earn income, one must sell goods or labor power. What jobs can be had often are remunerated at wages too low to support a household. Absent cultivable land, survival for the un- and underemployed

¹⁰ The effects of the 'U turn' on US inner-city communities resembles the impact of ecological disasters on the Bangladeshi village. But whereas the latter are periodic, the former was secular.

¹¹ The term "underclass" has provoked controversy because of its connotation of social pathology. Wilson himself emphasizes joblessness and low wages as the crucial determinants. Dymski (1996a) contrasts Wilson's framework with various 'racial culture' arguments about racial inequality.

¹² Indeed, the term 'inner-city' itself is used here because it commonly connotes communities with many low-income residents and minority residents.

¹³ Racial and spatial separation has led much of the US population to be completely ignorant of actual circumstances in the inner city. A telling example of this social isolation occurred in Los Angeles in 1992: after the civil unrest, two large busloads of bankers were given tours of an almost 100-square mile section of the city in which they had, for the most part, never set foot. This level of unawareness by the privileged of the circumstances of the poor is unimaginable in Bangladesh.

involves augmenting earned income with illegal activities, with cash or in-kind assistance from welfare agencies, and with cash derived by converting assets into consumption goods.

Before discussing the credit market, another important contrast should be indicated: the higher capital intensity of both consumption and accumulation activities for rich and poor in the US. Just as US median income is a multiple of Bangladeshi median income, so too are median financial and real asset levels in the US compared to Bangladesh. Even low-income housing in the US requires the commitment of thousands of dollars per residential unit, with substantial -- and often 'unaffordable' -- rental levels required subsequently to meet financing commitments. Similarly, substantial financing is required even for 'mom-and-pop' enterprises in the US. So a significant inflow of funds is needed to avoid the depreciation of both residential and commercial assets. In effect, the US household faces high carrying costs for even a modest home or business. To see this, consider the change in social and economic status of any household that becomes homeless when it cannot meet the non-trivial costs of even the humblest shelter.

Payment and Credit Mechanisms in the Inner City. Because the inner city is located within a developed capitalist economy, its residents conduct few in-kind transactions. Both rich and poor need ongoing access to cash payments and credit mechanisms. Indeed, whereas the income status of most Bangladeshi village households can be determined by the surplus or deficit of their agricultural yields, in the US inner city any household's income status can be determined by whether its net income and payment flows leave it with chronic cash surpluses or deficits. Surplus units can refresh their asset stocks and accumulate more, with liquid savings that enhance freedom of movement; deficit units must allow their assets to depreciate and/or accumulate debt simply to meet payment obligations.

Just as the inner city's production and jobs structures have been transformed in the past 3 decades, so too has its financial structure. In the 1950's, commercial banks and savings and loan associations (thrifts) maintained dense branch networks, even in lower-income communities. Households and businesses maintained transaction balances in commercial banks, and savings in thrifts; in turn, commercial banks provided firms with working capital, while thrifts financed the buying and selling of homes. In effect, this formal structure provided most urban communities with localized savings/investment mechanisms coordinated by autonomous branch managers.¹⁴

This banking structure changed dramatically in the 1970's and 1980's, just as white flight, desegregation, and deindustrialization transformed the social and economic face of the inner city. Banks and thrifts faced stiff competition from mutual funds for their wealthier (surplus household) customers; and non-bank intermediaries and brokers increasingly competed to provide credit and other financial services for larger and more established firms. At the same time, with the revolutions in computer and communications technology, lenders could use standardized information to make centralized loan decisions. The intense competition for blue-chip depositors and borrowers transformed the economics of the banking industry. Many banks and thrifts went under; those that survived closed branches and cut workforces.

¹⁴ The coverage of the formal financial sector was never complete in some areas, such as East Los Angeles and Pacoima, that were historically settled by minorities.

In particular, the formal banking system has substantially reduced its presence in inner-city communities (Dymski and Veitch 1994 and 1996a, and Caskey 1992). While formal banking institutions compete, as before, to serve higher-balance customers in suburban and exurban communities, bank branch networks have shrunk in the inner city. At the same time, the increasing 'shoe leather' costs and the fees required to maintain lower-balance bank deposits have pushed ever more households into being 'unbanked.' Informal institutions like check cashing stores and loan brokers have largely replaced formal banks in much of the inner city; these institutions offer convenience at the expense of higher fees for services (Caskey, 1991b).

