

Microfinance-led Strategies to Eliminate Bonded Labor

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Although poverty is prevalent in parts of South Asia, there is a dark side of poverty in the region that is only recently coming to light. Millions of workers are bonded to their employers, forced to work for substandard or no wages because their earnings are retained by the employer (or a middleman) to repay an outstanding debt.²

Caused by multiple factors—economic, social, as well as cultural—debt bondage is a complex phenomenon based on relationships of domination and alienation. But bondage can also be seen as a form of protection—in some circumstances it is not contradictory to use the term “voluntary bondage” (Genicot 2002; Servet 2003). Far from being a residue of tradition, the exploitative form remains surprisingly current and fluid: it disappears in certain sectors but reappears in others, sometimes giving rise to new hierarchies.

In 1998, the International Labour Organization (ILO) adopted the “Declaration on Fundamental Principles and Rights at Work,” under which member states have an obligation to eliminate all forms of forced labor.³ To help governments to abide by the Declaration, the ILO has established technical cooperation projects. One such initiative, the Dutch-funded “Preventing and Eliminating Bonded Labour in South Asia (PEBLISA),” began piloting integrated microfinance-led schemes in Bangladesh, India, Nepal and Pakistan in 2000. In each country the ILO has partnered with multipurpose NGOs to develop and deliver a package of services designed to *prevent* debt bondage (Bangladesh, and two sites in India: Andhra Pradesh and Tamil Nadu) or to *rehabilitate* bonded laborers that have been officially released (Nepal, Pakistan).⁴

The first step towards developing a solution to this problem is to understand the origins of bondage. Research shows that employee borrowing is typically for emergency expenses such as paying medical bills, buying food or burying a relative. Other loan purposes include social expenses like religious ceremonies and dowries, investments in one’s home or household enterprise, and vices such as drinking and gambling. But the loan itself is a symptom, not the cause. The underlying factors that contribute to bondage include:

- 1) Social exclusion, often connected to caste or tribe;

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² For a general overview, see ILO (2001). For specific research conducted in India, see Breman (2003), Byres *et al* (2003). For a specific research conducted in Pakistan, see PILER (2001).

³ There are four categories of Fundamental Principles and Rights at Work. Besides forced or compulsory labor, the Declaration also covers: 1) freedom of association and the right to collective bargaining; 2) the elimination of child labor; and 3) the elimination of discrimination in employment or occupation.

⁴ In Pakistan, India and Nepal, bonded labor is illegal. In these countries, there are policies in place for the identification, release and rehabilitation of bonded workers.

- 2) Asymmetric information, whereby illiterate workers are not aware of their rights and can be taken advantage of;
- 3) Financial and labor market monopolies, which limits the workers' employment and credit options;
- 4) Multiple roles of employers in society, which allows them to use their political influence as protection from legal enforcement; and
- 5) In-kind remuneration, which allows employers to exacerbate dependent relations and hide low wages.⁵

Given the complexity of the problem, PEBLISA employs a microfinance-led approach designed to address the causes of bonded labor. This integrated approach relies on three assumptions. First, since bondage results primarily from the inter-linkage of credit and labor markets, access to appropriate financial services is a fundamental prevention strategy. Second, microfinance is not sufficient to prevent bondage, but a group-based savings and credit delivery mechanism can be an excellent vehicle to provide other essential services for economic and social empowerment. Third, related activities should strengthen the capacity of households to generate a livelihood, contribute to the reduction of expenses that can push them into bondage, reduce their economic and social dependence on the employer, and build social capital by their inclusion in the community.

Based on field research carried out in Bangladesh, Pakistan and India, this article highlights the design issues that make financial services appropriate for the poorest segments of the population. Organized into two main sections, this paper begins with an introduction to the target populations in the three sites. The second section summarizes the main microfinance lessons in serving the most vulnerable segments of the population.

I. Vulnerability of the Target Market

This section describes the conditions of the target market for four of the ILO's partners in three regions: the National Rural Support Programme (NRSP), which works with former bonded laborers outside of Hyderabad in southern Pakistan; 2) the Society for Social Services (SSS) working with sex workers in Tangail, Bangladesh; and 3) two NGOs in Tamil Nadu, Integrated Rural Community Development Society (IRCDS) and Madras Social Service Society (MSSS), that assist laborers in rice mills and brick kilns, some of whom are in short-term forms of bondage, which is often the first step toward more severe conditions.

