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**FINANCIAL INTEGRATION
AND DEVELOPMENT IN
SUB-SAHARAN AFRICA:**

**A STUDY OF INFORMAL FINANCE
IN TANZANIA**

Mboya S.D. Bagachwa

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WORKING PAPER 79

**FINANCIAL INTEGRATION AND DEVELOPMENT
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Mboya S.D. Bagachwa

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Preface

As part of Structural Adjustment Programmes, many governments in sub-Saharan Africa initiated a large-scale restructuring of the financial system in the 1980s. Emphasis in these programmes was placed on the need to (i) adopt financial liberalisation measures, and (ii) enhance regulatory and supervisory functions to ensure prudence of the financial institutions. Special Financial Sector Adjustment loans have been adopted to uphold reform measures and to restructure and strengthen distressed financial systems in several African countries. An improved regulatory environment with enhanced supervision is emphasised in these operations, while the recent literature on the subject highlights the need for careful design of the sequence, pace and timing of financial liberalisation and the importance of its coordination with changing macroeconomic conditions.

However, financial reform has at best had limited *developmental* effects in the region so far. It has been increasingly recognised that the adoption of financial liberalisation policy alone has not been sufficient to generate a strong response in terms of increased savings' mobilisation and intermediation through the financial system, wider access to financial services and increased investment by the private sector. Fragmentation of financial markets persists, impeding efficient resource mobilisation and financial intermediation.

Given this, a research project on 'Financial Integration and Development in Sub-Saharan Africa' has been undertaken at ODI, with support from the World Bank Research Committee, to examine the performance of financial systems for resource mobilisation and intermediation for economic development in sub-Saharan Africa. Field work was conducted in Ghana, Malawi, Nigeria and Tanzania based on questionnaires addressed to formal, semi-formal and informal institutions and borrowers. The main objectives of the research were to:

- i) investigate the nature and degree of fragmentation and segmentation of financial markets in sub-Saharan Africa;
- ii) examine the sources of segmentation against several theoretical paradigms and evaluate the conditions under which linkages between segments utilise the comparative advantages of each and obstacles to such linkages;
- iii) examine operational constraints facing formal financial institutions and informal associations/lenders;
- iv) evaluate the effects of financial liberalisation on the whole financial system; in particular, to provide understanding of the impediments to financial

deepening in Africa and the extent to which they can be relieved through financial liberalisation and through active policies of positive interventions, technical assistance and infrastructure that support market development by facilitating information flows and lowering transaction costs and risks;

- v) help the design of long-term policies towards financial sector development and evaluate which policy and institutional measures can most effectively accelerate the financial system's ability to mobilise resources and intermediate between saving and investment for broad-based development in Africa.

This paper by Dr Mboya Bagachwa, Associate Research Professor at the Economic Research Bureau, University of Dar es Salaam, is one of a series that will provide initial presentation of results of the country case studies. *Working Paper 78* examines those for Ghana. This paper presents the *Tanzanian* case study, reporting the results of field work on the behavioural characteristics of *informal* financial organisations and agents and the operational constraints in urban and rural areas.

Machiko Nissanke
Project Coordinator

January 1995

Contents

Preface	3
1. Introduction	7
1.1 Objectives	7
1.2 Context and hypotheses	7
2. Methodology	10
2.1 Sources of data	10
2.2 Secondary sources: a review of the literature	10
2.2.1 Types of informal finance	10
2.2.2 Addressing gaps in the data	14
2.3 Primary data: field interviews	15
3. The characteristics of IFI operators and borrowers	17
3.1 Informal lenders	17
3.2 Borrowers	18
3.3 Observations	20
4. Deposit and lending operations	22
4.1 Deposit mobilisation	22
4.2 Lending characteristics	24
4.2.1 Informal credit as a complementary activity	24
4.2.2 Primary sources of capital for lending operations	25
5. Informal lending arrangements and the characteristics of loans	27
5.1 Trust, adverse selection, moral hazard and enforcement	27
5.2 The importance of personal ties for enhancing trust	28
5.3 The nature and types of loans	29
5.3.1 Interlinkage of loans	29
5.3.2 Loan sizes and maturity	30
5.3.3 Pledging of collateral	32
5.3.4 Intermediary credit agents	32
6. Quantity rationing, client sorting rules and loan monitoring	34
6.1 Lenders' objective functions, sorting rules and perceptions about risk	34
6.2 The cost of borrowing	35
6.3 Sorting behaviour: screening costs	38
6.4 Loan monitoring	39

7. Loan repayment and contract enforcement	40
7.1 Repayment schedules	40
7.2 Contract enforcement	40
8. Institutional linkages	42
9. Conclusion	43
9.1 Policy implications	44
References	48

Tables

1 Source of start-up capital for informal sector enterprises (percentage of total funds)	11
2 Selected characteristics of informal credit lenders by urban and rural area	17
3 Average annual number of loan applications and approvals by urban and rural area, 1990–92	19
4 Deposit characteristics by urban and rural area, 1990–92	22
5 Lender status by urban and rural area	24
6 Amount of credit loaned in 1990–92 (TSh 000)	31
7 Average monthly interest rates, 1992 (%)	35
8 Average screening costs per average loan by a typical lender by urban and rural area, 1992 (TSh)	38

1. Introduction

1.1 Objectives

This report on informal finance in Tanzania is part of a broader study of the financial sectors of three other sub-Saharan African (SSA) countries – Ghana, Malawi and Nigeria.¹ The broader comparative study is investigating why financial market integration and deeper intermediation in sub-Saharan Africa has not yet been achieved fully. Within this thrust, the Tanzanian study² is examining two specific issues:

- why dualism in the Tanzanian financial markets has persisted despite recent attempts to liberalise the markets;
- which policy, institutional and structural factors and measures can accelerate (or impede) the integration of its financial markets and improve financial intermediation.

In addressing these two issues, the study also assesses the implications of government policies for informal finance in Tanzania, and recommends the type of institutional interventions that can effectively accelerate the capacity of the financial systems to mobilise resources and intermediate between savings and investment, particularly by effecting better integration among segments.

1.2 Context and hypotheses

The impetus for the broader study is evidence that little interaction exists between the formal and informal financial markets in sub-Saharan Africa (Seibel and Marx, 1987; Adams and Fitchett, 1992). Tanzania is no exception (Bagachwa and Nyagetera, 1991; Hyuha et al., 1993). But in Tanzania, such a study assumes an added importance. Until 1991, the formal financial sector in Tanzania was characterised by four key features. First, it was highly regulated. The state owned

¹ The United Republic of Tanzania (Tanzania) comprises the Tanzania Mainland (formerly Tanganyika) and Zanzibar (that is, Pemba and Zanzibar islands). This survey of informal finance in Tanzania was not fielded in Zanzibar.