Subsistence Credit in the Inner City. Because jobs are short and the social safety net is leaky, subsistence gaps emerge regularly for inner-city residents.¹⁵ Even those with jobs may sometimes encounter subsistence gaps when unexpected illnesses or other catastrophes strain meager paychecks. As in Bangladesh, these gaps are often handled through borrowing from relatives or friends, or by reducing expenditures temporarily. Households for which neither course of action is feasible must borrow. The terms on which any household can borrow to cover subsistence gaps depends on its income stability, credit-rating, and wealth level.

Here a structural difference from Bangladesh comes into play. In the US inner city, the credit and labor markets are not interlinked because of the absence of any equivalent for cultivation as a residual activity. In Bangladesh, the farmer with a deficit of food from land can contract with a surplus farmer or trader promising future payment or services. But an unemployed worker in south-central LA cannot promise an employed worker, say, a portion of the wages from some future job. An inner-city resident who lacks a job now cannot count on one later; and a job that pays too little now to avoid a subsistence gap will most likely pay not cover this gap in the future. Rarely, a borrower might pay off a debt by working for another; but this would be restricted to cases of borrowing from entrepreneurs that hire labor.¹⁶

The absence of a commonly-held, labor-absorbing productive asset greatly limits the kinds of credit arrangements that can be struck. The hours of labor that employers actually hire determines the amount of wage-based expenditure, not the hours of labor that workers would like to supply; and no mechanism exists for a credible promise of future repayment based on supplying labor. The creditor cannot dispose of this future labor directly, and cannot afford to believe in borrower intentions in a community whose realities so often frustrate dreams.

For households with steady employment, a credit rating, and a bank account, finance companies are a likely supplier of credit. These households have the collateral and 'track record' to obtain stop-gap loans, or trade credit for consumer durable-goods purchases. In the absence of either steady employment or of financial reserves, the fail-safe borrowing option is to borrow from pawnbrokers by pledging, as collateral, durable consumption goods. Pawnbrokers' average loan is small (about \$50); most loans are made to cover unexpected expenses; default and interest rates are much higher than for banks (Caskey 1991a). Goods used as collateral lack ready secondary markets, and are exchanged for cash only at deep

¹⁵ Spalter-Roth *et al* (1992) show that most low-income women use two of three sources -- earned income, welfare benefits, spousal or child support -- to make their household budgets.

¹⁶ Inner-city credit and commodity markets are sometimes interlinked, when merchants sell goods on credit. But unlike in labor/credit market inter-linkage, commodity buyers supply no services to the merchant. That is, it does not tap residents' economic productivity: it merely defers payment.

discounts. Many borrowers at pawnshops lack bank accounts, and cannot pass formal institutions' routine credit checks.

In sum, whereas labor/credit market interlinkages reduce the need for collateral and makes for a low default rates in Bangladesh, the absence of labor/credit market interlinkage, together with uncertain labor-market prospects, lead to harsh terms, overcollateralization, and high default rates in the US inner city. Labor/credit market interlinkage and harvest variability allow flexible arrangements in Bangladesh, in which borrowers can use their wealth assets (land) recurrently to borrow when necessary in the *Mora Kartik*. But when the income prospects of US borrowers do not pan out as planned, future earning plans are irrelevant -- collateral is lost. Borrowers with subsistence gaps can liquidate their assets to cover these gaps; and when their assets are gone, they face eviction and homelessness.

Accumulation Credit in the Inner City. Most credit flows in the urban economy are oriented not to subsistence, but to the accumulation and exchange of capital. Household and firm accumulation processes generate various financing needs: for the construction, purchase, refinancing, and refurbishment of residences; for the start-up, operation, and expansion of businesses; and for the exchange of goods. Historically, different institutions have met these financing needs: thrifts have provided most home financing, commercial banks, construction finance and working capital; private investors, money for business and project start-ups; and firms themselves, trade credit. The banking transformation discussed above has caused some shifts in these arrangements: thrifts now share the mortgage market with commercial banks and mortgage companies, and much business credit is now provided directly through brokers.

Available evidence indicates convincingly that the inner city receives less than its share of the US economy's accumulation credit flows. The most comprehensive data on credit allocation exists for residential credit flows. With just a handful of exceptions, every study has indicated that inner-city areas are redlined -- that is, these areas receive lower credit flows than suburban and exurban areas, even when area income differentials are taken into account.¹⁷ This finding has generated substantial controversy; subsequent refinements in available data and in statistical tests have led to the conclusion that these fair-share differentials are partially, but not entirely, attributable to racial discrimination against minorities in the lending and home-buying process.