The Rehabilitation of Former Bonded Laborers in Pakistan

In Pakistan, one form of bondage began to emerge during the drought of the 1960s when sharecropping contracts became increasingly unfavorable to the sharecropper. The term sharecropper (*Haris*) is often used to designate people in a bondage situation (Piler 2001). In the 1980s, a process of liberating bonded families was initiated by a human rights NGO and various political parties. Almost 1,000 families were eventually transferred to camps created explicitly for this population. NRSP assists in the rehabilitation process of those families.

In the outskirts of Hyderabad, there are seven refugee camps, each containing 70 to 150 families. Some of the camps' residents were in a bondage situation for several years, others

⁵ See Daru, Churchill and Beemsterboer (2003). See also the baseline studies conducted by the ILO (full references are given at the end).

since infancy. Most of the former *Haris* worked in the agricultural sector and generally have no other skills.

Because of their personal history, residents are generally mistrustful of outside intervention. The diverse origin of the migrants—in terms of religion, caste and language—exacerbates this distrust. The camps are organized in communities relatively secluded from each other. Tensions, rivalries and conflicts make up the rhythm of everyday life. The camps' leadership is often sponsored by an external organization, political party or NGO, which played an important role in the liberation of the families. Although these leaders fulfill certain useful functions (e.g., providing access to water and electricity), nevertheless it seems that many misuse their position by regularly threatening the families.

For camp residents, health care costs, the irregularity of income and family ceremonies are the principal financial constraints. Marriage ceremonies are particularly critical; but they are extremely difficult because the persons involved are migrants and former bonded workers. Since the alliance should be between persons of the same community, the distance from one's native place is the major obstacle. The inability to honor one's social obligations and is often the first regret expressed by camp residents. This predicament breaks down family bonds and severely threatens the household's social capital.

For camp residents, the ceremonies provide a valuable source of dignity. The prospects for economic mobility are difficult if not impossible; just surviving from day to day is already a challenge. Many have seen their status fall during recent years. To marry off their children in the best circumstances—or at least under acceptable circumstances—is their only means of maintaining a certain honor and of ensuring a suitable future for their children.

To fight against child prostitution: a Bangladeshi example

With more than half of its population living below the poverty line, Bangladesh is among the poorest countries in the world. As elsewhere, prostitution has existed for centuries, although the phenomenon has expanded during recent decades. Destitution, caused by the extreme vulnerability of women and their lack of appropriate education and employment, has pushed many into prostitution or into other forms of sexual exploitation.

More than 150,000 women have become sex workers in Bangladesh, although the official statistics recognize only 9,000 (Shezhad 2002). Because of the weight of Islam and *Purdah*, prostitutes are especially ostracized, and the emergence of AIDS has exacerbated their rejection. Sex workers are generally secluded in specific neighborhoods; the brothels are like cities within a city, having their own shops and own governmental authorities. These places are the subject of regular attacks by religious fundamentalists. Once dragged into prostitution, women only rarely leave the space reserved for them.

From one woman to another, it seems that the stories repeat themselves. Some were attracted by middlemen with promises of marriage or jobs. Others were sold by their families in return for a sum of money, or simply to repay a loan of a few thousand takas (the price of a young girl varies from 7000 and 30,000 Tk⁶). Some were deserted by their husbands; prostitution was the only option they found to survive. Others grew up in the brothel and took over their mother's activity when she became undesirable.

⁶ 1 US\$= 57 Tk (January 2004)

For new arrivals, it is difficult to escape cooptation by a former sex worker (called *sardani*). The latter will give the former an advance for the first expenses, including a license, makeup, clothes, jewelry, and a bribe to the police. In exchange, the young prostitute (called *chukri*) works for free, usually for one year but sometimes longer. This constitutes one of the worst forms of bondage. Few manage to escape the system. Those who do escape pay a significant sum to the brothel committee, composed of house owners, influential *babus* (a kind of guardian attached to a specific sex worker) and *sardanis*. Under these circumstances, SSS is trying to break the bonds of dependency and hierarchy, and create lifestyle alternatives, if not for the women, at least for their children.

