

The Prevention of Debt Bondage with Microfinance-led Services

Patrick Daru, Craig Churchill and Erik Beemsterboer

Abstract: Millions of the poorest and most vulnerable workers in South Asia are bonded to their employers as they strive, often in vain, to repay loans. The root causes of this bondage include: interlinked and monopolistic labour and credit markets, deeply entrenched social exclusion, and asymmetric information particularly regarding legal rights. The International Labour Organization, together with its social partners and other relevant stakeholders, is currently pilot testing microfinance-led prevention strategies in India, Pakistan, Nepal and Bangladesh. This paper describes this initiative and summarises the early findings of this effort.

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Numerous South Asian workers are bonded to their employers, forced to work for substandard or no wages because their earnings are retained by the employer to repay an outstanding debt. Of the millions of people believed to be in debt bondage, most work in the agriculture sector, although bonded labourers can also be found in industrial sectors such as mining and gem polishing, brick-kilns, carpets and textiles, as well as domestic service. Although the conditions of debt bondage range from short term spells to longer term contracts, there is a clear linkage to persistent and chronic poverty. The victims of bonded labour tend to be the poorest and least educated segments of the population, from low castes and religious minorities.

In 1998, the International Labour Organization (ILO) adopted the “Declaration on Fundamental Principles and Rights at Work,” under which all member states have an obligation to respect, promote and realize the elimination of all forms of forced labour.¹ To help member states to abide by the Declaration, the ILO moved from the usual report-based supervisory mechanisms to a more proactive approach establishing technical cooperation projects designed to prevent forced labour and help rehabilitate labourers released from bondage.

Starting in June 2000, one such initiative, the Dutch-funded “South Asian Project against Debt Bondage,” began piloting integrated microfinance-led schemes in Bangladesh, India, Nepal and Pakistan. This paper, organised into four sections, reports on the main features of these schemes and the preliminary lessons learned. The paper begins with the definition, causes and manifestations of bonded labour in South Asia. Section two provides a

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

brief description of the main features of the project. The third section summarises preliminary operational insights from the schemes. The paper concludes with an analysis of the design and delivery implications for extending financial services to the poorest and most vulnerable segments of the population.

1. Understanding Bonded Labour in South Asia

Definitions of and perspectives on bonded labour vary. While significant progress is being made regarding the legal definition, in practice debt bondage is quite dynamic. Although there are examples of bondage for short periods that are not particularly exploitative, these are often first steps toward more severe forms of bondage.

Definition of Debt Bondage

International and national definitions. According to ILO Convention 29, forced labour is a service for which the worker has not volunteered and is performed under the threat of a penalty. The 1956 Supplementary Convention Against Slavery defines debt bondage as the combination of a credit and a labour contract in which the value of labour services as reasonably assessed is not applied towards the liquidation of the debt (e.g., only interest is repaid by the labour but principle is never repaid) or if activities are neither defined nor limited (e.g., the labourer can be required to work at any time day or night).

The four countries involved in this project have ratified both above-mentioned treaties so the definitions they contain are applicable to the national context. In addition, related national legislation enacted in three countries includes further descriptions of bonded labour (see Table 1).

Table 1: National Definitions of Bonded Labour

Country	National Law	Definition
India	Bonded Labour System (Abolition) Act, 1976 (amended in 1985)	Bonded labour is caused by a debt or by social customs and results in restriction of freedom of movement, and/or Restriction of freedom to look for alternative employment, and/or reduction wages and/or product prices
Nepal	Kamaiya Labour (Prohibition) Act, 2001	<i>Kamaiya</i> labour is caused by a debt and results in payment of low wages. It also includes abusive traditional forms of labour.
Pakistan	Bonded Labour Act, 1992. Bonded Labour System (Abolition) Rules, 1995	Bonded labour is caused by a debt or by social customs and results in restriction of freedom of movement, and/or restriction of freedom to look for alternative employment, and/or reduction wages and/or product prices

Local and traditional systems. International and national definitions have different scopes and outreach, and have been subject to different interpretations in the field when determining whether a person is bonded. More practically, local systems of bondage have developed over time with characteristics and types of exploitation that are well known to both employers and labourers, such as the *Kamaiya* and *Haliya* in Nepal, *Hari* in Pakistan, and in India, *Jeetham* and *Gothi*.

Under this project, the main focus is on economic forms of bondage primarily emerging from inter-linked markets (e.g., credit and labour). To that effect, the project has developed the following definition:

Economic bonded labour is a situation where the dominant position of an employer on the market of financial services and/or on other vital markets induces an important level of exploitation on the labour market, characterized by compulsory work against quasi-discretionary retribution.

Causes of Debt Bondage

To consider the causes of debt bondage, it is useful to understand why workers need credit. Baseline studies² found that loan usage is quite varied. Although the majority of loans are needed for emergency expenses such paying medical bills, buying food or burying a

² The project conducted baseline studies on the incidents and causes of debt bondage in certain regions in the four countries. While specific citations are not included in this paper, it draws from the data, analysis and conclusions of the papers listed in the bibliography.

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.

Similar demand for credit prevails in low-income communities worldwide, yet in most countries these do not result in debt bondage. In South Asia there are special conditions giving rise to bonded labour. ILO research has determined that the following factors contribute significantly to vulnerability to debt bondage:

Social exclusion. Families who experience exclusion because of religion, ethnicity or caste are significantly more vulnerable to labour exploitation and debt bondage than other economically poor families. For example, in Nepal former *Kamaiyas* are all from the low caste *Tharu* community while most of their employers were from a high caste background; in Pakistan, former *Haris* in resettlement camps around Hyderabad are Hindus and Christians while their former landlords are overwhelmingly Muslims. Social inequalities have contributed to an environment in which debt bondage has become a widely accepted practice. Migrant labourers and families without local social networks are also vulnerable to exploitation and debt bondage.