Unfortunately, while intermarket linkage assists the subsistence credit process in Bangladesh, a perverse intermarket linkage may partially explain why discrimination against individuals and communities of color persists even when, as mentioned above, lenders themselves have been under substantial competitive pressure (thus not in any position to disregard profitable loan opportunities). That is, *if* minority workers face discrimination in labor markets, this could make them less creditworthy as longer-term borrowers, *ceteris paribus*. In effect, discrimination in one factor market might 'justify' discrimination in another.¹⁸

For categories of accumulation credit other than residential credit, the available evidence suggests that inner-city businesses operate under severe credit constraints. While commercial banks

¹⁷ For discussions of these studies, see Shlay's essay in this volume and Dymski (1996b).

¹⁸ This argument is developed in Dymski (1995). Credit-market discrimination could also inhibit income-earning prospects for minorities, by reducing opportunities to finance education and training, and by forcing minority entrepreneurs to operate with insufficient bank lines of credit.

usually supply working capital for businesses, they do not provide start-up or expansion financing; and they often provide working capital only to firms with substantial experience, and then in amounts that may fall well short of ideal operating needs. Similarly, affordable-housing developers can obtain construction financing, but not start-up or take-out funding.¹⁹

Firms' universal need to rely on their owners' (or owners' families') resources for start-up funds suggests a further source of credit starvation in the inner city: most families' primary method of accumulating personal savings is to build up equity in their homes; but since inner-city areas are shortchanged in mortgage credit, inner-city residents are disadvantaged when looking for start-up funds. The profound racial gap in wealth levels (Oliver and Shapiro 1995) is consistent with credit redlining of the inner city and with persistent residential segregation.

Formal lenders' rent-seeking and administrative inefficiency, which explain the inadequate supply of accumulation credit in the Bangladeshi village, are not important factors in the US inner-city context. Instead, lenders' undersupply of accumulation credit to the inner city can be attributed to racial discrimination and perverse intermarket linkages, already discussed, and to one additional factor: large banks' tendency to overcompete for market share in areas of 'emerging credit opportunities.' These 'opportunities' include such subsequent busts as Latin American debt and commercial real estate. However, banks' recurrent need to satisfy equity markets with good short-term numbers minimizes learning-by-doing from lending disasters (Basu, 1991).

4. The Grameen Bank in Comparative Context

The discussion above illuminates two common flaws in the credit mechanisms of the Bangladeshi village and the US inner city. First, both systems for subsistence credit do not simply smooth income flows, but instead worsen asset impoverishment over time. Second, lower-income households in both communities lack effective mechanisms for accumulation credit. The absence of accumulation credit is due, in turn, to four common factors. Three are supply-side factors: an underdeveloped or anemic labor market; the channeling of investable funds elsewhere by the formal banking sector, due to either rent-seeking or competitive forces; and the absence of collateral. One is a demand-side factor: these communities' isolation from broader consumption markets.

The Grameen Bank is well-known for its innovative approach to poverty alleviation.²⁰ The Bank operates by recruiting members in small (usually 5-person) teams from among the very poorest households. Each team undergoes intensive social and entrepreneurial training, and each team member agrees to save regularly on a strict schedule. Most Bank members -- about 87% -- are women. After any team has built up its savings, one member of the group is eligible for a small loan (maximum of 7500 Tk or about \$180), which must be repaid with 50 weekly installments. The interest rate on these loans, while non-trivial (16% per annum, according to Hossain, 1988), is much lower than on other informal-market loans. All members of a borrowing team are equally responsible for repaying a loan made to any one member of that team. The loans obtained from

¹⁹See Parzen and Kieschnick (1992) and Dymski and Veitch (1992).

²⁰Most of the materials about Bangladesh and Grameen cited in this paper are not readily available in the US. However, a number of excellent new publications about the Grameen Bank are closing this information gap; see, for example, Wahid (1993) and Holcombe (1995).

Grameen are used primarily to initiate livestock and poultry raising, fish hatcheries, and small manufacture items such as baskets, furniture, and clothing.

This model attacks both supply-side and demand-side problems that keep low-income households poor. On the the supply side, the Grameen approach address two aspects of the subsistence and accumulation credit systems that prevent low-income households from autonomously producing (more) goods and services. First, it facilitates access to accumulation credit by substituting 'human' collateral (the mutual responsibility system) for land or other physical collateral. Second, it prevents the subsistence credit system from worsening impoverishment in two ways: by earning income through loan-financed activities, Grameen members can shift from being deficit to surplus households²¹; and Grameen members' savings provide a cushion against emergency spending needs that would otherwise be financed through local informal-market lenders.