² The author would like to thank N.E. Luvanga for assistance, especially during the data collection and data processing phases. This paper is abridged from a report submitted to the World Bank.

all the three commercial banks, all savings institutions, the only two major insurance companies, the single social security institution, and three of the five development banks. Second, these institutions operated virtually as monopolies or oligopolies. Third, most of the formal financial institutions in Tanzania were concentrated in urban areas, and, with the exception of the National Bank of Commerce, none of their branches extended down to the rural (district) level. Finally, the formal financial institutions discriminated against informal sector borrowers in offering credit (Bagachwa, 1993).

Yet the formal financial sector has not performed at a level that would preclude the formation of an informal financial sector (Bank of Tanzania, 1990). Given this lack of progress, the Banking and Financial Institutions Act was enacted in 1991 to effect a financial sector reform – to restructure existing financial institutions, promote competition among them, introduce private banking, deregulate capital markets, and rationalise and strengthen the legislative and supervisory powers of the central bank. Yet, thus far, financial reform has sought merely to strengthen the formal financial sector, ignoring the needs of and role played by informal financial institutions (IFIs). This myopic policy thrust is regrettable given evidence that the volume of domestic savings mobilised by the informal financial systems of most SSA countries exceeds the volume mobilised by their formal financial system (Nissanke et al., 1991). But it is equally unfortunate that financial liberalisation alone may not be enough to ensure effective resource mobilisation and financial intermediation. In Tanzania, certain structural and institutional rigidities and imperfections should be removed if financial liberalisation is to achieve its intended results.

Thus, the main premise of this study component is that developing a well-integrated financial market structure and building up integrated financial institutions are preconditions for promoting effective resource mobilisation and financial intermediation.

Given this premise, the study seeks to understand the determinants of dualism and why it persists to this day. Several specific hypotheses are at the heart of the study:

i) Origins of segmentation

- Restrictive financial policies and controls shift the allocation of investible funds from the financial market to the government, thus reducing the flow of funds into banks while also creating excess demand for credit at official rates. The resulting disequilibrium in the official credit market tends to generate a curb market, thus giving rise to and perpetuating an informal financial sector.
- Different types of financial institutions have a comparative advantage when dealing with different types of clients and transactions. In particular, the informal sector can engage readily in small decentralised transactions because their risk

management information and other transaction costs to formal banking institutions are relatively high.

ii) **Persistence of fragmentation**

- Informal small borrowers do not usually have access to credit in the formal market because their risk of default is perceived to be too great and the costs of administering small loans are too high.
- Informal units are excluded from the formal market because they have little direct contact with that sector, their transactions tend to be short term, and they have limited information about the formal markets.

iii) **Increased financial integration**

Greater access of informal and semi-formal agents to formal channels of credit will enable them to expand their lending operations.

2. Methodology

2.1 Sources of data

The information on which this study is based comes from both primary and secondary data sources. The secondary data are derived from a review of the pertinent existing literature, which yielded insight into how the extant secondary data could be used most effectively, and identified the major existing forms of informal finance to support the construction of the subsequent sampling frame. The information also helped identify certain knowledge gaps that are grounds for further inquiry, and served as a basis for comparing the results of this study. Primary data are derived from in-person interviews in the field with informal units in six regions – Arusha, Dar es Salaam, Iringa, Kilimanjaro, Morogoro and Tanga.

2.2 Secondary data: a review of the literature

2.2.1 *Types of informal finance*

The analysis of the existing literature revealed four important types of informal finance in Tanzania: financial arrangements among relatives, neighbours and friends; commercial moneylenders (i.e. landlords or farmer-lenders, and traders or trader-lenders); savings and credit societies (SCSs); and rotating savings and credit associations (ROSCAs). These financial entities are informal in the sense that their capital, reserve and liquidity requirements, interest rates, credit targets etc. are not subject to the regulatory powers of the Bank of Tanzania.

Financial arrangements among relatives, neighbours and friends. These arrangements have a long tradition in the country. They operate on a money basis among relatives, friends and neighbours, but because no interest charges are assessed they are non-commercial. The exact magnitude of these transactions is not known quantitatively, but the limited evidence available suggests that it is substantial. Various studies show that credit from friends and relatives constitutes an important source of start-up capital for many microenterprises in urban areas and for farmers in rural areas, in one case constituting up to 55% of total start-up investment funds (Table 1). This evidence is corroborated by studies on informal finance by Amani et al. (1987), Malkamaki (1990), Hyuha et al. (1993) and FAO (not dated). In particular, the FAO study, which was fielded in selected villages in Moshi, Pare and Korogwe districts, found that 40% of all informal loans were from friends. The quantitative importance of credit from relatives and friends is due to several factors. The most important is that such arrangements are deeply rooted in the Tanzanian culture – strong social linkages within the local community make

**Table 1 Source of start-up capital for informal sector enterprises
(percentage of total funds)**

Source	Tanzania mainland						Zanzibar
	Urban areas				Rural areas		1990
	1981	1985	1989	1991	1991	1992	
Own savings	80	40.1	64	50.5	74.0	80.3	46
Relatives and friends	15	55.3	24	47.5	19.0	17.7	45
ROSCAs ^a	0	0.1	1.0	0	0	0	0
Moneylenders	4	0	2	0.5	0.0	1.0	0
Banks/government	1	0.1	2	0.5	1.0	1.0	4
Others	0	4.5	8	0	6.0	-	5

^a Rotating, savings and credit associations

Sources: Bagachwa (1981), ILO/JASPA (1985), Sabai et al. (1989), United Republic of Tanzania (1991), Zanzibar Revolutionary Government (1990).

these mutual help schemes essentially social obligations. Another factor is the geographic proximity between lenders and borrowers, which, because it allows the financial interaction to be made on a more personal basis, facilitates the extension and repayment of credit. Finally, credit terms are popular – many of these loans do not require interest or collateral, their repayment arrangements tend to be open-ended, and they are based on reciprocity.

Commercial moneylenders: traders and landlords. Beyond non-commercial money lending among friends and relatives, evidence also suggests that the urban and rural segments of Tanzanian society contain various types of commercially-oriented moneylenders. Landlords, or farmer-lenders, are reported to exist in the rural areas of Iringa (Mlambiti et al., 1990). Another survey of rural informal finance undertaken by Malkamaki (1990) in Dar es Salaam, Morogoro and Mtwara regions found that about 5% of the respondents had borrowed from professional money or equipment lenders. However, professional money lending in Tanzania does not seem to be as pervasive as it is in some parts of West Africa. Hyuha et al. (1993) and the surveys by the FAO (n.d.) and Amani et al. (1987) suggest that professional moneylenders do not play an active role in the intermediation of informal finance. But the relatively low profile allegedly assumed by moneylenders in channelling informal credit could just be a camouflage, reflecting in part the traditional view that commercial lending is exploitative and in part the previous socialist policies and ideology that discouraged all forms of private entrepreneurship. Given this rather hostile environment, Malkamaki (1990) believes that most moneylenders do not admit to engaging in this practice. Thus, their numbers and their role in providing informal credit may be underestimated.