Asymmetric information. Families vulnerable to bondage are generally illiterate. There is an inverse correlation between a family's understanding of its contractual relationships with the employer (e.g., the terms of remuneration, interest rates on employer loans) and its vulnerability to bondage. Illiteracy and lack of numeracy allows employers to manipulate the credit and wage accounts with an intricate system of advances, payments in-kind and hidden interest rates. Furthermore, workers are rarely aware of their legal rights particularly regarding minimum wages and bonded labour.

Financial and labour market monopolies. Workers usually succumb to debt bondage because the only or primary source of available credit and employment is from the

same person. Since labourers cannot access credit elsewhere, and they have limited opportunities to diversify their sources of household income, employers have significant leverage to link the labour and credit contracts and to define the loan terms to their advantage. Some employers actively entice workers to take a loan as it allows them to trap the labourers in a cycle of indebtedness and exploitation.

Multiple roles of employers. The multiple social and political roles of employers (or their relatives) in the community also appear to increase the vulnerability of labourers to exploitation. Direct or indirect influence in locally elected bodies and/or in the law and order system (police, judiciary) allows employers to prevent labourers from taking legal action.

In-kind linkages. In-kind remuneration allows employers to hide low wage levels. For example, a worker's remuneration package may include food, security, shelter, clothing, health or other essentials. In-kind compensation promotes dependency, whereas monetary benefits would allow workers to make basic life choices themselves. This dependency also gives a greater leverage to an employer's threats than a possible cut in wages.

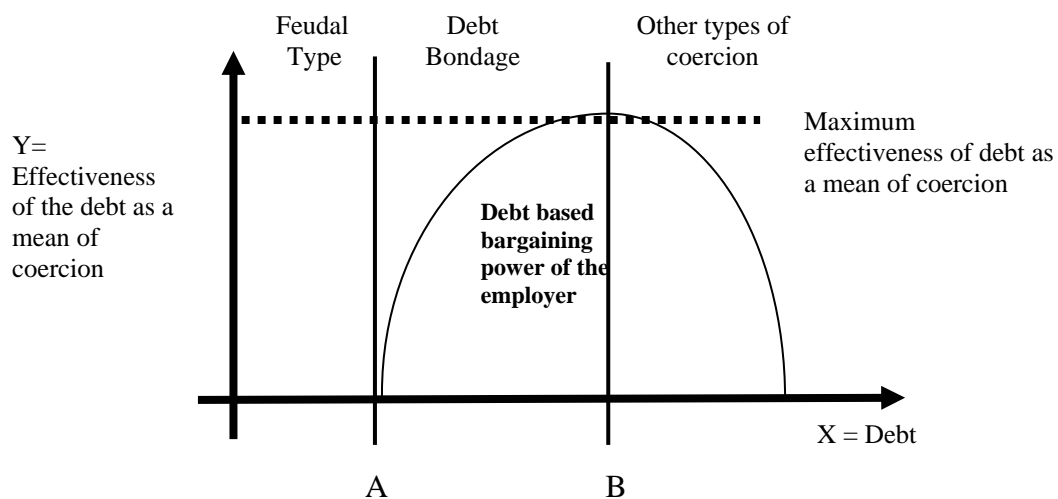
The employer's motivations to opt for a bonded contract, together with their bargaining power, are also crucial to understand the incidence of bonded labour. Among poorer workers, the presence of quasi-monopolies and the absence of law as a real deterrent imply the employer has a determining influence on bonded labour. Research in Nepal on the economic reasoning of employers to choose such contracts identified the following motivations: a) increased profit, b) ensuring the presence of labourers at a reduced price during the peak seasons, c) rent seeking behaviour (e.g., for absentee landlords), and d) maintaining a vote pool and political support.

Towards a “Worst Forms Approach” to Bondage

Bonded labour can assume many forms with a variety of degrees of severity. Bondage itself is not linked to the duration of contracts. One can be bonded for a month or for a lifetime. The labour of children is sometimes pledged to repay the debts of parents, and debt can even be inherited resulting in bondage across generations. There is a dynamic relation between indebtedness and labour contracts that are likely to make the latter increasingly exploitative as the debt increases. Exploitation can also adapt to environmental, economic or policy changes. After abolishment of the *Kamaiya*-system in Nepal, for example, bonded labour contracts evolved into conditional sharecropping agreements where wives and children have to work for free.

The conjunction of a labour and a credit contract is not however sufficient to define bonded labour. Bondage relations can occur as a result of traditional or social customs. Even economic bondage is not exclusively based on inter-linkages between the labour and credit markets. Inter-linkages between employment and basic needs such as shelter, food and water can also lead to bondage. In some districts of Nepal, for example, less than half of the *Kamaiya* families were indebted to their employer, but because families lacked houses and land, they were dependent on landlords for shelter and food, similar to a feudal relationship.

