

1. Introduction

Social capital is a concept which entered the arena of social science in the early 1990s and has become a broadly researched topic by social scientists. What makes the notion of social capital so appealing? Perhaps it is because the concept seems to help explain various social and economic phenomena, hitherto poorly explained by other theories. For the purposes of this study, the approach was to explore the concept of social capital from the perspective of microfinance and study the link between microfinance provision and social capital.

This article begins by examining the links between social networks, poverty and the process of transition in Central and Eastern Europe and continues by reviewing the body of literature on social capital in relation to microfinance. The main aim of this article, however, is to present the design, hypotheses and results of the Wider Impact Study, conducted by three microfinance organisations (MFOs): the Integra Foundation in Slovakia; the FORA Fund in Russia; and Integra Romania, as part of the *Imp-Act* programme. This study was a pilot attempt to assess the contribution of microfinance to community-building and political participation, with a view to designing an instrument which might be useful for the monitoring systems of MFOs. The final section of this article provides general conclusions derived from the survey, and poses some policy implications that can be useful for microfinance institutions.

2. Social networks, poverty and transition in Central and Eastern Europe

The region of Central and Eastern Europe and Russia, for almost 15 years, has been undergoing a process of transition from communism to democracy, from centrally planned to free-market economy. This transition has in many cases not been smooth and each country, having embarked on its process of *perestroika*, has been facing different problems. The role of informal social groups has been important and even essential, both in the process of poverty reduction and in the associated process of democratisation.

In the period following the process of *perestroika*, according to Rose, Mishler and Haerpfer (1997),

11. Microfinance, Social Capital Formation and Political Development in Russia and Eastern Europe

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Russia has developed a so-called “hour-glass society”, characterised by a rich social life at the base, consisting of strong informal networks based on trust between friends, relatives and other face-to-face groups. At the top of the hour-glass, a separate political and social life has developed, as elites of the *nomenklaturas* have competed for power, wealth and prestige. Rose and colleagues go on to argue that in this way the Soviet and, in a more muted way, the other former communist states of Eastern Europe left a double legacy: individual citizens are likely to have a high degree of trust in their immediate social networks, and a high degree of distrust, in even reformed states. In this climate, far more people rely on informal networks than on the formal institutions of the state to deal with their problems, in particular as a source of social security. Two-thirds of Russians say that they have a friend who could lend them up to a week’s wages if their household was short of money, and more than two-thirds know someone who would help if they were ill (Rose *et al.* 1997).

During the transition period, however, both formal and informal networks have undergone a process of transformation. Old networks have disintegrated and new ones have been formed. The natural consequence of the process of the decomposition of the previously existing networks, as Rose *et al.* (1997) points out, is that a significant proportion of the population has been left out of formal social networks. Those excluded, lacking the right social connections, actually constitute a core of a new social class in the transition economies: the “new poor”. According to a recent World Bank report one of the predominant characteristics of the new poor, in addition to general characteristics such as a good level of education, is the destruction of accustomed social patterns and, subsequently, lack of connections:

Driven into isolation by poverty and shame, the poor lack the resources to maintain important social contacts. They find themselves increasingly cut off from informal supports at the very moment when unusually sharp competition over access to jobs, assets, and other resources have made ‘connections’ more important than ever (2000a: 33).

3. Social capital and microfinance

The idea that social institutions can be economically productive is frequently embodied in the notion of social capital. The World Bank defines this (2000b) as ‘the ability of individuals to increase their well-being through involvement in social networks’. As originally demonstrated by Putnam’s study of Northern and Southern Italy (1993) and subsequently by a range of cross-country econometric studies such as that by Temple and Johnson (1998), the return on social capital can indeed be very significant. In acknowledging that social capital is important, we also have to acknowledge that altruism and reciprocal obligation within communities are significant, rather than only the pursuit of individual gain (Bowles and Gintis 2002).

Currently there is no general consensus among social scientists about what social capital actually is or how it can be measured (Durlauf 2002: 417). In particular, within the social capital industry there is ongoing debate between definitions of social capital that are based on community and those that are based on trust. However, the focus of this article is not to rehearse these debates, but rather to use all of the most widely acknowledged social capital indicators: trust, voluntary involvement, and political participation as a ground for our discourse about the relationship between social capital and microfinance. These understandings of social capital were also used for the purposes of the survey, detailed below.