Undoubtedly, recent trade liberalisation has not only allowed existing informal lenders to surface more openly but has also stimulated the emergence of new lenders. As Gordon (1989) documents, informal operators have reacted vigorously to the dismantling of grain trade restrictions:

In volume terms, open market sales grew seven-fold between 1980/81 and 1987/88. The growth in volume has been accompanied by an increasing number of market participants both in assembling grain and wholesaling and retailing in urban centres. In Dar es Salaam wholesale markets a new class of traders has emerged that provides short-term financing for crop purchasing and financing and who, in addition to trading on their own account act as brokers, provide buying and selling services to others for a fee. The number of these traders has grown from 15 in the early 1980s to nearly 100 now. Similarly the number of traders active in rural markets has grown significantly. (Gordon, 1989, cited in World Bank, 1991: 50–51)

Savings and credit societies. The informal financial sector also contains savings and credit societies (SCSs). These associations consist primarily of groups of individuals linked together by a common ethnic, or residential or occupational bond and who adhere to internally set rules and regulations. Most of these groups are formed spontaneously, although in some cases the government has tried to influence their formation. Two broad types of SCSs exist in Tanzania. The '*SCSs proper*' are independent legal cooperatives, primary societies that raise money from routine contributions by their individual members and then use some of the money as loans to members. The SCSs proper operate primarily in urban areas. '*Savings and credit schemes*', whose objectives are similar to those of SCSs proper, are not independent legal entities but merely the savings and credit activities of primary cooperative societies whose functions extend beyond mobilising savings and providing credit to members. These schemes currently operate primarily in rural areas (Keddie, 1992).

The Cooperative Societies Act of 1991 allowed primary cooperative societies to raise money from their members on both share and deposit accounts. In practice, SCSs proper use both accounts, while savings and credit schemes raise money almost exclusively on deposit accounts because they lack shares. While money in deposit accounts is voluntary savings and can be withdrawn at the depositor's discretion, money in share accounts can be withdrawn from the cooperative society only when one withdraws entirely from the society.

Traditionally, SCS loans in Tanzania have been used to purchase consumer goods. However, growing economic difficulties have prompted the societies to offer three types of loans: productive loans for income-generating activities, housing and other subsistence needs; provident loans for school fees, medical fees and so forth; and emergency loans for funerals, weddings, or other disasters. Membership is open to persons aged 18 years and older who have a regular source of money and the acquaintance of other members of the society. Group membership is limited to 10

people. The groups operate in occupational areas, workplaces, parishes, villages and other community configurations. Normally, each member can save as much money as he or she is able, provided that none of the members owns more than one-fifth of the total savings of the group. Participants in these groups contribute payments periodically (monthly or fortnightly).

Rotating savings and credit associations. Rotating savings and credit associations (ROSCAs) generally combine savings and credit arrangements. They explicitly pool savings and tie loans to deposits. As with savings and credit societies, ROSCAs are owned and controlled mutually by a group. To minimise loan-collateral and borrower-information problems, they enrol only members in whom all others have confidence or who are sponsored by someone who can guarantee their performance. Consequently, loan recovery is not a problem: defaulting members not only lose the opportunity to remain in the association, but they may also be shunned altogether by social and business peers.

In Tanzania, ROSCAs are known as *upatu* or *mchezo*. Two detailed studies have revealed that *upatu* are spread widely throughout both urban and rural areas (Ndanshau, 1990, and Malkamaki, 1990). Ndanshau's study was based on interviews with 90 members in 49 *upatu* groups, and addressed both operational features and demographic composition. It found that these groups intermediate a substantial volume of savings among their members, and that members participate in these thrift groups as a response to the economic hardships they face from increases in the cost of living and the inaccessibility of formal financial credit. Thus, the funds loaned to participants in *upatu* groups go largely toward financing the purchase and consumption of such expensive items as furniture – items that cannot be purchased solely from individual income. The study also found that a limited amount of the savings in *upatu* went toward the purchase of inflation hedges, such as gold bangles and necklaces, and that the groups had different payment contribution periods: 47% had a payment contribution period of one month, 32% a period of one week, and the rest a daily contribution policy.

Ndanshau also found that more than 80% of the *upatu* groups in Dar es Salaam consisted of from 5 to 10 members, but that some groups contained up to 56 members. Moreover, 76% of group members were women; 50% of these women were married and 26% were unmarried. Of the unmarried women, about 15% had at least one dependent child.

Finally, all of the 49 *upatu* groups surveyed were formed primarily on the basis of the similarity of relationships among members: 33% were formed from employment relationships, 20% from geographic proximity, 13% from friendships and about 20% from shared housing arrangements. Only one group had been formed from a tribal relationship.

Malkamaki's (1990) broader study of informal finance was undertaken in the Morogoro region (Dumila and Mgole villages), the Dar es Salaam region (Changanyikeni village and Manzese ward) and the Mtwara region (Mtwara town, Newala town, Masasi town and Mtendachi village). Of the 300 interviewees participating in the study, 15 belonged to *upatu* groups, and 12 *upatu* members were women. Of all respondents, about 17% knew of the existence of the *upatu* financing arrangement in the surveyed areas.

Most *upatu* respondents held a positive view toward the groups: 9 indicated that *upatu* were performing well, while 5 indicated that they were performing satisfactorily. Of the *upatu* members, 12 had used their money to open up or sustain business operations, and 3 had used it to purchase consumption items. Interestingly, because restrictions are not normally placed on how *upatu* money can be used, about 50% of the participants indicated that they had saved part of their *upatu* income. This finding is confirmation of Tripp's (1988) study, which found that *upatu* gained momentum in the late 1970s and early 1980s when income erosion forced many wage earners to seek opportunities in income-generating activities in the real informal sector (that is, as part of microenterprises). The *upatu* no longer served solely consumption needs; money was increasingly being used to finance productive investment in the real informal sector.

2.2.2 Addressing gaps in the data

In general, studies on the informal financial sector in Tanzania reveal that the sector has two important characteristics. First, the several diverse informal financial institutions that exist are operating on a small scale and are semi-organised, primarily unregulated intermediation processes undertaken largely by mutually related groups of individuals. This intimacy and flexibility allows wide latitude in decisions about types of loans, lending conditions and repayment schedules.

Second, the sector can play an effective role in mobilising savings and in the intermediation process – due in part to its compatibility with the social-cultural environment in which it operates. For example, the wide geographical dispersion of the units makes them better suited to serving a small number of scattered borrowers; their organisational flexibility supports a wide range of financial services; and the close-knit organisations, built around local values and traditions and the intimacy of borrowers, create great social pressure to repay loans. But the sector's potential for dynamic growth is also due in part to the evolving financial behaviour of borrowers: a substantial amount of loanable funds are going toward financing production and investment for expanding productive capacity.

Despite offering valuable data on informal finance in Tanzania, the existing literature lacks information on the factors that have given rise to such market fragmentation. In particular, a systematic study has not been undertaken on the

structural and institutional features that tend to separate the informal and formal segments of financial markets – differences in transaction costs and credit risks, information on borrowers and the extent of financial repression. This study endeavours to fill this knowledge gap.