Figure 1: Effectiveness of Debt to Coerce Bondage



Bondage could therefore be depicted as a continuum (see Figure 1). In feudal like situations, the credit link is not needed because the worker “belongs” to the employer. In situations where social customs and blind allegiance is no longer effective, credit is used to bind workers. Credit alone, however, is only effective up to a point. Beyond a certain level of debt (depicted by Line B), the employer and labourer know that the loan can never be repaid. In this situation, the use of debt to coerce labourers is no longer effective, so the employer must resort to other measures such as violence and restrictions on the freedom of movement. Accordingly, the perceived advantages and disadvantages of bonded labour vary according to the periods, as shown in Table 2.

Table 2: Employer and Employee’s Perceptions of Debt Bondage

	Advantages: Between A and B*	Disadvantages: Beyond B*
Employer	<ul style="list-style-type: none"> • Employee will stay during peak season 	<ul style="list-style-type: none"> • Less productive • Loss of investment (credit will not be repaid) • Loss of control through debt
Employee	<ul style="list-style-type: none"> • Labour guarantee • Advance (not always repayable) • Informal safety net 	<ul style="list-style-type: none"> • More violent • New forms of exploitation • No escape • No private life • No bargaining power

* See Figure 1.

This continuum helps to establish a distinction between the worst forms of bondage—which could be defined based on the length of the contracts, working conditions and limitations in freedom of movement—and milder forms that labourers enter into temporarily as a risk management strategy or for the improvement of their living standards. In a less exploitative form, employers use loans to guarantee labour availability during peak seasons while labourers are secured of their daily meals in slack seasons. In certain villages in Andhra Pradesh, it is common to find one-year bonded contracts against which labourers secured a wage advance to finance housing improvements.

The research findings from the project suggest that there may be a progression in time from milder forms of bondage towards more exploitative types. The distinction is important because the programming approaches would be quite different if the project targets households that received a salary advance and are paid below-market wages for a limited period, or alternatively those households that suffer from severe exploitation without any hope to escape.

For the worst forms of debt bondage, the enforcement of legislation would be an appropriate strategy, assuming that the bonded labourers were amenable to such an intervention. This assumption, however, should not be taken lightly. Legal provisions in India and Pakistan for instance require the labourer to testify in court during release procedures, which could provoke retributions if the labourer is not protected. Furthermore, given the worker's high degree of dependency on the employer, "rescue from bondage" could result in exclusion from essential resources and services in the community. Release without the availability of livelihood alternatives may force a household deeper into destitution.

Legal enforcement is probably inappropriate to address milder forms of bonded labour. Instead, the project does not differentiate between prevention strategies and services to persons who are bonded for short periods of time without coercion. Such a distinction is not practical given the dynamic nature of short-term bondage.

Microcredit to Release Bonded Labourers?

In principle, the ILO's project does not provide credit to bonded households for repayment of their debt as this undermines the implementation of the law—bonded labour is illegal. On a larger scale, this strategy would also create a market for bonded debts, which could sustain the existence of bondage. In practice, however, the situation is not that clear-cut. In geographic areas where debt bondage is prevalent, microfinance institutions (MFIs)

have some clients who are in a less severe form of bondage, or another household member is bonded, without the MFI's knowledge.

In contrast, some non-governmental organisations (NGOs) not associated with the project purposefully provide loans to bonded labourers to buy their freedom. These organisations, or the bonded labourers themselves, give the following justifications for such action:

- Offenders of national bonded labour acts are rarely prosecuted and punished. As payment below minimum wage is a fact of life in many rural parts of South Asia, members of the community would generally oppose strict punishment of employers in the relatively milder form of bondage.
- In some regions the employer is sometimes the only reliable provider of work. Vulnerable households do not want to jeopardize their only livelihood source by denouncing their employer.
- The real level of indebtedness depends on the capacity of a creditor to enforce repayment. For instance, even though the debts of former *Kamaiyas* have been declared illegal and are officially nullified, some former *Kamaiyas* still feel obligated or pressured to repay their old loans. As a consequence, the level of indebtedness is difficult to ascertain in many cases, and MFIs are not in a position to judge whether their clients are bonded.

In Bangladesh, there is no legislation against debt bondage and therefore this discussion, however valid, does not take place among microfinance providers.

The project's saving and credit groups do include members of bonded labour families, but the groups do not encourage repaying debts to employers through the project's microfinance services. However, money is fungible; it is not always possible to monitor how

loans are used, nor may it be in the best interest of the bonded household to keep these two different types of financial relations completely separate from each other.

2. Preventing Debt Bondage

To prevent debt bondage, viable forms of intervention must be developed. To this end, the ILO is piloting cost-effective interventions to solve bonded labour situations in Bangladesh, India, Nepal and Pakistan. In each country the ILO has partnered with multipurpose NGOs (see Table 3) to develop and deliver a package of services designed to prevent debt bondage (Bangladesh, Andhra Pradesh, Tamil Nadu) or to rehabilitate bonded labourers that have been officially released (Nepal, Pakistan). With most partners, the project is small part of the NGO's overall activities, but one that has attracted a significant amount of attention and support from the NGO's senior management.