Apart from creating means whereby poor households can supply goods to the market, however, the Grameen model also succeeds because it boosts aggregate market demand. In general, the goods and services generated through Grameen loans are sold locally; this follows logically from the small scale on which entrepreneurial operations are established. To whom are goods sold? Clearly, surplus households provide one source of demand. But in addition, Grameen operates on a sufficiently large scale that its member households themselves become an important part of the village consumer market. Hossain (1988) notes that as of February 1987, Grameen had been introduced into only 6% of all Bangladeshi villages; however, within the five districts in which it operated, anywhere from 19% to 55% of all villages were covered. And whereas Grameen covered only 4% of all eligible *households* as of this same date, in its five districts of operation it covered anywhere from 8% to 29% of eligible households. These figures imply that in villages in which Grameen operates, approximately half of all households are mobilized as Bank members.

In effect, Grameen membership breaks the power of interlinked credit and labor markets over low-income households. A portion of the monopoly rents enjoyed by subsistence lenders on lean-season borrowing and labor-supply agreements is eliminated. These reduced rents lead, in part, to productivity gains which are shared locally, as low-income households not only supply, but demand, goods and services generated with Grameen loans. The reduction of lenders' monopoly rents also, however, redistributes income downward from rich to poor (see Hossain, 1988).

Limitations of the Grameen Model. The Grameen Bank approach has been embraced by many other countries and by the World Bank; it has been lionized by President Clinton. At the same time, even its advocates have recognized its limitations. First, Grameen is not financially viable in the sense of operating at a profit; indeed, it has consistently run at a loss since its inception. The average annual loss is difficult to calculate: while its low-income loan operations run at a deficit, the Bank obtains many of its in-country funds at a substantial discount, and invests many of these profitably in government securities; .and it also obtains a large volume of funds from overseas philanthropical sources. Hossain (1988) calculated Grameen's cost of loan operations at about 26.5% for 1986, and the implicit subsidy on loan operations at 39% when concessionary fund costs are taken into account. Wahid (1994) notes that efforts have been made in recent years to

²¹Wahid (1994) also presents evidence that Grameen borrowers' agricultural land is significantly more productive than that of comparable non-borrowers, suggesting that Grameen membership may have provide incentives for higher agricultural labor effort.

improve Grameen's operating performance; but he presents figures which suggest continuing operating losses of the magnitude computed by Hossain.

In a recent book, Otero and Rhyne (1994) and their co-investigators argue that this specific limitation of Grameen Bank and of other providers of microenterprise finance may disappear with continued institutional evolution. They argue that these institutions may not require the attention to client education and development that has characterized the Grameen Bank. They go on to argue that opportunities for encouraging and pooling savings among the poor have been underexploited, and that communities in which microenterprise ventures take root soon generate more savings and more demand for loans. If lending and savings collection are accomplished economically, reflecting the small scale of funds involved, these communities eventually become attractive banking markets for competitive banking firms. If these authors are right, then operating deficits will disappear with the community development spurred by microenterprise lending.²²

Apart from operating deficits, two other limitations stand out. First, will Grameen's rapid horizontal expansion within Bangladesh lead to the saturation of the markets serviced by Grameen-financed entrepreneurs? Hossain (1988) argues that as local incomes have increased, demand for Grameen-sponsored products has increased more than proportionately. Assuming he is right, will this condition hold true as Grameen continues its expansion? What volume of low-capital, consumption-oriented production can be initiated successfully without taking steps to either improve agricultural yields or extend entrepreneurs' marketing reach into other geographic areas.

This limitation may be significant, because Grameen's efforts to take these further steps have not been uniformly successful. Substantial improvements in agricultural productivity or in trading income require the more substantial capital investment (in irrigation, and in transportation and other aspects of infrastructure) that the Bank has avoided funding thus far. Taking on such efforts would force changes in its basic lending model, since these efforts would require much more substantial loans to individual borrowers than member-teams could hope to amass from their own savings, with much longer pay-off periods than twelve months. And further, making loans of this type would bring Grameen's loan officers and borrowers face-to-face with economic imbalances (in urban/rural terms of trade, in the implicit patterns of subsidy for different activities, and so on) not simply within the village economy, but at the regional and even national level.

A second possible limitation is the social and political reaction that Grameen has generated within Bangladesh due to its very success. Since the early 1980's, its members have almost exclusively been women -- so Grameen's success has involved the economic and social empowerment of women (Holcombe, 1995). But this cuts against tradition: in largely Muslim Bangladesh, women's freedom of economic movement is seriously constrained. The Grameen's decision to focus on women members was based on a narrow criterion -- their superior default performance. However, the wider strategic importance of this focus is clear from the discussion above:

²²These authors' analyses combine experiences in very diverse settings. Otero and Rhyne readily admit that the structural circumstances of microenterprise providers such as ACCION in Peru and of the Bank Rakyat Indonesia in Indonesia, and the circumstances of the informal sector as a whole, vary widely from place to place. Nonetheless, they suggest that the shift from developmental finance to financial-service markets is broadly achievable.