2.3 Primary data: field interviews

Primary data for the study come from a random sample of informal financial institutions (IFIs) in 6 of the 20 regions of Tanzania. Multi-stage sampling generated the sample, and the six regions chosen reflected the diverse socio-economic and ethno-cultural aspects of IFIs. The Dar es Salaam region along the Indian Coast contains the largest city and is the largest commercial and industrial centre in Tanzania. Boasting the largest per capita income and hosting about 12% of real informal sector enterprises in the country, the region also has the most diverse communities of different cultures. The Arusha region, north of Tanzania, contains the second largest industrial town. Its rural communities are predominantly pastoralist, with strong cultural ties. The Kilimanjaro region, northeast of Tanzania, is the most densely populated. It has the most developed rural infrastructure and is the major producer of coffee, Tanzania's leading export crop. The region has the most aggressively commercially oriented communities. Iringa, southwest of Tanzania, hosts one of the fastest growing towns in the country. The Morogoro region, located in the centre of Tanzania, is one of the poorest regions, with a badly developed infrastructure. It has a mixed rural community of both seasonal crop growers and pastoralists. Finally, Tanga, along the eastern coast, is inhabited predominantly by Moslem communities.

Within the six regions, the selection of the six regional headquarters – Dar es Salaam, Arusha, Moshi, Iringa, Morogoro and Tanga was automatic. However, informal finance operators within each town were selected randomly from the ward that contained the largest population.³ Although operators within rural areas were selected at random, the sample was confined to rural villages bordering that town (except in Dar es Salaam, which was primarily urban). Much of the analysis is qualitative. Frequencies and other descriptive statistics are used to describe the characteristics of the sample. Where data permit, t-tests and the F-statistic have

³ The underlying assumption was that the intensity of 'informal' finance was positively correlated with population size. Where the required number of informal lenders was insufficient for a sample, lenders from another ward supplemented the sample.

been used to test the significance of differences in means of comparable variables and of different variables respectively.⁴

This study focuses primarily on IFIs already identified in the previous studies, i.e. commercial moneylenders – traders, landlords, SCSs and ROSCAs. The study excludes arrangements involving relatives and friends, because, though predominant, they are not commercialised.

⁴ Statistically significant differences in the t-tests are always reported at the 5% level here; when the F-statistic is less than one, the null hypothesis that no significant difference exists is accepted.

3. The characteristics of IFI operators and borrowers

3.1 Informal lenders

The composition of respondents to the study is heterogeneous, exhibiting a wide distribution of socio-economic and demographic characteristics (Table 2). However, the predominance of male lenders in both urban and rural areas is conspicuous. Of the 31 urban lenders surveyed, only 6 were women; in rural areas, only 8 of 28 lenders were women. Most female lenders were concentrated in ROSCAs (57%). Women lenders were not represented among traders and there was only one landlady. But when the employment profiles of IFIs and microenterprises in the real informal sector are compared, it is apparent that IFIs have proportionately fewer female operators – 24% versus 35% (for figures, see United Republic of Tanzania, 1991).

IFIs are managed by fairly literate persons. Only 2 of the 59 lenders did not have any formal education and both of them were located in rural areas. Slightly more than one-third of the lenders had completed just primary school education (grades 1 to 8), while the majority (61%) had attained secondary school or post-primary school vocational (technical) training and above. The relatively high levels of formal training among the IFIs contrast sharply with those prevailing in the real informal sector. A recent survey found that 16.7% and 30.7% of the real informal sector operators in urban and rural areas, respectively, did not have any formal education, about two-thirds had completed primary education, but less than 10% had attained secondary school and/or vocational training and above (for figures, see United Republic of Tanzania, 1991).

Table 2 Selected characteristics of informal credit lenders by urban and rural area

	<i>Gender</i>				<i>Educational level</i>					
	<i>Urban</i>		<i>Rural</i>		<i>None</i>		<i>Primary</i>		<i>Secondary/ vocational</i>	
	<i>M</i>	<i>F</i>	<i>M</i>	<i>F</i>	<i>Urban</i>	<i>Rural</i>	<i>Urban</i>	<i>Rural</i>	<i>Urban</i>	<i>Rural</i>
Traders	13	0	9	0	0	0	5	4	8	5
Landlords	0	0	7	1	0	1	0	6	0	1
SCSs	12	4	2	1	0	0	2	0	14	3
ROSCAs	0	2	2	6	0	1	1	3	1	4
Total (n=59)	25	6	20	8	0	2	8	13	23	13

Source: Survey data from the study.

Differences in formal training levels seem to explain why the process of recording business transactions differs between IFIs and the real informal sector. The low levels of formal training among informal operators in the real informal sector imply that, although they are technically proficient in their respective areas of operation, they tend to be ignorant in financial and business management and organisation. This fact may explain why more than 80% of the proprietors do not even keep a rudimentary set of books for business transactions: they simply lack the knowledge to do so. In IFIs, 99% of lenders keep records of loan transactions.

3.2 Borrowers

The sample is not large enough to allow definitive statements about the relative volumes of different types of clients. However, the major categories of borrowers include farmers, traders, microenterprises, wage employees and members of various associations. It appears that traders tend to lend primarily to other traders (65%), either directly or for on-lending, and to a limited extent to microenterprises (10%) and farmers (25%). Farmer-lenders or landlords tend to lend primarily to small farmers (68%) and large farmers (32%), while ROSCAs and SCSs tend to confine their loans to members. The major beneficiaries of SCSs are public servants (in urban areas) and farmers (in rural areas).

The majority of clients live in the same town (93%) or village (80%) as do their lenders. Even for the few non-resident clients, the usual distance between the client and the lender appears to be somewhere between 10 and 20 km. Proximity is in part a reflection of the fact that informal credit transactions tend to be based on personal relationships, which in turn enhances trust among the transacting parties. Moreover, decisions about creditworthiness based on long-standing personal contracts among borrowers and lenders who live nearby can probably be made more accurately and less expensively than those based on detailed investigations by loan officers in formal financial institutions. Equally important, locational proximity helps delay transportation costs and overcomes poorly developed channels of information.⁵ Proximity reduces the costs not only of screening loans but also of monitoring loans – attributes that reportedly hold in The Gambia (Shipton, 1991) and Taiwan (Biggs, 1991).

The demand for informal credit, as reflected by the number of applicants, seems to have grown significantly between 1990 and 1992 (Table 3). The total number of loan applicants in the sample increased by 21% during that period, from 2,795 to 3,393. Demand increased slightly more rapidly in urban areas than in rural areas

⁵ This may be the case where the costs of obtaining information about conditions in distant markets exceed the possible profits from trading in those markets (Jones et al., 1991: 7).