Even if it is now widely accepted that social capital is important, there is much less agreement on how to create or develop it. Of the various instruments by which the social capital objective may be promoted, microfinance – loans to very small businesses whose operators are too poor to be able to put up collateral – is one of the most attractive. Microfinance is potentially a very powerful tool in Russia and Eastern Europe, where the social costs of transition, discussed earlier, have been particularly severe. Poverty levels in Russia have risen from insignificant levels prior to the transition period to as much as 40 per cent, depending on which poverty measure is taken, at the turn of the millennium. Inequality has also increased dramatically, rising, over the same period, from one of the lowest levels in the world

Table 1: Research design

TREATMENT GROUP				
	Russia	Romania	Slovakia	Total
Group clients	163	0	32	195
Individual clients	20	50	14	84
<i>Total:</i>	183	50	46	279

CONTROL GROUP				
	Russia	Romania	Slovakia	Total
Just-accepted clients or current loan applicants	11	12	0	23
Training clients (SK, RO)/ non-clients (RU)	13	12	41	66
Non-client entrepreneurs/ just-accepted clients	41	24	24	89

to a level greater than in the United States (Brainerd 1998).

The strategies adopted by international financial institutions to correct this state of affairs rely heavily on reforms in transparency and social inclusiveness, and within this general heading the role assigned to microfinance is to overcome the social and political exclusion of the poor, and specifically poor women – directly, by addressing their financial exclusion, and indirectly, by creating a more open financial market at the bottom end which limits the adverse impacts of corruption on business. It is hoped that these positive changes may eventually lead to broader-based political participation. These effects are far broader in scope than those commonly expected of microfinance, which relate principally to the well-being of the client household. For that very reason, they form a valuable proving-ground for the *Imp-Act* programme's attempt to assess wider impacts of microfinance – impacts which go beyond the client household.

4. Wider impact study: design and hypotheses

There is still little formal analysis of forms of social capital created through access to microfinance. The survey conducted by Integra aimed, therefore, to investigate links between social capital and microfinance in an experimental way. The study focused on 279 clients (for details on research design see Table 1) from three microfinance institutions: the FORA Fund in Russia, the Integra Foundation in Slovakia, and HIRO (currently renamed Integra Romania) in Romania – three out of a number of micro-lending initiatives that have become established in the course of the 1990s in this region.

The FORA Fund is sponsored by the international NGO Opportunity International, and the Integra Foundation is an NGO founded in Slovakia in 1995, which, together with its partner agency, Integra Romania, is a member of the Integra Venture network of socio-economic agencies operating in several post-communist countries.

Both FORA and the Foundation organisations provide a mixture of individual and group credit, while Integra Romania only provides individual credit. In FORA, groups are not of fixed size and may expand organically to take in new members – a process that, as will be shown in this article, is often controversial. In terms of the overt objectives stated in their publicity material, FORA puts more emphasis on quick, easily-accessible credit to the micro-business sector and Integra on the social objectives of corruption control and credit to the socially excluded, especially women at risk and other marginalised groups.

In all three organisations, a questionnaire was applied to a clustered sample of borrowers intended to be representative of the programme as a whole, and interviews were conducted on individuals who either constituted “outliers” from the regressions or for whatever reason appeared likely to yield interesting insights about patterns of causation. Using both methods, the approach taken was to examine the main linkages between microfinance and the measures of social capital – trust, voluntary involvement, use of available informational resources, and political participation – that we have identified as the most relevant for the purpose of our study. The focus, as discussed earlier, was on the ability of policy and microfinance design features to influence these social capital indicators.

The working hypothesis from which we began was that microfinance influences social capital through three channels:

1. By encouraging mutual trust and dependence within borrower groups, in those cases where that is the loan modality used. This is known as bonding social capital within the borrower’s immediate reference group.
2. By providing an alternative to existing and sometimes corrupt channels of supply of financial services. This is referred to as bridging social capital between the microfinance client and an organisation above him in the organisational hierarchy.
3. By setting up support services and organisations which encourage association

between citizens, including the financing of community resources such as child care, transport, and legal/benefit advice centres, and in some cases explicit participation in the political process. This is known as linking social capital between the client’s immediate reference group and other groups.

4.1 Wider impact study: results

From the quantitative analysis of the data, it appears that microfinance has only relatively small apparent impacts on formal associational membership, although this varies between countries – for example, Romania had the lowest level of formal associational membership, and Slovakia the highest and most varied level of reported involvement. However, it became apparent during the study that the links which mattered were not so much membership of the formal associations, but rather the informal defensive links within the community at the ‘bottom of the hour-glass’ described by Rose *et al.* (1997). Links within solidarity groups, as nurtured by both FORA and Integra, are a special case of these, but many informal ties were also formed by individual clients, and it is very important to emphasise that, for both group and individual clients, the scope of “social capital” goes beyond membership of borrower groups.

