

## CREDIT AS A TOOL IN THE PROMOTION OF IMTs

### Clarity on Credit

Clarity about the role of credit in helping people to acquire IMTs is of primary importance. The financial viability of a credit service hinges on this clarity of purpose. If, for example, some form of credit service is established but is subverted by some high-order goal (such as simply the sheer numbers of IMTs distributed), loans can rapidly be written off as grants and the viability of the service placed immediately at risk. In this context and as noted above, the test of appropriateness of an IMT is not just its engineering and technical performance but its affordability, with or without viable credit services, under real conditions. The risks of assigning lower priority to the viability of credit services are illustrated in box 12.

*Benefits justifying credit for IMTs.* The question for the designer/planner is whether the value of benefits derived from investments in IMTs are likely to outweigh the opportunity costs of the funds involved (in terms of capital funds from credit services as well as repayment obligations in the perception of borrowers). For example, if high rates of return can be projected for investments in transportation infrastructure, they may justify providing funds to relieve second-order obstacles to the wider use of IMTs, such as low purchasing power precluding spontaneous "off the shelf" purchases. In other words, if the infrastructure is there, if production and marketing opportunities exist to be exploited, but if the residual problem is the unaffordability of IMTs from current income, credit support may be a legitimate way of lubricating the system to realize the full range of potential benefits. On the other hand, expecting rural households to incur cash expenditures on IMTs-albeit through credit-purely, for example, to relieve the drudgery of women's workload may be unrealistic. Some financial payoff will have to come from IMT use by devoting the time and effort saved to some more productive activity.

### Options in the Provision of Credit

The two cost categories that have most often been underestimated in the design of credit services for extensive but small loans are commercial risk and administration. Indeed, given the riskiness of extensive lending to an untested clientele, the high transaction costs in small-scale lending to spatially dispersed borrowers, the lack of collateral among borrowers, and sometimes interest rate restrictions driven by policy, it is not surprising that mainstream commercial financial services rarely venture into this territory. These issues need rigorous attention in credit service design. Four broad options are reviewed below.

*Publicly owned credit services.* This option is not recommended. Such services tend to suffer all of the problems that have dogged other state-owned commercial enterprises,

including high civil service employment costs, overstaffing, lack of commercial discipline, rent-seeking and "queuing" costs owing to credit subsidies, and high costs associated with the monitoring and supervision of small loans. Beyond these problems, experience has shown that negative peer group pressure can actually occur among borrowers who fail to see any individual or collective responsibility to repay loans issued by the government.

*Commercial targeted credit services.* Experience in using commercial financial institutions to serve a target clientele have shown mixed results but on balance are also generally not recommended. Although their staff costs have been lower, their earnings have generally not covered loan appraisal costs. They cannot usually apply their collateral and business plan requirements in appraising loan applications; even when collateral has been provided, it has sometimes been politically unacceptable to foreclose on bad debts.

*NGOs and semiformal organizations.* Credit services provided by NGOs and semiformal organizations have kept administrative costs in check, some relying on low paid or semivoluntary field workers to maintain their presence at the village level. Nevertheless, startup costs can be high and the contradiction between welfare objectives and commercial viability in providing credit can lead to loan loss problems. To minimize the need for a staff-intensive system of credit supervision, many NGOs have adopted the joint liability group lending approach. This relies on peer pressure to maintain credit discipline. It works best, however, only when borrowers rely on continuing access to new credit (for example, on an annual basis), hence, the need to maintain repayment performance throughout the group to preserve collective entitlement for future loans. These mechanisms may be difficult to apply to "one-off" lending for the acquisition of IMTs requiring sizable investments for which repayment periods will be correspondingly longer.

*Traditional credit mechanisms.* Reliance on existing informal credit mechanisms through local moneylenders, traders, and the like has so far been more studied and discussed than implemented. Providing additional funds to these entrepreneurs would entail virtually no administrative costs. Moreover, because borrowers often depend fundamentally on moneylenders and traders, such traditional services are likely to show healthy rates of recovery. Two main potential drawbacks to such an approach exist. First, in view of the often high interest rates demanded (up to 20 percent per month in South Asia, for example), endorsing what may be seen as the usurious practices of those who are already regarded as having too much economic power at the local level by giving them access to additional external funds that make them still better off risks political unacceptability. Second, it may be difficult to monitor the end use of loan funds to ensure that they go toward the desired end of promoting the use of IMTs.

Source: World Bank. 1996. *Promoting Intermediate Means of Transport*. SSATP Working Paper No. 20. Africa Regional Office, Knowledge Information and Technical Center, Washington, DC, pp. 35-37.

To Learn More:

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