women's labor is disproportionately at risk in lean-season borrowing. The Grameen Bank has partially accommodated this cultural context: female Grameen borrowers almost never borrow funds to engage in trade, but male borrowers often do (Hossain, 1986). Under Muslim law as interpreted in Bangladesh, women are unable to trade in the marketplace; so many female Grameen Bank members depend on men to act as their traders. In the past several years, the Grameen Bank has dramatically expanded its operations -- for example, it tripled its branches between 1987 and 1992, and increased its members by a factor of five. Even as Grameen's size has ballooned, however, critics, especially mullahs (the villages' Muslim clerics), have charged that Grameen abrogates Muslim law and tradition (Newsweek, 1995).

So the success of the Grameen model has itself generated social conflict at the intersection of religious belief and gendered power relations. We should add that successful Grameen borrowers, if their activities grow sufficiently large in scale, will ultimately hire workers in their enterprises. In this case, depending on how workers are paid, class conflict may emerge along lines more familiar in urban settings. That is, the Grameen model does provide impoverished rural communities with a means of escape from stagnation traps; but its very success may spur a number of gender- and class-based conflicts.

Transporting Grameen to the US inner city. The success of the Grameen Bank has spurred many people and organizations in the US and elsewhere to create "micro-enterprise" funds which incorporate some Grameen design elements.²³ The loans made by these funds usually are very small (\$5000 or less), and allow borrowers to begin or expand informal, small-scale business operations. These funds have succeeded in achieving uniformly low default rates and numerous personal triumphs. As with Grameen, these funds have been run at a deficit; but it is not clear that they have necessarily targeted very low-income households.²⁴

The process of transplanting Grameen must take account of the structural differences, discussed above, between the US inner city and the Bangladeshi village. The higher level of capital intensity in the US creates higher hurdles between having an entrepreneurial idea, on the one hand, and producing and marketing the resulting good or service, on the other. An entrepreneur needs a larger cash flow in the US because renting production space and obtaining inputs almost invariably involves monetary exchanges, whereas this is not the case in Bangladesh. Urban residents are seldom homeowners, and even homeowners face substantial out-of-pocket costs in the US inner city. Further, bringing goods to established market outlets in the US also entails significant costs. All of this means that fixed and running costs are larger for a permanent business establishment.

These costs can be sidestepped by the use of the home for production activities and of informal sales outlets, such as swap meets, street vending, and open-air bazaars. Of course, a home with space for

²³ Studies of US micro-enterprise include Solomon (1992), Novogratz (1992), and Mondal and Tune (1993). Clark and Huston (1992) compile a directory of US micro-enterprise programs.

²⁴ Novogratz (1992) describes one prominent microenterprise fund, the Banco Sol of Bolivia. Unlike the Grameen, Banco Sol runs at a profit, providing working-capital loans to established entrepreneurs (mostly men) in Bolivia's thriving informal urban sector. Novogratz observes that Banco Sol is profitable in structural circumstances very different from those in Bangladesh. There is little systematic evidence on whether US microenterprise funds have worked primarily with very low-income borrowers. Mondal and Tune's (1993) study of borrowers at the Good Faith Fund in Arkansas finds only 26% were below the poverty line, and about half were men.

production activities itself requires substantial running costs, even in the inner city. But here is where another structural difference -- the absence of any equivalent for the agricultural cycle in the US inner city -- comes into play. This cycle, in Bangladesh, creates a periodic flow of income for most village households, and thus creates a ready-made localized consumer market for would-be entrepreneurs to target. Despite its inconstancy, the agricultural cycle binds households into an interrelated, localized economic fabric. By contrast, in the US inner city, deindustrialization and industrial decentralization have eliminated many stable income sources; and commercial and financial restructuring have reduced intra-community cash flows. Many households survive by piecing together income from a variety of uncertain sources. Shopping expeditions mean a trip out of the local community setting. Thus, compared with Bangladesh, the US inner-city market for microenterprise goods and services is hampered by more uncertain and less integrated local demand.

These structural differences may pose a dilemma for microenterprise funds. If these funds assist very low-income households with small-scale loans, they may expose their borrowers to substantial uncertainty in the medium run (after the loan is repaid) due to unstable local demand and uncertain market outlets. Borrowers looking for more than supplementary income from activities funded in this way may be disappointed; and those who succeed may face further barriers insofar as formal-sector lenders are not interested in providing expansion financing for small businesses in low-income, low-wealth areas (as discussed above). If, on the other hand, these funds provide expansion and working-capital financing for entrepreneurs with more established businesses, they will not only indirectly improve the circumstances of the very poor.