Table 3 Average annual number of loan applications and approvals by urban and rural area, 1990–92

	<i>Urban</i>				<i>Rural</i>				<i>Total</i>			
	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>%age growth 1990–92</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>%age growth 1990–92</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>%age growth 1990–92</i>
Applications												
Traders	30	40	53	76	29	34	41	41	59	74	94	59
Landlords	–	–	–	–	56	77	88	57	56	77	88	57
SCSs	2,323	2,710	2,795	15	265	237	268	1	2,588	2,947	3,063	14
ROSCAs	18	22	37	105	74	92	111	50	92	114	148	61
Total	2,371	2,772	2,885	22	424	440	508	20	2,795	3,212	3,393	21
Approvals												
Traders	21	31	39	86	29	34	41	41	50	65	80	60
Landlords	–	–	–	–	54	71	71	16	54	71	71	11
SCSs	2,284	2,596	2,778	22	254	218	258	2	2,538	2,814	3,036	20
ROSCAs	18	22	37	106	74	92	111	50	92	114	148	61
Total	2,323	2,649	2,854	23	411	415	481	17	2,734	3,064	3,335	22

(22% versus 21%). In general, more males than females apply for credit (66.3% versus 33.7%). Similarly, the total number of loans that were approved increased from 2,323 to 2,854 in urban areas (23%) and from 411 to 481 in rural areas (17%). Thus, the demand for informal credit appears to be growing more rapidly in urban than in rural areas. This is also the case within the real informal (microenterprise) sector. Between 1990 and 1992, the number of loan applicants in the microenterprise sector increased by 32% in rural areas and by 35% in urban areas. In general, but especially in rural areas, the peak borrowing period occurs near the start of the growing season and many loans are repaid after the first crops are harvested.

3.3 Observations

The observed recent increase in the demand for informal credit from IFIs appears to coincide with the recent rapid increase in the number of establishments and employment in the real informal (microenterprise) sector. Bagachwa (1993) has reported that employment in the microenterprise sector nationwide has more than doubled in the past five years. The rapid expansion of the sector can be explained by three factors: the continuous erosion and compression of formal wages and salaries to levels that can no longer sustain a good standard of living; the stagnation of formal employment while the labour force continues to expand rapidly; and government retrenchment programmes and the subsequent freeze on employment growth following the adoption of the economic recovery programme.

It should be noted that the expansion of the volume of informal credit, and indeed of the mobilisation of informal savings (see section 4), is now occurring in a much more liberal environment (in which, for instance interest rate ceilings have been removed). If the informal credit market were strictly a parallel market, then it would have been eliminated when financial liberalisation was implemented. That is, if the informal market reflected merely a disequilibrium in the *official* credit market because the government controlled interest rates, which would in turn reduce the flow of funds into banks while simultaneously creating excess demand for credit at official rates, then this channel of credit would not have persisted with the liberalisation of interest rates.

But, as it appears, and as has been demonstrated by Yotopolous and Floro (1991) for the Philippines, informal credit institutions would exist even in the absence of government-induced financial repression. In credit markets characterised by imperfect information about borrowers, interest rate increases by banks in order to maintain the balance between supply and demand may give borrowers an incentive to adopt higher yield but also riskier projects, thus increasing their probability of default. Consequently, as interest rates rise, low risk borrowers may be forced to drop out altogether, leaving a pool of income-disposable and thus more desirable clients.

In such circumstances, lenders would prefer to ration credit on the basis of a client's perceived risk of default. Since small business owners, traders, poor farmers and households cannot provide acceptable collateral, are not regular bank clients and require small loans (and thus incurring higher administrative costs), they are perceived to be higher risk and are thus rationed out of the formal credit market. The poor borrowers must resort to informal lenders to satisfy their credit demands, even if sometimes at higher rates of interest than in the formal sector. This is one source of credit market fragmentation.

4. Deposit and lending operations

4.1 Deposit mobilisation

According to the survey, commercial moneylenders (trader-lenders and landlords) do not generally mobilise deposits. Deposit mobilisation is carried out by SCSs and ROSCAs. Both play an important role by mediating savings that would otherwise not have been accumulated. In doing so, they also manage to induce small savers to keep money that would have been spent otherwise on non-essential consumption. In addition, such groups tend to keep the money circulating in a community.

The apparent success of these operations is reflected by the rising number of deposits in both rural and urban areas (Table 4). The total volume of deposits

Table 4 Deposit characteristics by urban and rural area, 1990-92

	Urban				Rural			%age change 1990 -92
	1990	1991	1992	%age change 1990 -92	1990	1991	1992	
Total deposits (TSh 000)								
SCSs	36,670	47,230	60,180	18	2,225	3,990	4,921	5.3
ROSCAs	350	340	700	100	1,100	2,252	2,395	40
Average number of depositors per lender								
SCSs	238	281	281	64	93	91	98	121
ROSCAs	9	11	18	100	10	13	14	117
Average value of deposits per lender (TSh 000)								
SCSs	2,292	2,956	3,761	64	741	1,330	1,640	121
ROSCAs	175	170	350	100	138	282	300	117

Source: Computed from survey data.

mobilised by SCSs and ROSCAs increased by almost 2.5 times (57% in real terms) during 1990–92. The average number of depositors per SCS lender in rural areas increased from 93 in 1990 to 98 in 1992; in urban areas, the increase was much greater – from 238 to 281 depositors during the same period. In general, the observed increase in deposits is due to the absolute increase in both clientele and actual amounts deposited.

In general, the frequency of deposits differs between SCSs and ROSCAs. Monthly deposits in SCSs show wide fluctuations, peaking immediately after harvest seasons in rural areas and declining in December (Christmas time) and in the holy month of Ramadhan. In ROSCAs, all members tend to contribute a fixed amount at each of a series of regularly scheduled meetings, after which one of the members takes home the contributions until the entire contribution cycle is completed. Savings in the ROSCAs do not earn interest; as such, with a 22% inflation rate during 1990–92, the real interest rate on savings was actually negative. But it appears that most poor persons, especially in rural areas, are willing to forgo the interest they might earn in formal institutions as a compromise for the inconvenience of using formal savings mechanisms – long distances, inconvenient banking hours, minimum deposit and withdrawal rules, and cumbersome paperwork.

Accurate estimates of the total amount of resources mobilised by SCSs and ROSCAs nationwide are not available. However, the limited evidence available for SCSs suggests that the volume could be substantial. In 1990, for example, Tanzania contained about 485 urban-based SCSs proper and 438 rural-based savings and credit schemes, with an estimated 93,111 and 68,385 members, respectively. The total volume of resources mobilised by these IFIs was estimated to be about TSh 828.4 million in 1990, representing about 4% of the total savings deposits of commercial banks, but 3.1 times the total deposits mobilised by the Tanzania Postal Bank. Loans outstanding were estimated to be TSh 458.3m for SCSs in urban areas and TSh 44.7m for schemes in rural areas. These figures imply a loan–deposit ratio of 0.82 and 0.17 respectively, and suggest that savings and credit schemes are underexploited in rural areas.

That an expansion of informal deposit mobilisation is occurring in an environment in which official nominal interest rates have been liberalised and raised to positive levels in real terms runs contrary to the belief that interest rate deregulation would stimulate a transfer of funds from the informal to the formal financial market. This transfer may not have taken place for two reasons. First, as mentioned in section 3.2, formal financial institutions would prefer to ration credit and extend loans to large and more established traditional clients, creating a large pool of potential borrowers. Second, and as highlighted later, informal lenders tend to have a competitive advantage in small decentralised transactions, since their management information and other transaction costs are negligible when compared with those for formal banking institutions. This advantage is an incentive that helps perpetuate their existence.