Table 3: Implementing Partners in the Prevention of Debt Bondage

	Area	Sector	# Clients	Partners
Prevention	Bangladesh, Tangail	Sex workers, weavers	375	Society for Social Services (SSS)
	Bangladesh, Sirajganj	Agricultural workers	375	Thengamara Mohila Sabuj Sangha (TMSS)
	India, Tamil Nadu, Terivellure District	Agricultural workers	2000	Integrated Rural Development Society (IRDS) and Madras Social Service Society (MSSS)
	India, Andhra Pradesh, Ranga Reddy District	Agricultural workers	1020	Ankuram Sangamam Puram (ASP)
Rehabilitation	Nepal, Banke District	Agricultural workers (mainly former Kamaiyas)	985	Mahila Upakar Munch (MUM) and Rural Reconstruction Nepal (RRN)
	Pakistan, Hyderabad	Agricultural workers (former Haris)	820	National Rural Support Programme (NRSP)

Given the complexity of the problem, the project employs a microfinance-led approach designed to address the causes of bonded labour. This integrated approach relies on three key postulations. First, since bonded labour results primarily from the inter-linkage of

credit and labour 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 support their greater social inclusion in the community.

Although the actual activities vary between the four countries, the project includes the following five main components:

1. *Microfinance services for extreme poor.* The project organises savings and credit groups to extend financial services to very poor households at risk of bondage (or already in mild forms of bondage) or who have been legally released from bondage. For prevention, targeting criteria include poverty indicators as well as factors that suggest that the employer might coerce these families. The ILO's implementing partners in the four countries are all experimenting with different sets of financial services specifically designed for poor households, with an emphasis on building assets, diversifying income sources and reducing vulnerability.
2. *Social empowerment.* Through the saving and credit groups, social awareness messages are spread on critical topics such as human and labour rights, hygiene and health care, reduction of unsustainable expenses, and procedures for accessing Government schemes. Communication methods include discussions in group meetings, songs, street theatre, and wall painting. Also functional literacy classes are provided to some groups based on demand.
3. *Education.* The intergenerational nature of bonded labour, and the fact that children are often the victims, necessitates an intervention that also assists youths. The project

provides non-formal education centres for children between 9 and 14 years old that dropped out or never attended school because they had to work to repay their parents' debts. These bridge schools provide remedial education to prepare students to be mainstreamed into the school system. For children above 14 years of age, the education component involves the provision of basic literacy and numeracy classes and skills training.

4. *Skill training*. Skill training is provided to adults and adolescents as per their capacity, market needs and their personal development plans. It is possible to either upgrade their competence in their current field or to offer an alternative livelihood. The objective is assist households to diversify their income sources so they become less economically dependent on the landlord or employer.
5. *Health*. Since health expenses are primary debt triggers, the project provides both preventive and curative health services to the target population. These services vary from one place to another depending on the locally identified need but their common feature is to allow the population access to safe drinking water (hand pumps and rain water harvesting), reinforce hygiene practices (pit latrines), and provide mother and infant care (pre- and post-natal follow-up, training of traditional birth assistants). In some places services also extend to the creation of health posts, implementation of a system of referrals and emergency transport to hospitals.

In sum, the prevention of debt bondage requires an integrated approach to tackle both trigger and root causes. Table 4 summarises the main vulnerability factors and describes how the project addresses them.

Table 4: How the Project Reduces Vulnerability to Debt Bondage

Vulnerability Factors	Project Response
Low and irregular income based mainly on casual wage labour or sharecropping	Loans for income generating activities; skill and entrepreneurial training
Urgent, temporary, unforeseen financial need (health, death, natural disasters)	Savings easily accessible, emergency loans; preventive and curative health services as well as referrals to the nearest health posts
Unsustainable expenses (alcohol, gambling, ceremonies, dowry)	Awareness raising within the groups on the negative impact of overspending, and on the direct benefit the employer gets out of this practice
Financial market in the hands of the employer	The provision of alternative microfinance services
Illiteracy renders the labourer vulnerable to creditor's fraud and limits livelihood options	Adult literacy and numeracy classes, bridge education for children to mainstream them in the national curricula or to integrate them in a skill-training programme.
In-kind benefits provided by the employer increase the dependence of the labourer	Depending on the needs, provision of safe drinking water, education, health services, and (in the case of rehabilitation) land on a leasing method or in connection with other programmes
Labourers are unaware of their human and labour rights	Awareness raising in the groups; introduce collective bargaining concepts

3. Preliminary Operational Insights

Although the “South Asian Project against Debt Bondage” has only been in full operation for two years, a number of useful lessons have already emerged. This section summarises operational and project design issues, while the next section covers microfinance specific issues.

Reaching Households rather than Children

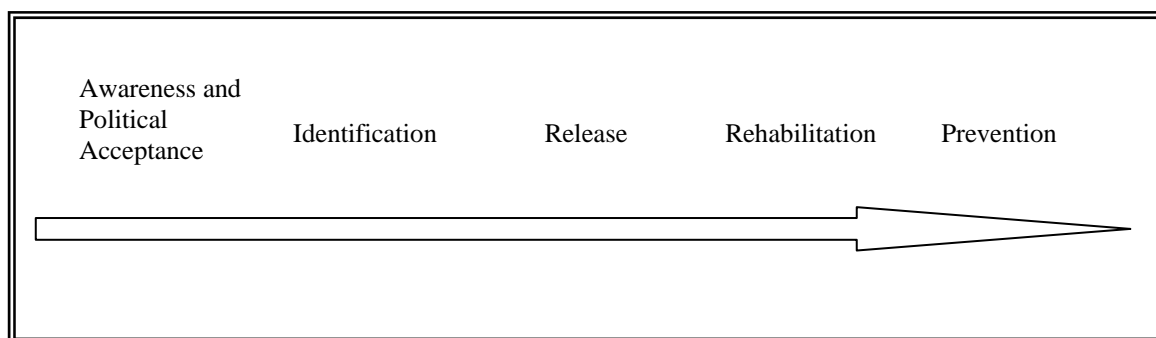
The original project title, “Children as Collateral,” reflects the initial emphasis on bonded child labour. In most cases, however, children are not kept in bondage separately from their parents. The entire family is bonded and children work for little or no remuneration along side their parents. In cases where children work in bondage away from their family (e.g., domestic work), a decision was made by adult household members to place a child in bondage. In other cases children can inherit debt from parents. As a consequence,

to prevent child bondage interventions must impact the whole family. A “child only” approach will not succeed because it would not address core household problems (e.g., lack of income, food insecurity).