Rice Mills and Brick Kilns in Tiruvallur District, Tamil Nadu

Instances of bonded labor are frequently reported in brick kilns and rice mills in and around Tamil Nadu's Tiruvallur District. There are more than 500 rice mills in the district, where NGOs estimate that there are more than 1000 bonded families, some working for the same employer for two or three generations.

Most of the rice mill owners belong to a few of the dominant castes of the area and have strong political affiliations. Rice mill workers often belong to the Irular community, a scheduled tribe that was traditionally rat and snake catchers. They used to live in the forests maintained a system of mild interdependence with the neighboring villages, selling honey, wax, firewood, etc. in return for village products. Following the Forest Protection Bill of 1976, the traditional livelihood of the Irulas became illegal and most of them have been condemned to find alternative occupations.

In the rice mills, whole families live in atrocious conditions within the factories; children often work as well to help their parents meet their quotas. Their freedom of movement is highly restricted until advance is repaid (usually between Rs. 10,000 to 20,000). If allowed to go out, the worker must leave another family member in the rice mill to ensure that s/he returns. If this is violated, it results in physical and verbal abuse and harassment. The workers are psychologically traumatized and sometimes terrorized.

Perhaps even more shocking than the conditions is the workers' lack of awareness. Workers do not have any freedom, they earn almost no wage—often just a subsistence allowance for food paid in-kind—and yet they do not realize their situation. Some are even grateful to their employer since he ensures their daily survival. One of the main challenges, therefore, is to try and change their mindset, to convince them to think of the debt as a monetary payment rather than a duty.

The situation of the brick kiln workers in Tiruvallur can be considered as a milder form of bondage. Brick kiln work is seasonal, for six or seven months, until the rains come. Workers are usually brought in from poorer communities by a middleman who provides a salary advance (which was advanced to him by the kiln owner). Although the working conditions are unattractive, wages are around the poverty level.⁷ Workers are not usually managed through physical violence, and they have some freedom of movement, although the advance creates a

⁷ What we call "wage" includes the advance given at the beginning of the season, the weekly allowance received throughout the season and the balance received at the end: on average the advance represents 60 percent of the wage, the weekly allowance 35 percent and the balance at the end of the season 5 percent. Figures are preliminary results of an empirical study conducted by the French Institute of Pondicherry for the ILO and are based on a sample of 250 brick kiln workers.

moral obligation to spend the season at a specific kiln. Since they often come from dry areas, during the low season, workers typically have few other income opportunities. Consequently, their primary means for acquiring cash is to pledge their labor for the following season, launching a perpetual cycle of commitments.

Under these conditions, the ILO is partnering with IRCDS and MSSS to pursue bonded labor free zones in selected blocks in the district. The free-zone strategy involves a tripartite intervention, including a) microfinance-led services for vulnerable workers, b) efforts to persuade employers to voluntarily improve conditions and eliminate bondage, and c) legal enforcement for the worst forms of bonded labor (or for intransigent employers).

II. Lessons for Microfinance

The conditions for many of these workers, or survivors, seem quite hopeless. Efforts to provide support often encounter significant obstacles, either by those who benefit from the current system—such as the owners of brick kilns and rice mills, and the leadership of the brothels and camps—or by the intended beneficiaries themselves. As the entry point for other activities, and as a critical service in the prevention of debt bondage, this section reviews some initial lessons about the extension of microfinance to the poorest of the poor.

Ancillary Services

Microfinance alone will not solve debt bondage. So the first point about microfinance for the poorest is that it must be combined with complementary non-financial services to achieve sustainable poverty reduction. The target population has been regularly exploited, deceived and abused. Significant efforts must first be made to build up their trust and confidence in the organization, but not create a new dependence. If the dependent relationship merely switches from the employer to the NGO, the organization has not succeeded. The workers will remain vulnerable to the next employer or middleman who appears to be offering a better deal.

Social empowerment initiatives are provided to the groups based on the premise that the process of functioning within a group will raise members' confidence, contribute to the empowerment of target families, and facilitate collective action. Without a certain level of bargaining power, discrimination and exploitation will prevail. Without social awareness and financial education, unproductive expenditures (e.g., ceremonies, dowry, and alcohol) will continue to offset any increase in income.