4.2 Lending characteristics

4.2.1 Informal credit as a complementary activity

A notable characteristic of IFI operators is that their lending operations are largely part-time activities (Table 5).

Table 5 Lender status by urban and rural area

<i>Urban</i>		<i>Rural</i>	
<i>Part time</i>	<i>Full time</i>	<i>Part time</i>	<i>Full time</i>
13	0	8	1
0	0	8	0
13	3	2	1
2	0	8	0
28	3	26	2

Source: Survey data from the study.

In rural areas, 26 of the 28 lenders interviewed reported operating on a part-time basis; in urban areas, 28 of 31 reported operating part-time. Although information on the actual flow of labour-hours spent annually on different activities is unavailable, the perceptions of respondents suggest that part-time lenders in rural areas spend about 33% of their time on lending, and that part-time lenders in urban areas spend less, about 20%. In rural areas, the other major activities of part-time lenders include trading and other farming and non-farm activities; in urban areas, they include wage employment and small businesses. In general, the primary occupation of trader-lenders is trading and the primary occupation of landlords is farming.

It appears that both the financial and real segments of the informal economy operate largely part-time. In the real informal sector, it is estimated that about 38% of informal operators in rural areas spend about half their time on informal sector activity. In urban areas, this proportion is lower at 30% (Bagachwa, 1993). The pronounced seasonality of rainfall has a significant effect on labour use in agriculture, which tends to be concentrated in peak periods of relatively short duration – typically 30% to 50% of total annual labour in a 2 to 3-month period. Thus, a portion of the rural labour force can also be involved in part-time non-farm activities, especially during the slack period. Seasonality is also an important

determinant of IFI economic activity in rural areas, in which money revolves around the harvest season. Lending tends to be liveliest after a poor harvest and repayments tend to peak immediately after a good harvest.

Beyond the time made available by seasonal factors, the prevalence of part-time informal finance can be explained by the exigencies of the primary or regular occupation of the lender – whether farming, trading, input dealership, land leasing and so forth. As Yotopoulos and Floro have noted, it is the risk and uncertainty associated specifically with a regular and reliable supply of inputs for the lender's primary economic activities that provide an additional motivation to interlink credit:

Landlords are uncertain about the level of tenants' efforts and are wary of any shirking that might reduce their share of the harvest. Traders . . . have no assurance regarding their share of farmers' output, which in turn determines their supply of selling inventories. Input dealers are not certain of the level of expected demand for their merchandize. Rich farmers . . . lack prior information on the farmers who are likely suppliers of land occupancy or usufruct rights. (Yotopoulos and Floro, 1991: 146)

By linking other market transactions with credit, lenders can improve their forecasts of anticipated input supply needs, thus facilitating their forward planning.

4.2.2 Primary sources of capital for lending operations

The major sources of initial lending capital vary by type of lender. The sole source of start-up capital for ROSCAs has been membership contributions – that is, deposit mobilisation. SCSs have depended primarily on shares and deposits from their members and clients (82% of their initial capital) and secondarily on income from other activities, which is even more true of rural-based schemes. Trader-lenders and landlords have derived about 60% of their initial lending capital from accumulated personal savings, and about 35% from income generated by other activities. Bank loans do not appear to have been an important source of start-up capital for lending.

The main sources of current lending capital are membership contributions – 100% for ROSCAs and about 74% for SCSs. Revolving funds and accumulated profits from lending account for about 65% and 53% of the sources of current lending capital for trader-lenders and landlords, respectively. Income from other economic activities contributes between 35% and 40% of current lending capital for moneylenders. Most respondents (85%) indicated that, since the beginning of lending activity, the capital base has grown, and only 3% indicated that it has declined. The remaining 12% reported that it has not changed.

The observed growth of the capital base for lending has four important implications, particularly in light of the fact that a significant portion of this capital consists of revolving funds and mobilised informal savings. First, the growth dispels the belief sometimes held that household savings, particular in rural areas, are not substantial. Indeed, the official national accounts do not capture the sizeable amount of savings that exist. Second, it suggests that rural households and some of the poor urban communities of Tanzania are increasingly shifting away from the traditional non-monetary forms of savings – stocks of agricultural products, livestock, valuables, household assets and so forth – toward monetary forms of savings. This tendency has also been observed in Zambia (Mrak, 1989). These more liquid forms of savings are being used to finance the education of children, to meet such irregular expenses as funerals and weddings; and to invest or expand investments (for example, to buy or build a home, purchase inputs or equipment, and improve or enlarge farms). Third, the rapid expansion of the capital base for informal lending reflects the responsiveness of informal lenders to their clients' economic and social requirements – easily understood rules and procedures, flexible lending arrangements, the absence of restrictions on how loans are used, credit at short notice and local adaptability. Finally, it suggests that informal financial institutions face relatively low transaction costs, in particular extremely low costs for assessing the borrower's creditworthiness and collecting loans, due to strong social pressure.

5. Informal lending arrangements and the characteristics of loans

5.1 Trust, adverse selection, moral hazard and enforcement

Credit, whether formal or informal, involves an intertemporal relationship between a borrower and lender, with the promise that the borrowed amount will be repaid in the future. Since repayment is not always guaranteed, credit transactions generally involve an element of trust. In formal credit transactions, trust is secured with a well-developed financial and legal infrastructure – the availability of legally recognised collateral, information networks, well-established financial regulations, court systems and so forth. This infrastructure facilitates the flow of essential information and helps ensure that contracts are enforced and that collateral can be liquidated and transferred if necessary. As such, it significantly reduces some of the transaction costs – of information gathering, negotiations, coordination, monitoring and contract enforcement. However, IFIs are without this trust-building market infrastructure.

Beyond the issue of trust, both formal and informal lenders face three related problems, particularly given the asymmetry of information and the longitudinal nature of credit disbursement and repayment. The first pertains to adverse selection, that is a lender's inability to distinguish a potentially good borrower from a bad one at reasonable cost. The second is a moral hazard, in which prohibitive monitoring costs arise from an uncertain environment (for example, random production, a consumption shock, or bad luck) that might negatively affect the returns on a borrower's activities and capacity to repay. Third, the lender faces problems with enforcement, since, in the event of default, the lender must recover the principal and interest either from the borrower's returns or from the collateral specified in the loan contract (Bell, 1990).

But within the limits imposed by an inadequately developed market and its associated transaction costs, several IFIs in the survey appear to have evolved a variety of informal methods for enhancing trust among transacting parties, minimising adverse selection and mitigating the moral hazard:

- using personal ties to build an intimate knowledge of the borrower's character and circumstances, thereby enhancing trust among transacting parties;
- using interlinked contracts to increase information, improve contract enforcement, and adapt to the moral hazard implicit in many loan transactions;

- using collateral pledges;
- specialising in small decentralised transactions for which formal financial institutions face relatively high management information and other transaction costs;
- using intermediary agents ('credit layering') to reduce the costs of monitoring credit and gathering information;
- using quantity rationing to allocate credit funds according to differing criteria for creditworthiness.