The interviews conducted for the study revealed interesting details about how these relationships developed. Clients from one of the groups interviewed in Novgorod (Russia) – all women who sold lingerie in the marketplace – formed an informal support group in 1991 when their husbands lost their jobs. They went to FORA for a loan much later, when the group was already mature.

In another case, a woman started a group after she was divorced from her husband, and then became unemployed. Her account shows the degree of selectivity involved in forming the group:

I went to Moscow, bought some second-hand clothes in the market and sold them locally. In those days (sc. 1993–4) it was much easier, because most local authority staff had no idea how to regulate. I gathered a group around me,

Table 3: Influence of microfinance on access to and relations with other organisations

Awareness of government support programmes:	Russia		Slovakia		Romania	
	Treatment group	Control group	Treatment group	Control group	Treatment group	Control group
Does MF affect your access to other government organisations supporting entrepreneurs?	4%	0	13%	54.2%	4	0
Does your cooperation with MFOs help you to improve relations with other organisations?	6%	0	15.2%	20.8%	42.0%	33%

Source: 2002 Wider Impact Survey.

using as a criterion the people who had lasted in the market place for a long time. One group member fell into arrears and others had to pay her share so she was eventually excluded from the group. You can see in people's eyes whether they can be trusted or not. (Interviews, Borisoglebsk, Southern Russia, 11 September 2002).

To summarise, microfinance was found to have little impact on patterns of formal association in our samples. It has a substantial impact on patterns of informal association, although what it does is often to provide financial support to social networks which are already mature, such as the ones described above. These informal associations sometimes expand into supplementary forms of social action, and into linkage with state organisations. One of the key functions of microfinance appears to be the indirect function of nurturing these links.

The data did not indicate that microfinance has a direct impact on formal political participation. However, the evidence gained through the interviews indicated a very high level of informal political participation, building on other already-established informal linkages.

This informal participation often involved the transformation of one kind of social capital into another. For example:

In Poltar, Slovakia, a client converted an incipient federation of entrepreneurs into a political entity capable of negotiating with government, in the process of institutionalising training facilities and providing a channel for inclusion of previously excluded Romany groups. Not the least of his achievements was the linking up of these facilities with the government employment service.

Indeed, it appears that microfinance, in the institutions we have studied, does not so much directly create social capital between microfinance clients as provide a catalyst by which pre-existing forms of social capital – either “bonding groups” of existing associates or “bridging groups” created by local authority initiative – are linked with the previously scarce resource of access to financial markets. This catalytic role is supported by the data in Table 3. Some supplementary social capital, in the sense of increased trust, is in addition created through activities of collective training, moral support, and linking with contacts especially in local government, and some of the impact of these

links may be reflected in the higher levels of trust in local government encountered in Table 2. These gains in community-building then fed, in all the sample countries, into an increase in political participation, often of an informal nature, which was reflected more accurately in qualitative interviews than through formal questionnaires.

5. Conclusions

The results of the study revealed that, for the three institutions examined in Russia, Slovakia and Romania, microfinance appears not to be associated with higher levels of formal associational membership, but is associated with the development of informal associations, which in some cases lead to informal political participation. It appears that informal associations are more cohesive where there is strong leadership. Political participation itself, as revealed by the interviews, tends most often to be of an informal nature rather than consisting of formal activism within political parties.

There are three dimensions of the relationship between microfinance, social capital and enterprise performance which are particularly interesting. The first is the influence of prior experience on trust: prior linkages bonded in the hard experience of

perestroika tended to survive and induce more trust than more recent and more ad hoc associations, and microfinance often provided a catalyst to empower these prior groupings rather than bring them into being. A second is the ability of some microfinance groups to reproduce themselves and extend social capital into related areas. In encouraging this process, strong leadership appears to be important, although sometimes the leadership comes from outside the group. Finally, there is some evidence of a relationship from microfinance to political participation and thence to the creation of a more open society; but often this participation is of an informal nature.

We believe that this is the first impact assessment study of microfinance in relation to social capital; it has therefore needed to take an experimental approach to both methodology and the specification of social capital variables. Nonetheless, one of its basic objectives was to help microfinance institutions understand better their "wider social impact" which, we believe, the approaches presented here offer a possible method to estimate. The question of how to incorporate the findings into the management practice of Integra and other organisations inside and outside Eastern Europe is one which the *Imp-Act* programme is trying to address.

Notes

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