One important contrast between the Grameen Bank and microenterprise funds in the US is their relative scale of operation. As shown above, Grameen operates on a large scale in the villages within which it intervenes, encompassing as members up to half of all low-income households in some areas; by contrast, US experiments of this sort have been miniscule. This large operating scale may be one key to Grameen's success: involving a large fraction of a target community in income-generating activities augments not just the supply of goods and services, but the demand for this supply and the means to buy it. However, if US microenterprise funds were established on a large scale, yet another structural difference indicated above between village and inner city might come into play: the extreme physical, social, and racial separation between suburbs and exurbs, on one hand, and inner city, on the other, might pose important political constraints.

Consider South Central Los Angeles as an example. This area has approximately 300,000 residents. Suppose one third of these residents, those with the lowest incomes, are deemed eligible for participation. This would leave a pool of approximately 33,000 households. Suppose half of these participated in a microenterprise fund, organized into teams of five, with one-fifth of all members receiving a loan in any given year. Finally, suppose loans averaged \$2,500 and operating and other fund costs averaged \$.25 per dollar lent. If the default rate were 4%, then over a five-year period, approximately \$20 million in loan funds would be needed, together with another \$20 million in operating funds. If a program on this scale were implemented nationwide, costs over 5 years might be in the range \$0.5-1 billion. Extending the program to rural areas and providing supplemental funding for day-care centers and health-care would at least double these costs. So an initial appropriation of \$1 billion and ongoing funding of \$250 million or more might be anticipated.²⁵

²⁵ This calculation assumes half of 33,000 households in South Central participate, with one-fifth receiving 1-year loans of \$2,500 in each of five years, and with defaulted funds replaced in the

These costs can be viewed in different ways. On the one hand, these appropriations are non-trivial, and would be subject to the kind of political attacks on social-welfare spending that have characterized recent debate in the US. These appropriations would clearly redistribute income from richer to poorer households (given the existing tax code), as has occurred in Bangladesh. On the other hand, these dollar sums are not inconceivably large. Their scale relative to, say, the military budget is indeed very modest. And if private-sector funds can be attracted for the required microenterprise loan pools, the public-sector funding requirement would fall. Nonetheless, the point is that an operation on this scale would be controversial due to its scale and cost. And the politics of race and gender might further muddy the policy waters, as they have throughout US history.

5. The South Shore Bank in Comparative Context

The Shorebank Corporation of Chicago provides the US with its own outstanding success story as a means of encouraging urban renewal through a financing mechanism: it has been cited by President Clinton and HUD Secretary Cisneros, among many others, as the paradigm for US “community development banks.” To this end, the federal government has appropriated some \$33 million for fiscal year 1996 to inject monies into similar institutions around the country. However, a close look at South Shore’s experience raises questions about whether its success can be generalized, and about whether this experience provides a blueprint for poverty alleviation per se.

The South Shore community of South Chicago, once been a tony suburb, by the late 1960’s had become a haven for white middle-class and working-class families. However, South Shore underwent rapid racial change due to “blockbusting” and white flight. Moving into the neighborhood were members of Chicago’s “enlarged black middle class” (Taub, 1988: 15). The community underwent decline in the midst of its racial transition. Ron Gryzwinski, a successful local banker, helped to launch an initiative for a community development corporation that could provide for community housing and economic-development needs. This plan underwent rapid evolution, and quickly became an effort to take over the declining local bank as a vehicle for community development.²⁶ Plans for widespread community involvement were shelved. Gryzwinski staked \$100,000 of his own funds to buy South Shore National Bank, found another \$700,000 in investors’ funds, including churches and foundations, and borrowed another \$2.4 million from a bank.

The bank pursued a two-pronged strategy. First, it sought to stabilize the local housing market. This involved both lending for single-family houses to the African American households that wanted to get into the neighborhood, and also providing purchase and rehabilitation loans for the area’s many multi-family housing units. For lenders, the latter are riskier because they lack a secondary market -- an organized market on which these mortgage can be sold off to other (longer-term) investors. Nonetheless, because multi-family housing was so common, financing its renewal was the key to reviving the South Shore residential market. South Shore took substantial risks in

loan pool. The scale of national costs depends on whether the program would be conducted like Model Cities -- that is, with national participation by only the cities with the most impacted areas - - or like the Community Development Block Grant (CDBG) program, which shunts funds widely to even small municipalities.

²⁶ Illinois was then a unit banking state -- that is, no commercial bank could have more than one branch. So even as a failing institution, the South Shore franchise was valuable.

multi-family lending, with outstanding results: the South Shore housing market turned around, and indeed by the mid-1980s was actively sought out by many other lenders.