5.2 The importance of personal ties for enhancing trust

Since credit involves trust, increasing the level of confidence in the borrower's ability to repay in the future is an essential component of any credit programme. Trust-building in informal credit transactions appears to revolve around personal relationships. Personal considerations seem to be a necessary (though not sufficient) loan criterion. This aspect is reflected in many forms. Much of the previous literature indicates that small farmers and owners of microenterprises turn first to relatives or friends if they wish to borrow (Bagachwa, 1993; Hyuha et al., 1993). They appear to do so whether they are seeking credit for start-up capital or for capital expansion. Potential borrowers tend to resort to these sources for various reasons, including the lender's locational proximity, the likelihood of persuadability, the low interest charges (sometimes none at all), and lenient repayment (Mrak, 1989; Shipton, 1991). Lenders prefer to lend to relatives or friends for similar reasons – proximity that reduces information and monitoring costs, kinship ties that exert social pressure to repay, and a well-established tradition of mutual help that has long been considered a social obligation. It is perhaps not surprising that most loans among relatives and friends, do not require guarantees or collateral. The social pressure to repay is ever present, as is the threat of being refused future loans in case of default.

The survey revealed that personal ties are also an important determinant of loans among informal non-relatives. In choosing lenders, non-relative clients will lean on community, ethnic, or other social ties, such as peer groups, school acquaintances, and recommendations from reliable and established relatives, friends, or other clients. According to the survey, 78% of urban informal clients and 90% of the rural informal clients rely primarily on ethnicities and recommendations from relatives, old clients and contact persons to acquaint themselves with a lender's business.

Similarly, the lender's familiarity with the borrower's economic and social behaviour appears to be essential for facilitating the loan screening and selection

process. Survey responses reveal that an average of 86% and 63% of urban and rural informal lenders, respectively, always personally knew the persons who applied for loans (the proportion was almost 100% for ROSCAs). Only 9% indicated that they did not always know the persons who applied for loans (the rest indicated that they sometimes knew the applicants). In general, more than two-thirds of successful applicants were personal acquaintances of lenders before they made their applications. Furthermore, the fact that about 95% of repeat loan applicants in 1992 were successful suggests that moneylenders prefer to deal with known, longstanding clients in order to mitigate the problem of moral hazard.

Thus, the extended family, friendship, kinship and other social relationships are instrumental in shaping the personal ties that not only enhance trust between transacting parties but also facilitate simple loan processing and monitoring. By making burdensome and time-consuming documentation and other paperwork unnecessary, they reduce the lender's screening, processing and monitoring costs. For example, 27 (87%) and 25 (84%) of urban and rural informal lenders, respectively, indicated not having ever tested applicants before granting them loans. It is important also to note that the presence of trust and the existence of operational flexibility usually allow lenders to grant clients almost the same amounts as they request (see Table 3).

5.3 The nature and types of loans

5.3.1 Interlinkage of loans

The survey identified two main types of informal credit contracts: linked and unlinked loans. Unlinked loans are contracts between borrowers and lenders that deal only with one market exchange. They are the domain solely of trader-lenders and landlords. Linked credit transactions involve two or more market exchanges (Braverman and Srinivasani, 1980). In poorly developed credit markets, the interlinkage of contracts has three main advantages. First, it helps increase information (by reducing *bounded rationality*)⁶ and improve contract enforcement (since it reduces *opportunism*).⁷ Second, it reduces uncertainty by improving the

⁶ In this context, bounded rationality refers to the inaccessibility of information about market opportunities and thus an inability to predict future outcomes of certain events or contracts.

⁷ Opportunism refers to the possibility that mutually reliant parties may mislead, distort, disguise, or confuse each other in order to expropriate wealth from each other (Biggs, 1991: 193). For example, control over the borrower's assets constitutes some form of dependence and can be one way to reduce post contract opportunism.

lender's forecast of individual behaviour and thus the lender's ability to select risk appropriately from several potential borrowers. Third, it expands the control variables and strategies available to a lender, enabling the lender to influence the borrower's actions. An interlinked transaction may thus be considered a disguised form of collateral and may help mitigate moral hazard or adverse selection (Udry, 1990).

Four main types of market interlinkages were identified during the survey of rural moneylenders:

- i) loans linked to the sale of output to the lender
- ii) loans linked to the purchase of inputs or equipment from the lender
- iii) loans linked to the transfer of land rights
- iv) loans linked to the provision of labour services to the lender

The first two market interlinkages are prevalent among trader-lenders, whose loans to farmers are often linked to the purchase of inputs or the sale of output. Loans linked to output are generally linked to the agricultural cycle and require that borrowers sell their output to their lenders. The sale of crops to a lender enables the lender to exercise first claim on proceeds at an advantage over the borrower's other creditors. In such cases, lenders sometimes use credit interlinkage to close the borrower's access to other lenders. The last two are exclusively the domain of landlords, who link loans to their primary occupation. Among all rural moneylenders, the most dominant form of informal credit contracts appears to be linked loans, which constituted 86% of their total volume of credit in 1992 (Table 6). Of the total volume (TSh 21.4m) of loans issued by trader-lenders in 1992, 87% (TSh 186m) were linked. Among landlords, 71% of their total volume of credit was linked.

Two types of linked loans between lenders and farmers are tied to land. Richer farmer-borrowers can borrow by pledging highly productive land as collateral. The lender can then use the mortgaged land for cultivation or receive an agreed-upon portion of the borrower's harvest from the land. After the conclusion of the contract (generally one to two years), the land use rights are returned to the borrower, and the loan, both principal and interest, is considered repaid in full. Alternatively, for smaller loans, a lender may issue a loan against the mortgaged piece of land, which it can use indefinitely until the loan principal is paid in full. In both cases, the lender acquires rights to the land in the event of default.

5.3.2 *Loan sizes and maturity*

In general, linked loans tend to be larger than unlinked loans. In 1992, for example, an average linked loan by a trader-lender was five times larger than a non-linked loan. For landlords, it was twice as much. Average urban loan amounts are

Table 6 Amount of credit loaned in 1990-92 (TSh 000)

	<i>Urban</i>			<i>Rural</i>		
	1990	1991	1992	1990	1991	1992
Total amount by category of lender						
Traders	31,570	47,500	55,670	9,770	15,780	21,388
Linked	0	0	0	8,010	12,625	18,608
Unlinked	31,570	47,500	55,670	1,760	3,155	2,780
Landlords	-	-	-	530	695	870
Linked	-	-	-	350	452	626
Unlinked	-	-	-	180	243	244
SCSs*	40,440	118,620	82,350	3,070	2,950	4,040
ROSCAs*	351	341	5,990	1,160	1,855	3,060
Average loan amount						
Traders	1,500	1,530	1,430	337	464	522
Linked	-	-	-	276	371	453
Unlinked	1,500	1,530	1,430	61	93	68
Landlords	-	-	-	10	10	12
Linked	-	-	-	6.5	6	8.8
Unlinked	-	-	-	3.3	3.4	3.4
SCSs*	18	50	30	12	13.5	15.7
ROSCAs*	19	16	162	15	20	27.5
Highest & lowest loan amounts, 1992						
Traders						
Highest			4,000			3,600
Lowest			500			20
Landlords			-			
Highest			-			60
Lowest			-			3.4
SCSs						
Highest			900			120
Lowest			2			0.5
ROSCAs						
Highest			40			30
Lowest			5			3.5

* All loans were unlinked.