Prevention versus Rehabilitation

There are five different types of interventions necessary to eradicate bonded labour, as summarised in Figure 2. First, policymakers need to accept that debt bondage is an issue about which they should be concerned, and then create an appropriate legislative and legal environment. The second intervention is to identify bonded labourers and then, third, to use the legal system to release them. The fourth step is to rehabilitate released labourers. The final intervention is to create conditions in the labour and credit markets to prevent debt bondage.

Figure 2: Five Areas of Interventions against Bonded Labour



The project was originally conceptualised to focus on the fifth area, the prevention of debt bondage, with some additional work on broadening awareness and political acceptance. The situation in Nepal and Pakistan, however, has allowed the project to also consider the issue of rehabilitation.³ In Nepal the cabinet decision in July 2000 to abolish the *Kamaiya* system lead many families to leave the employer’s land. In Pakistan, bonded labourers that

³ In the next phase of this project, the ILO’s Social Finance Programme will partner more closely with the Special Action Programme to Combat Forced Labour (SAP-FL) of IFP/Declaration to address all five intervention areas.

escaped or were freed from bondage settled in a number of camps near Hyderabad. In both cases, households possessed next to nothing and were in urgent need of support. NGOs and government provided some immediate aid such as food and temporary shelter. Medium-term assistance for sustainable socio-economic rehabilitation, such as skills training, education for children and access to employment, was severely lacking.

The Nepalese and Pakistani Governments suggested that the ILO should address the problems of former bonded labourers since, without a sustainable rehabilitation package, they were highly vulnerable to relapse into bondage. This risk was confirmed by former bonded labourers in Nepal who revealed that, even though their debts were extinguished in July 2000, many families became highly indebted again, some to their old landlords.

Experience so far has shown that the start-up of activities with households that are released from bondage takes longer than with families vulnerable to bondage. Compared to vulnerable households, the households of former bonded labourers tend have the following characteristics: they generally show a higher level of dependence; they often lack self-confidence; they have no experience participating in group processes; they find it difficult to trust outsiders, including NGOs trying to support them; they suffer from a higher level of social exclusion; they usually have had (even) less access to education; and they have fewer assets to fall back on.

Targeting

In the process of preventing debt bondage, the project needed a reliable method to identify and target vulnerable persons. To address this issue, the project created the Vulnerability to Debt Bondage Index (VDBI), a relatively simple survey tool to assess if certain groups in a pre-determined area are vulnerable to bonded labour. The survey data is triangulated with qualitative research tools, such as focus group discussions, and desk research into general characteristics of the area.

The survey gathers information on socio-economic and environmental factors that can cause or contribute to bonded labour. These factors include basic literacy and poverty levels, frequency and associated costs of health expenses and other economic shocks, the family's dependence on the employer for basic amenities (e.g., water, shelter), diversification of household income sources (or lack thereof), the significance of in-kind pay, the social divide between the employer and the labourer (caste or religious based), the family's attitude toward social expenses (e.g., dowries and ceremonies), the availability of credit from diverse sources, and the labourer's understanding of credit mechanisms.

The VDBI creates a rating for every family; those with a high score are the most vulnerable to bondage. The utility of this approach lies in an analysis and comparison of different population groups as well as an assessment of the potential for bondage between communities. In short, the VDBI is a useful tool to assess to what extent bondage is or could be a problem in a certain area (and/or sector). It helps to determine where interventions are most effective and which groups to target.

Non-financial Interventions

Although microfinance is the entry point for the project's interventions to prevent debt bondage, complementary non-financial services are required for the sustainable reduction of vulnerability to bondage. Project studies and experience confirm and even strengthen the perception that without social empowerment escape from extreme poverty is unlikely. Without a certain level of bargaining power, discrimination and exploitation will prevail. Without social awareness, unproductive expenditures (e.g., ceremonies, dowry, alcohol) may offset any increase in income.

The project, therefore, has adopted an integrated approach in which target families are motivated to form savings and credit groups. Social and economic empowerment initiatives are provided to the groups based on the premise that being a member and learning to function

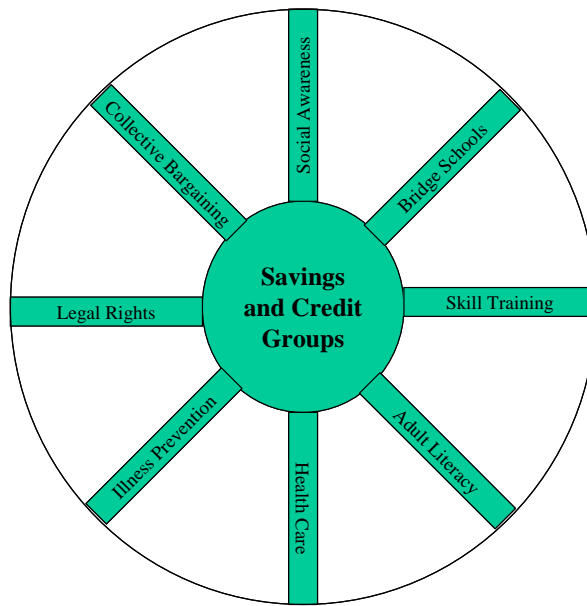
in a group will raise members' confidence, contribute to the empowerment of target families, and facilitate collective action.