To address these issues, the ILO's partners rely on two main approaches: learning conversations and participatory rural appraisal (PRA) tools. Learning conversations are based on real stories that illustrate the daily problems faced by the participants, such as the cost of marriage, the risks of over-indebtedness, the consequences of illiteracy, and the conflicts among communities (see Box 1). Sometimes, participants themselves tell their own stories. Discussions about the story serve several purposes:

- To help participants to become aware of a specific problem;
- To collectively solve a specific problem faced by one of the member;
- To reinforce cohesion among the members group and enable them to take; and
- To take collective action, thus increasing their bargaining power.

Box 1: Learning Conversation regarding Collective Action

Vettaikara Colony is a small habitation inhabited by the people belonging to scheduled tribes mainly Kattunayakans. They live on the banks of the village lake as they were considered as the untouchables by the other caste in the village. There are 52 families in this habitation. Lack of drinking water, link roads, housing, and education facilities for the children are the major problems encountered by them. Though they live in this location for few decades, they could never solve their **drinking water problem**. They were not allowed by the high castes to fetch water from the irrigation wells and the common drinking water well in the main village.

The formation of 2 savings and credit groups (SCGs) with 32 families helped them to have critical awareness of their problems. Through the training programmes they received awareness and the ways and means of solving the existing problems. In the beginning, both the groups joined together and passed a resolution and submitted to the Panchayath President which was turned down. Even though they had demonstrations and repeated representations they couldn't get it solved.

As a next stage, they met the Block Development Officer (BDO) and presented their case, but this was also turned down by the BDO as they were minority. Despite the continuous failures, the SCG members tried again to represent the matter to the District Collector. All SCG members and their husbands met the Collector and elaborated all their hardships faced due to drinking water problem.

Seeing the plight of the minority, the Collector ordered immediate study and implementation of drinking water scheme for Vettaikara Colony. But the Panchayath showed different attitude towards the villagers and erected bore well in a half hazard manner without reaching the water table, though Collector had ordered a very deep bore well. In the meantime the Panchayath officials also played a cunning role to divide the community by providing alcohol to some of the husbands of the SCG members. But all the 42 women stood together and met the District Collector once again and represented the matter and brought the Collector himself to the village. After verification, he ordered the Panchayath Presidents to deepen the Bore Well up to 115 feet and provide pump set and over head tank within 3 months.

Now, the Vettaikara Colony enjoys good drinking water and their collective action has given fruits.

This case was developed by MSSS from Tamil Nadu.

The PRA tools are used to help participants understand household budgeting and planning, to prepare for seasonal fluctuations by setting aside more savings during periods with net incomes, and to identify "leakages" where funds are not spent wisely. In Tamil Nadu, MSSS and IRCDS have involved men in the PRA activities. As a consequence, the women have reported substantial shifts in the men's behavior, including greater participation in housework and income-generating activities, and less time and money spent on gambling and alcohol.

Complementing the social empowerment activities, the organizations also offer vocational and entrepreneurial training for economic empowerment based on thorough research of market opportunities for alternative livelihoods. For the workers in the brothels, brick kilns and rice mills, this intervention is intended to reduce their dependence on the employer or the brothel leadership through alternative sources of income. For the former *Haris*, this intervention helps them to start over by initiating primary and secondary income sources.

As with all integrated programs, the design of PEBLISA has some important challenges, not the least of which is the coordination of diverse activities. To ensure that activities do not take place in isolation, the project uses the savings and credit group as the focal point or

wheel hub to which all interventions are linked. There are, however, limits to the group approach, especially among persons who are strongly distrustful of others. For many of the sex workers and the former *Haris* in particular, since they have been dislocated from their social networks, it is necessary to consider some services on an individual basis.

Diverse Financial Services

Mainstream microfinance products are not designed to respond to the needs of the poorest, such as those targeted by PEBLISA. Together with its implementing partners, the project seeks to develop a package of financial services that addresses the specific characteristics of the target group, with particular attention to the household's cash flow and its vulnerability to risks. Besides assistance in starting alternative livelihoods, households vulnerable to bondage need financial services such as savings and emergency loans to smooth income and expenses, manage risks, and possibly pay for social obligations—in essence, creating a substitute or replacing the need for employer credit.