The second prong of South Shore's strategy was to finance commercial revitalization. Here it undertook several initiatives, which have succeeded only partially. The bank's staff had expertise in packaging SBA (Small Business Administration) loans for local small businesses; however, these loans proved inordinately costly to make for an institution that, after all, had to at least break even to survive. In Taub's (1988) judgement, initiatives aimed at producing South Shore entrepreneurs have absorbed substantial staff time, but have not succeeded. The most notable failure in the commercial-lending area was South Shore's effort to revitalize the 71st Street shopping strip. Here overcoming storeowners' problems of credit availability were not sufficient to overcome other problems, such as: small store size and scale of operation; congestion, image, and parking problems; youths congregating on the strip; and so on. The centerpiece of South Shore's strategy was an effort to attract a national grocery store back into the neighborhood. However, the day after the bank signed loan documents to bring in an A&P store, the national parent corporation of A&P announced the closure of all its Chicago stores. When Taub wrote his assessment in the late 1980's, this strip still had only anemic business, and most stores along it were Korean or Vietnamese owned.²⁷

One other aspect of South Shore's experience deserves mention here. This institution has never been self-sufficient -- to the contrary, it has actively pursued a "greenlining" strategy. In its chairman's judgement (Grzywinski, 1991), the bank could not have succeeded by financing from below. South Shore first created a "development division" in 1974, aimed at attracting deposits from contributors to liberal causes (from outside the neighborhood). By year-end 1986, South Shore had \$119 million in deposits, of which \$46 million were "development deposits." As of that same year, South Shore's deposit base from local residents, adjusted for inflation, had apparently shrunk slightly over the 15 years of its operation.²⁸

In sum, it may be difficult to replicate South Shore's success elsewhere; further, the South Shore model is not well-suited for alleviating poverty by establishing direct financial linkages with very low-income entrepreneurs.²⁹ The success of South Shore can be attributed to three factors: its management team's willingness to take large risks on an inner-city community; the presence of a relatively sound housing supply and of a pool of potential housing demand; and the strategy of "greenlining" -- attracting deposits from outside South Shore. In the absence of a constituency of African Americans with secure middle-class jobs, the residential lending strategy would have failed. There remain numerous economic groupings in US inner cities that might become sources of housing demand; for example, Latino households in great numbers are currently purchasing homes in South Central LA. The point here, however, is that South Shore's most successful strategy -- residential lending to homeowners and apartment owners -- aims at homeowners with secure

²⁷ Another component of this plan was the formation of the Phoenix Partnership, wherein investors bought up 35 storefronts along three blocks of 71st Street and coordinated development activities so as to capture spillovers. The bank supplied \$250,000 in loan funds for this initiative between 1976 and 1981, much of which was subsequently written off.

²⁸ Taub calculates that \$38 million of original deposits would have become \$96 million by 1986 due to inflation; instead, local deposits in 1986 totalled \$73 million, a real shrinkage of 30%.

²⁹ A caveat: this interpretation of South Shore does not take into account very recent developments.

middle-income jobs, not at the poor. Its record on commercial lending is checkered. To its credit, South Shore has continued to experiment aggressively with commercial-lending and community-development programs, and has established “how to” training programs for other bankers and for activists. Nonetheless, South Shore’s hard-headed commitment to doing good (urban revitalization) by doing well (making profits) has continually placed its efforts at financing small-scale enterprise in jeopardy.

6. Financing Mechanisms and Urban Community Building

Our analysis has suggested some important contrasts between the Bangladeshi village, in which financing strategies have been so successful in attacking poverty, and the US inner city. The US inner city lacks anything like agricultural land and the agricultural cycle -- a shared labor-absorbing productive asset which offers a residual local source of livelihood. Further, the credit and labor markets are not interlinked, as in Bangladesh. Finally, the US inner city is subject to greater social and spatial separation, and hence to greater political isolation. Because of these differences the subsistence credit system operates in a more socially destructive manner in the US inner city; and the path to reform through large-scale financial intervention has opened more readily. In Bangladesh, subsistence gaps are handled through credit which is linked to future labor. While this increases the ranks of the landless over time, and leads to stagnation (Mitra, 1990), it allows the preservation of social and cultural practices. In the US inner city, by contrast, most lending to cover subsistence gaps is made only against physical collateral; and employment prospects are slim and becoming slimmer. So defaults occur at a higher rate; and households rapidly lose their net worth and social standing when they experience subsistence gaps. The inner city’s political powerlessness, reinforced by racial polarization, makes the full-scale launching of a Grameen-like initiative unlikely at present.