The process of economic empowerment is strengthened by the provision of vocational and entrepreneurial training. Although it is too early to determine the impact of this component, it is intended to generate increased and more reliable income sources. To this end, the project relies on a research-based approach to identify skills training needs. The types of training should not be based only on the often insufficiently informed wishes of the trainees and/or on the availability of trainers, but on thorough research on market opportunities for alternative livelihoods.

Challenges to Integration

As with all integrated programs, the design of this project 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, as depicted in Figure 3. For example, groups are responsible for designing and initiating key non-financial services; health officers report to the group on a regular basis; payments of contracts for hand-pumps is done through the group; bridge school students occasionally visit the groups to discuss their experiences as bonded labourers and to share their academic progress.

Figure 3: Integrated Project Design



There are, however, limits to the group approach. As discussed in more detail below, some microfinance services may work better on an individual basis. Training should build on people’s individual strengths and interests while encouraging a diversification of livelihood activities in the community. Also, the coordination of the project’s components should be done according to each individual’s own development plans which define when the person should get credit, training or marketing support.

Because of the need for tight integration of various activities, in all four countries the project has partnered with multi-purpose NGOs that provide both financial and non-financial services. While this arrangement facilitates integration—as coordination with an organisation is usually easier than between agencies—there is a limitation on the flexibility and type of financial services they can offer because most partners are not regulated MFIs. A preferred arrangement would be to work with an NGO that has created a regulated financial institution, but the NGO is still experimenting with new products and services. This situation would facilitate the “graduation” of groups from the NGO to the sister-MFI after they have received the full benefit from the initial non-financial interventions.

The synergy between the different services depends on the capacity and previous experience of the implementing partners. The project builds on existing services of local NGOs while orienting them to the issues of indebtedness, bonded labour and microfinance for very poor families. The level of change that could be introduced in the activities depends on the competence of the partner organization. Most partners view the project as an opportunity to exert more creativity and to boost their institutional capacity for experimentation and change. Perhaps more importantly, they see significant potential to integrate key lessons from this project into their core activities.

Similarly, there are limitations to the technical and managerial capacity of ILO project staff. The combination of managerial, political, social, communication and technical skills—which include microfinance, group processes, social awareness, education, health, social rehabilitation, enterprise development, etc.—are a challenging package to assemble in a small team. Contracting additional short-term (external) technical expertise is therefore a crucial input for a project with a multi-faceted integrated approach that aims to develop high quality services. Additional expertise was sought from other departments of the ILO and other United Nation agencies (e.g., UNICEF, WHO).

Regional Approach

While the project will not by itself solve the problem of debt bondage in South Asia, it will test interventions in different environments and will thus generate knowledge about the effectiveness of interventions. It will also encourage new policy development through its demonstration effects. At the end of an initial five-year period, there should be sufficient evidence regarding costs and benefits to encourage governments, donors and civil society to scale up efforts to aggressively tackle this problem.

Even though the situation in each country (and between Indian states) is quite different, there are important advantages to adopting a regional approach. Because bonded

labour is manifested differently by location and economic sector, the sample of test sites needs to be selected to reflect this variation. Indeed the project sites are currently too biased toward agricultural production without sufficient experience in industrial sectors.

The regional dimension facilitates the exchange of lessons and resulting good practice at all levels of intervention. To date the project has held three regional workshops—on microfinance products, social empowerment and gender—where implementing partners shared their experiences with others working on the same challenging issues. This arrangement has generated some healthy competition between the partners as to who can come up with the best ideas or the most effective interventions. In addition, regional activities help to build consensus among policymakers as to the best approaches for tackling bonded labour while diluting potential resistance that might ensue if the project were to be implemented at national level.

Involving Employers

As the project has progressed, it has become clear that the involvement of employers is crucial in areas with a large labour supply and limited employment opportunities. Liberation of bonded labourers without access to alternative employment is not a solution. Indeed it may worsen the workers' situation if employers stop production, contract other workers on a similar basis, or replace workers through mechanisation.

The project has therefore started to study financial and labour markets from the perspective of employers and will invite a number of them to take part in small demonstration projects to explore alternatives to bonded labour. These pilots are intended to secure the continuity of employment for labourers, with improved conditions, while providing examples of economic substitutes and “good conduct” to other employers.

This approach of course needs to be balanced with the threat of prosecution in cases of severe exploitation as provided for under national laws. However, a “rights-based”

approach in which employers are stigmatised as offenders may have a more limited impact than an approach based on dialogue. Toward that end, the project will bring more attention to local social and moral values that denounce the exploitation of fellow community members.

Policy Impact

Although there is a strong emphasis on developing successful models in the field, this project is ultimately aimed to influence policy. The project has placed considerable emphasis on dialogue and building trust to make an impact at that level. Although other factors influenced a general trend towards more openness on bonded labour in South Asia, the project has contributed to positive changes on the subject (Table 5).