Savings

For persons vulnerable to debt bondage, it is somewhat incongruent to give them a loan and put them (further) into debt. Consequently the project prioritizes savings and asset building to create a buffer to fall back on if the household experiences an economic shock. The most appropriate product is contractual savings, which is offered along with financial education and counseling. By assisting the household to identify expected income and expenses, it is possible to highlight the need to curtail some expenses while saving up money for future lump sum needs, such as home improvement, school fees, or religious ceremonies.

A typical argument against a savings-led strategy for the poorest is that, if they do not have sufficient funds to pay for food, how they can possibly save money? In fact, the majority of the target population does save in some way, whether it is cash kept at home or given to a trusted person, or purchasing assets such as small livestock, jewelry and crockery. These savings practices have many limitations: a) they lack of security: how to find a safe place, free from theft (including theft from family members), fires and floods; b) they are vulnerable to temptation: people are very aware of their weaknesses and the fact cash burns their fingers; c) they may not be sufficiently liquid, in the case of assets, or if liquidated in haste they may not fetch their true value; and d) they are vulnerable to requests from family and friends, or in the case of the sex workers, from officials and the brothel's leadership.

To overcome these challenges, organizations need to find a way to encourage regular and frequent savings without significant transaction costs; they need to create savings opportunities so that on those occasions when today's income exceeds today's expenditures, the clients can put the money aside; and they need to balance liquidity and security.

For the sex workers, SSS has set up a daily savings collection point just outside the brothel to allow the women to safeguard their cash (and jewelry). This facility provides protection against extortion (since they do not keep money with them), and the opportunity to withdraw for urgent needs. The distance seems ideal for balancing their liquidity needs with a disciplinary mechanism obliging them to save. For the poorest women, this new form of saving represents a survival net more than anything else. Even if the amounts remain limited, the act of saving enables them to consider what seemed completely unattainable: for them, or at least for their daughters, to quit prostitution.

Initiating the savings service was not easy. The majority of women have been deceived, swindled and misled many times. To overcome their reluctance, SSS staff invested heavily in forging personal relationships with the women as individuals, understanding their personal histories. SSS also switched from group to individual savings to provide confidentiality to each woman's finances. By providing complementary services—in particular, the boarding and training centre for the children—SSS has demonstrated its trustworthiness. The fact that a number of women came spontaneously to deposit their jewelry following an extortion threat says a lot about the quality of the rapport.

This savings approach works for SSS because the target population is all housed within the brothel compound, so there is a natural economy of scale. In contrast, NRSP in Pakistan and both partners in Tamil Nadu, IRCDS and MSSS, have developed an alternative strategy for promoting daily savings without the costs of daily transactions. All three organizations provide participants with lock boxes into which clients place little bits of extra cash from time-to-time, and then deposit the contents into the group's account on a weekly, fortnightly or monthly basis.

For the *Haris*, this approach represented an adaptation of an existing informal system in which people saved in a clay pot. In contrast to the pot, which needs to be broken to access funds, the metal box balances liquidity and security. The locked box is kept at home, and every two weeks NRSP staff open the boxes and give savers the choice between withdrawing their savings or transferring them to a bank account. At the same time, the staff provides financial advice to promote two objectives: to convince the clients of the usefulness of saving, even if it amounts only to one rupee a day; and to help them to analyze their income and their expenses and to budget for future needs. This arrangement provides a secure and convenient place and encourages people to save *regularly*. The fact that the savings facility is private prevents a public airing of intra-family inequalities. Certain people, mostly women, explain very clearly that from now on they have the chance to develop their own projects.

The lock boxes in Tamil Nadu were introduced as an experiment to see what effect they might have on people's savings practices. The results were quite dramatic, with households increasing their savings by an average of 250 percent over the fixed savings amount previously required by the groups. Several factors account for this increase. First, previously members were only bringing savings that they had set aside from the previous days to the group meeting, but the box enables them to easily set aside a little bit every day. Second, the boxes were placed in positions of honor in the household, for example near the portraits of gods and goddesses in Hindu households (which also reduces the risk of theft). To promote savings, the boxes were decorated with slogans, such "drop by drop, we fill the ocean." Finally all members of the household were encouraged to contribute to the savings, which persuaded some husbands to cut back on drinking and increase savings.⁸

This last observation prompted the partners in Tamil Nadu to take the experiment one step further and introduce men's savings groups. Actually the strategy to form men's groups (although not necessarily savings groups) was initially conceived because it was determined that men decide whether or not the family should borrow from the employers, therefore precipitating bondage. Consequently, to prevent bondage, the social awareness messages