Limits to Financial Mechanisms. Bangladeshi and US experience teach us three lessons about the limits and uses of financial mechanisms to alleviate poverty. First, financing approaches cannot accomplish the revitalization of low-income communities on their own. Resources must be transferred into these communities -- either via governmental expenditures on needed infrastructure expenditures and/or social welfare payments; via “greenlining” practices which transfer savings to inner-city financial institutions; or via a governmental attempt to embed Grameen-like entrepreneurship among a significant percentage of the nation’s very low-income households.³⁰ To accomplish these required redistributions, ways must be found to overcome the political and economic isolation of inner-city communities; and this means developing a response to the severe racial polarization of contemporary US society.

Second, to build financial mechanisms for poverty alleviation and inner-city revitalization, it is not sufficient to put institutions like Grameen or South Shore into place; it is also necessary to address structural weaknesses in the existing formal and informal financial markets. The informal subsistence-credit system has a gap: means by which many inner-city households can build financial and non-financial savings. This gap must be closed. Further, accumulation credit is scarce for both proto-entrepreneurs and established small businesses, due to the inner city’s anemic labor

³⁰ Schlesinger (1995) has recently suggested the creation of a National Reinvestment Fund to accomplish this redistribution; he suggests that a broad class of financial institutions -- not just banks -- might capitalize this Fund. Dymski and Veitch (1996b) have, in turn, suggested the creation of a secondary-market mechanism specifically for loans made in low-income areas.

market, to bank strategic choices, to the lack of collateral, and to inner-city economic isolation. Labor-market anemia can be overcome either by the kind of resource redistributions mentioned above or by high-pressure, stimulative macroeconomic policies. The channeling of bank funds and resources out of inner cities can be slowed or stopped by continued popular pressure under the Community Reinvestment Act of 1977. These changes will, in turn, help to revive inner-city residential markets, allowing the accumulation of wealth in the value of homeowners' primary residences.

Third, while Grameen and South Shore are often mentioned in the same breath as new financial alternatives for poverty alleviation, our analysis leaves no doubt that even apart from their distinct histories, these institutions have very different structures and aims. South Shore has been immensely successful in reversing decline in an inner-city community, without catering to the very poor within its market area -- indeed, to some extent it has succeeded because it could target middle-income households in its market area. Grameen-like operations have thrived in US inner cities, but have not taken on the larger tasks of reversing overall community decline: it is not clear that entrepreneurship initiatives alone could succeed; and in any event, as discussed above, using Grameen-like institutions to tackle inner-city stagnation would entail significant costs.

The Need for Financial Mechanisms. This discussion suggests caution about whether financial strategies can revive the economic prospects of the inner city and the low-income households living there. However, this caution should not be taken to imply that financial strategies are useless or unimportant in efforts to overcome poverty and inner-city decay.

Much recent policy discussion about urban revitalization has virtually ignored financial considerations. Consider the recent plan for urban revitalization proposed by Henry Cisneros (1995), President Clinton's Secretary of Housing and Urban Development, which draws heavily on Kanter (1995) and Porter (1995). In this analysis, economic growth occurs when clusters of technologically-competent local firms form and then establish links to global firms and markets. So urban growth depends on creating or nurturing such industrial clusters. This, in turn, means: emphasizing job skills in schools and providing for the retraining of workers; cutting costs by deregulation, tax cutting (and shifting), and tax forgiveness schemes; and allowing for "bottom-up" planning by firms whose skills, connections, and ideas are "world class" (in Kanter's phrase).

The inner city, in turn, can be turned around in two ways: first, opening it up to the global market by cutting its taxes and regulations and retraining its workforce; second, by encouraging the rise of entrepreneurship in lieu of social spending. In Porter's phrase, wealth can be created instead of redistributed. But the first of these alternatives is problematic. There is little evidence that "world-class" firms would create inner-city industrial clusters; and little reason to believe that government can simultaneously cut taxes and improve services, unless it shifts the tax burden further off capital and onto labor; see Dymski (1996c). This leaves entrepreneurship. But given the lack of financial and non-financial wealth in the inner city, entrepreneurship depends on mobilizing financing; and this depends, in turn, on having a robust set of financial institutions in place. This leads us back, indeed, to the financing strategies explored herein. And to succeed, Grameen or South Shore initiatives require political will, sufficient resources (redistributed by market or government institutions), and reconstruction of financial and non-financial market structures in US inner cities. Experimentation may lead to yet new financial models for inner-city revitalization; but experiments large enough to make a difference require the political recognition that nothing worthwhile comes free, including initiatives aimed at creating wealth through market processes.

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