Table 5: Policy Changes regarding Debt Bondage: 2000-2002

	Situation 2000	Situation 2002
Nepal	<i>Kamaiyas</i> freed on 17 th July without rehabilitation plans	<ul style="list-style-type: none"> • Comprehensive rehabilitation plan drawn up • <i>Kamaiya</i> Act adopted • Informal recognition of <i>Kamaiya</i>-like situations beyond the group identified
India	No technical cooperation project on bonded labour	<ul style="list-style-type: none"> • Approval of first technical cooperation project on bonded labour by Central Government • Invitation by 3 States to initiate activities: Andhra Pradesh, Tamil Nadu and Karnataka • All 3 State Governments have committed to contribute 20% to the budgets of bonded labour projects
Bangladesh	Existence of bonded labour not recognized	<ul style="list-style-type: none"> • Concept of indebtedness linked to labour exploitation accepted • Recognition of the need to undertake research on the subject
Pakistan	Bonded labour sensitive topic	<ul style="list-style-type: none"> • National Action Plan Against Bonded Labour adopted

4. Lessons for Microfinance

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 microfinance and presents an outline of where the project intends to go. Microfinance alone will not solve debt bondage and an integrated approach is needed to address the root and trigger causes of bonded labour.

Interestingly, this and the other lessons that follow are generally applicable to extending microfinance to the poorest segments of the market, not just for the prevention of bonded labour.

Serving the Poorest Exclusively?

The project currently targets persons who are vulnerable to debt bondage or in need of rehabilitation and supports those individuals exclusively. It does not seek to provide services to the community at large. From a development perspective, this approach is reasonably sound. Experience has repeatedly shown that community-wide approaches tend to be hijacked by elites while the most vulnerable are excluded. A broader approach might worsen rather than reduce social and economic inequalities.

From a microfinance perspective, however, exclusively serving a small minority of persons in a community, while purposely excluding others, creates challenges and limitations. There are the costs of identifying the poorest and most socially isolated persons and then motivating them to participate in a savings and credit group—the latter is no easy task since the target market consists primarily of persons with low self-esteem who have been habitually excluded and exploited. By supporting one or two groups in each village, the project is not able to exploit service delivery efficiency. Field staff can only manage a small number of persons because the groups are dispersed over a wide geographic area.⁴ The members also have a significant time constraint. During peak seasons, they are only available in the early morning and late evening since many are engaged in day labour. In addition, scattered pockets of clients discourage service providers from creating a branch infrastructure that can be more responsive to client needs than group meetings every week or two. Small numbers of relatively homogeneous clients also make it difficult to intermediate between net savers and net borrowers.

⁴ This is not a problem in Pakistan where the former *Haris* are based in resettlement camps.

However, alternative approaches may leave the poorest without support. Most MFIs in South Asia do not work with the poorest segments of the population, but rather focus on the market that is a little better off, sometimes referred to as the “middle poor”. This situation is partly explained by sustainability arguments from MFIs that are concerned about higher default risk and the transaction costs for smaller loans. The group selection process is also a contributing factor since the group excludes the poorest community members who represent a threat to group cohesion and stability. The poorest of the poor also opt out of participation or quickly drop out because their irregular cash flows are not suited to the MFIs’ strict repayment conditions. Staff members naturally gravitate toward persons who are easier to work with, especially if staff are offered incentives to achieve performance targets.

Consequently, targeting support exclusively for the poorest might be costly, but it may be necessary to reach these groups. As the project moves forward, some partners may experiment with a two-tiered approach that provides special services to one segment of the market (those most vulnerable to bonded labour) while being a financial intermediary for the community at large.

Diverse Financial Services

The project is based on the view that existing microfinance products are not designed to respond to the needs of the target population. Together with its implementing partners, the project seeks to develop a package of financial services that addresses the key characteristics of the target group, with particular attention to the household’s cash flow and its vulnerability to risks. In addition to support for the development of alternative livelihoods, households vulnerable to bondage need financial services 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.

Based on market research and experiences thus far, it appears that a core set of four financial services are needed to reduce the vulnerability of the target families:

- 1) *Income-generating Loans*: This bread-and-butter microfinance product requires a fresh look to serve high risk clients with irregular and unpredictable income flows without—and this is the really tricky part—putting clients in a situation that could actually make them worse off.
- 2) *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 household crisis or 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.

Often this service is provided through the savings and credit 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. Second, loans are usually only available during group meetings, which is not sufficiently responsive for some emergencies. To more effectively replace employer loans, further experimentation is required to explore other delivery mechanisms, such as daily service, and credit risk controls, such as pawn lending.

- 3) *Contractual 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 emphasizes and prioritises savings and asset building to create a buffer to fall back on if the household experiences an economic shock. Contractual savings is the easiest savings service for most MFIs since it has many of the same characteristics as

forced savings that they are used to offering. Plus they may be able to offer contractual savings without ruffling regulatory feathers. This product can be structured with a particular goal in mind, such as home improvement or school fees, or for an ongoing need such as health care.

Clients like contractual savings because it creates discipline for them to set aside a little bit of money on a regular basis. In some contexts, the ILO's implementing partners are striving to offer savings opportunities every day. For example, SSS, which is working with sex workers in Bangladesh, has set up a daily savings collection point to allow the women to safeguard their cash. Both partners in Tamil Nadu, IRDS and MSSS, are experimenting with lock boxes in each members' house into which clients place little bits of extra cash from time-to-time, and then deposit the contents into the group's account at the weekly meeting. The major change proposed by the project is to completely de-link savings and credit so that saving is no longer a precondition for accessing a loan and does not serve as cash collateral.