⁸ The Tamil Nadu NGOs also experimented with different approaches to managing the keys for the boxes. Some groups wanted the NGO to keep the keys, others wanted the group leaders to keep the keys in the trunk box (which contains all the records and savings of the group), while others wanted to keep the keys themselves. Thus far, no significant differences have emerged between the savings behaviors among these three different approaches.

needed to be conveyed not just to the women, but also to their spouses. Research on household expenditures showed that men controlled a significant percentage of the income for their personal expenses (such as alcohol), while women controlled the budget, often a smaller budget, for the household, particularly food.⁹ The combination of these observations led MSSS and IRCDS to use savings mobilization for large expenditures, such as marriage, house construction and education, as the primary purpose of the groups, and to use that opportunity to convey appropriate awareness raising messages. Although the emergence of these groups is only a few months old, the results thus far in terms of attendance, savings mobilization and reduced expenditures have been very promising.

Table 1. Innovative Savings Services

	Individual Savings (Bangladesh)	Individual Dump Box (Pakistan and Tamil Nadu)	Men's Groups (Tamil Nadu)
Target population	Sex workers	Mainly Haris (Pakistan); persons vulnerable to bondage or in mild forms of bondage (Tamil Nadu)	Men who are vulnerable to bondage or in mild forms
Individual or collective	Individual	Individual or family dump box	Family and group savings
Compulsory/voluntary	Min 10 Tk per week (in practice more flexible)	Min 15 Rs fortnightly (in practice more flexible)	Fixed as per the group decision
Period of collection	Office time	Anytime (the box is kept at home)	1 x per month
Place of collection	Office (20 m from the brothel)	Locked box kept at home Boxes are opened weekly or fortnightly by the staff: cash is withdrawn or transferred to a bank account	Group meeting
Deposit/security	NGO's bank account	Into a group bank account	Into a group bank account
Withdrawal options	Any time during office hours	Fortnightly	Only at the end of agreed term (although loans against savings is possible in an emergency)

Income-generating Loans

To serve high risk clients with irregular and unpredictable income flows, the basic microenterprise or income-generating loan requires a fresh look to ensure that it does not put clients in a situation that could actually make them worse off, yet finds a way to balance repayment discipline with a concern for the clients' vulnerability.

With typical microfinance customers, MFIs are very strict, following up immediately when clients miss a repayment. Persons with less than perfect repayment records may lose access to future loans. This approach is considered necessary because the loans are unsecured; tight delinquency management is effectively a collateral substitute. Furthermore, in some group lending methodologies groups impose their own sanctions on struggling members, perhaps seizing assets from them and removing them from the group at the end of the loan term.

⁹ Numerous literature exists on that topic. For a literature review, see Guérin 2000.

With persons vulnerable to bondage, a hard-line commitment to repayments would invariably cause more damage than good. But would a soft approach be more effective? Regardless of the client's poverty level, if the MFI does not take repayments seriously, borrowers certainly will not either. Consequently, PEBLISA strives to cultivate a 'tough-love' approach to repayments in which carrots greatly outweigh sticks—although sticks are still there—with lots of chances for redemption as long as the problem clearly stems from an inability, rather than an unwillingness, to repay. Some important elements to this approach include:

- *Financial education*: A trusting relationship between lender and borrower is critical so that the latter is willing to fully disclose information about the household's cash flow, including other outstanding debts and repayment requirements. Accurate information is important to engage in an effective discussion about how much the household can afford to borrow, but it also helps to illustrate borrowing and expenditure patterns that are not sustainable, which are bound to lead to bondage.
- *Cautious beginnings*: With this target market, lenders need to take great care that they are not setting up their borrowers to fail. Loan sizes need to start smaller and increase gradually. A loan analysis should ensure that the household will have the capacity to repay even if the business venture fails (or if the household chooses to use the loan for other purposes).
- *Incentives*: As with regular microfinance, if clients regularly repay on time they get access to larger loans and better terms. In addition, NRSP, for example, offers supplementary loans to clients in good standing. The intention is to develop mechanisms that rest more on rewards than on sanctions.
- *Tailored repayment schedules*: The lender and borrower will also jointly establish a customized repayment schedule that mirrors the household's expected cash flow. For the clients of SSS, for example, repayments are often made in larger, lump sums that correspond to the sex workers' cash flow. Customized repayments are particularly needed for the poorest households because they have fewer sources of income, and smaller cash buffers, so they are less able to patch together the regular, equal installment amounts required by most MFIs.
- *Repayment holidays*: Although this has not been formalized, both NRSP and SSS allow clients to skip a certain number of payments during the loan term so they can make adjustments when they have unexpected cash flow problems.
- *Ancillary services*: Although the primary motivation is not to reduce credit risk, non-financial services play an important factor in maintaining portfolio quality. For example, NRSP offers subsidized health care services and has provided flood relief. For MSSS's livestock loans, the organization has a partnership with an insurance company to repay the loan if the animal dies; for its other income generating loans, if the borrower dies the loan is written off and the beneficiary receives Rs. 20,000 for a natural death and Rs. 50,000 for an accidental death. This latter scheme, partly subsidized by the government, also provides an educational grant of Rs. 100 per month for students in classes 9 through 12. For the sex workers, the boarding and training centre for the children also plays a key role: for many women, it is the only way to provide a future for their children apart from prostitution.
- *Open discussion about rescheduling loans*: Perhaps the most controversial aspect of the project's alternative repayment culture is to initiate discussions about the MFI's rescheduling and refinancing policies even before clients receive a loan. Not all partners are willing to explain that possibility upfront, but all are willing to consider

rescheduling (though not refinancing) in clear cases of need. The intention is to avoid pushing clients to the moneylender or to employers for loans. Although it is too soon to know whether this will work, the idea is that lenders should emphasize the huge upside of establishing a positive credit history while communicating that the organization will assist clients who experience unforeseen problems during the loan term. The key to the success, if it does succeed, is open communication in which clients are completely honest with the MFI regarding their household finances, before and throughout the loan term, which allows the MFI to make informed decisions regarding rescheduling, or perhaps even refinancing loans.

- *Establish benchmarks for vulnerable clients:* Since PEBLISA is working with seven financial service providers in four countries that all target a similar type of client, it is in the unique situation of being able to establish portfolio quality benchmarks that are appropriate for the most vulnerable clients. It is expected that the 5 percent portfolio at risk (30 days past due) commonly used by MFIs may not be appropriate for this market, but only after tracking this information over time will it be possible to say whether the benchmark should be 10 percent or 30 percent.

Table 2. Income-generating Loans

	NRSP	SSS	MSSS and IRCDS
Average amount	\$ 60	Depends on the purpose; from \$87 to \$350	Internal loans \$25, External loans \$65
Period	12 months	12 months	Internal loans, max 5 months External loans, 1 year
Repayment	12 monthly installments	12 monthly installments	Internal loans, weekly, fortnightly or monthly-- whichever is most convenient
Interest rate	20% (declining balance)	15% per annum	Internal loans 24% p.a. (half of the interest stays with the group)
Conditions	9 months in the camp; minimum saving (10%); 3 guarantors; appraisal	Minimum saving (10%); Meeting attendance (75% of the members should be present) In practice, the staff is more flexible	Attendance and savings practices of the group
Cumulative amount		\$19,298	
Outstanding amount	\$7600	\$6614	External loans \$16,560
Number of loans	126	111	Internal loans 2657 External loans 342
Use in theory	Enterprise development (56%), livestock (44%)	Trade (33%), livestock (11%), housing (44%), debt consolidation (8%), others (4%)	Internal loans: emergencies, debt consolidation, IG activities, ceremonies External loans: IG activities
Use in practice	According to our observations, 1/3 use loans for social purposes	A small part is used for social purposes	Same
Portfolio quality	Portfolio at risk 0% (1 year) Portfolio in arrear 19% (3 months)	Portfolio at risk 9% (1 year) Portfolio in arrear 32% (1 month)	Internal loans 5% PAR (30 days) External loans 1% PAR (30 days)

Emergency Loans

One of the more important services for vulnerable clients is an emergency loan, perhaps in parallel with an income-generating loan, which they can access if they experience a severe cash flow problem. While the income-generating loan is intended to reduce families' economic dependency on the employer, emergency loans are designed to partially replace employer credit.¹⁰

In Tamil Nadu, this service is provided through the self help group, which lends out its savings to members in need. While this approach is reasonably effective in controlling credit risk and screening out inappropriate loan usage, there are two important constraints. First, loan amounts are limited by the quantity of group savings so only very small loans are available to one or two people at a time. IRCDS and MSSS have addressed this problem by partly capitalizing the internal account on a declining basis, i.e., once the savings reaches certain benchmarks, the SHG has to repay a portion of the capital. The second constraint is that loans are usually only available during group meetings, which is not sufficiently responsive for some emergencies. To address this problem, the organizations encourage their SHGs to keep a balance in the group's trunk box, which can be loaned out in emergency situations with approval from three of the group's officers (or 50 percent of the members).

What constitutes an emergency need depends on the local expectations. For the poorest, the repayment of old debts can relieve them of a significant financial burden (e.g., interest as high as 10 percent per day) as well as alleviate a moral weight, including verbal, physical, and sexual violence. Consequently, IRCDS is beginning to experiment with a debt consolidation loan specifically intended to help households manage their debt better and more cost effectively.

III. Conclusions

When people first hear about bonded labor, they assume that the workers are chained or kept captive physically. In fact, that is not usually the case, but instead they are held captive psychologically by their obligation to repay the advance. Consequently, a solution to the problem must look beyond the economics and explore social and psychological issues—the mindset must be changed before the worker can become truly liberated.

All of the innovations, flexibility, and handholding required to provide microfinance-led services to persons vulnerable to bonded labor means that these services are not likely to ever cover the full cost of delivery. This reality requires the microfinance industry to re-evaluate its attitude toward subsidies and assess under what circumstances, and in what fashion, subsidies might be appropriate. The conditions of the poorest require a qualitatively different approach in all aspects.

Besides determining what services are needed and for how long, one of the PEBLISA's objectives is to ascertain the average subsidy needed to move a family out of extreme poverty and vulnerability to bondage. With this information, and with evidence to show that the models succeed in making this transformation, the project will be able to make informed policy recommendations to eradicate bonded labor in the region. This point is important because this is an action research project intended to create demonstration models from which lessons could be learned and applied on a large scale.

¹⁰ For more details see Churchill (2003).

It is premature to assess the impact of the project, but anecdotal evidence provides some insights. Certain clients, in particular those who were already economically active, clearly improved their situation. The simple fact of being released from the dependency on wholesalers improves their profitability. Some clients have upgraded their situation, either because they have started or improved a business, or because they have managed to diversify their activity.

Thanks to the savings, one also observes the materialization of long term projects, including both professional (opening a grocery, buying cattle) as well as familial (marriage). For the sex workers, the act of saving provides them with hope, if not for themselves, at least for their daughters. For the rice mill and brick kiln workers, not only has savings allowing them to plan for the future, but that process is beginning to improve gender roles and responsibilities.

Some participants have not improved their situation, but at least they have succeeded in stopping the process of degradation. They may have used their “income-generating” loan to buy food or health care services, to pay for ceremonial expenses, or to consolidating other loans. While these may appear to be unproductive purposes, the families may have succeeded in avoiding a seasonal migration, or have been able to keep children in school. These can be seen as constructive results even if they have not yet resulted in net increases in the household’s income.

Along with a few success stories, there are nevertheless a number of failures. Even among the poorest of the poor, some are more vulnerable than others. One of the main differences is that the most vulnerable lack social capital, which is necessary for a number of reasons, including finding employment, receiving assistance in a time of need, having the strength to negotiate with employers and others, and avoiding harassment by officials. Since participation in religious ceremonies and inter-household assistance is an important strategy for building social capital, external interventions should actively encourage activities that allow them to build social capital. Participation in savings and credit groups is certainly a start, but additional consideration is required to find other ways to accumulate social capital.

Regarding field-based interventions, the prevention of debt bondage requires an integrated approach, combining microfinance along with social awareness and skills training, to tackle both trigger and root causes. A menu of appropriate financial services needs to be developed to cater to the specific characteristics of persons vulnerable to bondage, with a strong emphasis on savings. Finally, the use of microfinance to prevent bonded labor requires a new approach regarding repayment culture and sustainability. While numerous debates are taking place today regarding the role of microfinance with the poorest,¹¹ lessons from this project may enrich the discussion by giving practical examples.

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¹¹ For a summary of the different positions, see Fernando 2004.

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