- 4) *Liquid Savings*: An individual passbook account is perhaps the hardest service for the project's partners to offer, although it could be the most valuable service for clients. The target market would like a safe place to store small amounts of surplus cash—in part, to reduce the temptation to spend it—but they would also like to access it when they need it. The challenge for the implementing partners, and for most MFIs using a group-based methodology, is that the group can be an impediment to members' willingness to save. They may not want to deposit more money than others; they may not want other members to know how much they have in their accounts; and they will be very reluctant to make voluntary deposits if they think their savings might be lost to repay the debts of other members.

A particular challenge is the appropriate sequencing of these services. The implementing partners, and indeed most MFIs in South Asia, generally believe that a strong record of compulsory savings is required for a group to demonstrate that it is eligible for a loan. Ideally the project would like to offer the financial service or services that each member requires when she requires them. Consequently, assuming that the partners could find alternative ways of controlling credit risk, members may access income generating or emergency loans before they establish a savings record. More flexibility in this regard would not only benefit the clients, but could also assist the partners in liquidity management since some members would be net-savers while others would be net-borrowers.

Besides these four core services, some partners are conducting market research on, or experimenting with insurance, debt consolidation loans, leasing, safe deposit boxes and remittances. The project also intends to explore the potential role of combining initial grants with loans to help families to start enterprise activities, especially for families released from bondage.

Culture of Repayment

Another major challenge of providing microfinance to the most vulnerable segments of the population is how field staff in particular, and the lending organisation in general, approaches repayments. 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 loans tend to be unsecured, so 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.

With persons vulnerable to debt bondage, a hard-line commitment to repayments would invariably cause more damage than good. There is an issue whether a soft approach would be more effective. Regardless of the client's poverty level, if the MFI does not take repayments seriously, borrowers certainly will not either. Consequently, the project strives to cultivate a 'tough-love' approach to repayments in which carrots greatly outweigh sticks—although sticks are still there—with lots of second, third and fourth 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 could include:

- *Timely repayment refund*: If clients regularly repay on time, at the end of the loan they receive cash back. Essentially, a delinquency fee is built into the interest rate and then refunded if borrowers are not delinquent, but it can create a strong incentive for timely repayment.
- *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, as well expected incomes and expenses. 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, and that are bound to lead to bondage.
- *Customised loan amounts*: With this target market, lenders need to take great care that they are not setting up their borrowers to fail. With transparent data on the household's cash flow, the lender and borrower mutually agree on a prudent loan amount that will assist the borrower without creating a major credit risk.
- *Tailored repayment schedules*: The lender and borrower will also jointly establish a customised repayment schedule that mirrors the household's expected cash flow.

Customised 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 instalment amounts required by most MFIs.

- *Repayment holidays*: Allowing clients to skip a certain number of payments during the loan term, they can make adjustments when they have unexpected cash flow problems.
- *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. 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 organisation 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 the project 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.

One of the major problems with developing an alternative approach to repayments is that it will be extremely difficult, if not impossible, for hard and soft approaches to coexist in

the same communities or to be delivered by the same field agents. So if an MFI wants to pursue a two-tier approach, in which the project and the organisation's regular services are operational in the same village, it will have to solve this vexing problem.

Sustainability and Subsidy

All of the innovations, flexibility, and handholding required to provide microfinance to persons vulnerable to bonded labour 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.

In microfinance, there is a general acceptance that most MFIs need some subsidies during their start-up period while they develop systems, adapt products and services to the local conditions, and achieve sufficient volumes to create economies of scale. Then after a three- to five-year incubation period they should be in a position in which they can operate without grants and perhaps without subsidised loan capital.

The project applies this same attitude toward the poorest families. During the "start up" phase when they are most vulnerable to bonded labour, certain operational subsidies are necessary to pay for both the non-financial services as well as to support the extra efforts required in the financial service delivery. These subsidies are not intended, however, to be ongoing. Just as an MFI is expected to achieve financial self-sufficiency, these families are expected to become less vulnerable, more independent, and eventually graduate to the MFI's standard financial services that are designed to achieve full cost recovery.

Since vulnerable families are expected to eventually be mainstreamed in the MFI's regular services, it is important to design the "intensive care" services in such a way so as to best facilitate that transition. Therefore the project's services should generally mirror the footprint of MFI's regular service; for example, the savings and credit groups should be

structured along the same lines. An important aspect is that the interest rates should also be the same so there is not an incentive for inappropriate persons to pretend that they are vulnerable to bonded labour (i.e., to get cheaper credit) and the project's clients are not shocked by the higher prices when they graduate. From the other end, it is also expected that some of the more effective adjustments or innovations that are tested in the project will also become integrated into the regular services, which will also facilitate the transition while improving the quality of services to all.

Finally, in addition to determining what services are needed and for how long, one of the project'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 labour in the region.

Conclusion

The pervasiveness of bonded labour in South Asia represents a major human rights challenge. The International Labour Organization, together with its social partners and other relevant stakeholders, is pilot testing field-based approaches to address this problem. Although these efforts are still relatively new, some useful lessons have emerged.

To eliminate bonded labour, it is necessary to distinguish between mild and severe forms of bondage because they require different interventions. Careful attention should be given to the motivations of employers since they can be a valuable ally. 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. The financial services should strongly emphasise the importance of savings. A menu of appropriate financial services needs to be developed to cater to the specific

characteristics of persons vulnerable to bondage. Finally, the use of microfinance to prevent bonded labour requires a new approach regarding repayment culture and sustainability.

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