Source: Computed from survey data.

consistently larger than those in rural areas. Similarly, trader-lender loans tend to be larger than those granted by other lenders. Overall, informal loan sizes vary enormously, but they are generally very small. In 1992, the largest loan issued (in

the sample) was Tsh 4m (about US\$12,500) while the smallest loan was TSh 2,000 (about US\$6.25). Analysis of variance (ANOVA) confirms the existence of significant variations in loan sizes by type of lender, urban/rural location, and whether or not loans are linked.

Loan maturity periods vary from one lender to another, but range between 1 and 24 months. Trader-lenders typically grant loans of between 1 and 12 months with unlinked loans maturing in 3 months and linked loans maturing in 6 to 12 months. Loans that are linked to land tend to have the longest maturity period (sometimes up to 24 months) and are expected to be repaid during harvest. Most loans for ROSCAs mature in 3 months. Although very few SCS loans were reported to mature in 24 months, the average loan matures in 3 months.

5.3.3 Pledging of collateral

According to Udry (1990: 252), collateral pledged in exchange for loans serves three important functions. First, it directly reduces the lender's cost of a loan default. Second, it is an added incentive for the borrower to repay, thereby reducing the moral hazard. Third, it can mitigate the problem of adverse selection by enabling the lender to screen out borrowers most likely to default. The fact that the majority (63%) of the informal lenders interviewed indicated that they always asked for security against loans suggests that they take the problems of moral hazard and adverse selection seriously. Thus, although most of the loans are transacted within the same village or town, the existence of linked transactions and the pledging of collateral indicates that information asymmetries between the transacting partners are important. This contrasts with the situation in northern Nigeria, where they have been found to be unimportant (Udry, 1990).

5.3.4 Intermediary credit agents

In two cases, trader-lenders used landlords as their intermediaries. Typically, a trader-lender advances capital to a farmer-lender for re-lending. The loans are to be repaid in the form of output, normally during the harvest period. The in-built advantage of this informal credit layering is that it reduces the number of borrowers served by a lender to a manageable number. In doing so, it directs credit to clients who are well known and can thus be observed closely. It is another trust-building mechanism that helps reduce transaction costs.

The analysis in this section has shown that IFIs in Tanzania do not rely heavily on the institutional and market infrastructure to build trust and reduce transaction costs. Rather, they rely primarily on interpersonal relationships and credit interlinkage. As shown later in section 7.2, these strong social ties have helped ensure an extremely low loan default rate. Furthermore, credit interlinkage reduces

the transaction costs of lenders and producers, thereby facilitating both production and financial contracts. IFIs follow a sort of market 'niche' strategy by specialising in small loans for which formal financial institutions face relatively high risk and management information and other transaction costs. However, this niche strategy has its own limitations. The small size of the transactions, their short-term nature and operations, and their locational proximity limit access to information about markets and in some cases may restrict competition.

6. Quantity rationing, client sorting rules and loan monitoring

6.1 Lenders' objective functions, sorting rules and perceptions about risk

The survey appears to suggest that different categories of informal lenders have different objective functions and hence different perceptions of risk. This type of behaviour has led some lenders to use quantity rationing – allocating credit funds on the basis of their own subjective criteria of creditworthiness – rather than to clear the market by charging what the traffic will bear.

As pointed out in section 5.3.1, ROSCAs and SCSs prefer unlinked loans and target members of their associations as clients. The two are interested primarily in maximising savings, because the loans are usually tied to deposits or shares. This arrangement implies that they tend to screen potential borrowers not necessarily on the basis of liquid or tangible collateral, but on the basis of a good track record of fulfilling deposit obligations. They address the problems of loan collateral, creditworthiness, and borrower information by enrolling only members who have mutual confidence in each other or who have sponsors who can guarantee their performance.

Trader-lenders and landlords tend to have different objective functions and different perceptions about risk. As pointed out earlier, the main occupation of trader-lenders is trading. They thus seek to maximise returns on their main (trading) activity, want farmers to sell their output immediately after harvest so that they pay their loans in output as soon as possible. Because they need a high volume and reliable supply of trading inventories, traders prefer linking credit with output and/or purchases of farm inputs. This practice ensures trader-lenders of a future supply of inventories and the continued loyalty and dependability of the borrower, thus minimising market risk. It also tends to make traders very much concerned with the borrower's repayment capacity and to prefer to lend to borrowers with a low risk of default (that is, richer borrowers).

Landlords behave differently than trader-lenders. Since the main activity of most landlords is farming, informal lending plays two important roles. First, it supplements their farming income with interest income. Second, when credit is tied to land and the borrower fails to repay the loan, it can be used to acquire land. In fact, since both customary and state laws in Tanzania prohibit the sale of land, money lending has become an important form of acquiring land. Poor farmers are

especially vulnerable, and may be forced to give up a part of their landholdings to pay accumulated debts.

In such circumstances, landlords behave in a way that maximises their joint returns from farming (the acquisition of land for cultivation) and lending (interest income). But since access to land depends on whether loans are repaid, landlords have an incentive to lend to poor farmers (those with smaller marketable surpluses and who are vulnerable to the vagaries of weather and market fluctuations). Thus, it is not surprising that 72% of loans from landlords are tied to land.

6.2 The cost of borrowing

Another form of quantity rationing among informal lenders is the application of different interest rates to customers who pose greater or lesser degrees of risk. This practice is particularly common among trader-lenders and landlords. Moreover, it is clear not only that linked loans are larger, but that they also carry consistently lower interest rates than do unlinked loans (Table 7). Larger loans are offered to borrowers at relatively low interest rates in order to deter borrowers from spreading their loan demand over several lenders. For landlords, the accommodating terms are meant to weaken the borrower's resistance to land mortgage. Thus, credit interlinkage is sometimes used to close the borrower's access to other lenders. According to the survey, the monthly interest rates charged by trader-lenders on linked and unlinked loans averaged 6% and 9%, respectively, for a 3-month loan, and 4% and 6% for loans of longer than 6 months. Nominal interest rates charged by landlords on linked and unlinked loans averaged 6% and 8%, respectively, for a 3-month loan, and 5% and 6% for a 1-year loan. Two rural trader-lenders indicated that, even on linked loans, new customers pay slightly higher interest

Table 7 Average monthly interest rates, 1992 (%)

	Arusha		Dar		Iringa		Morogoro		Moshi		Tanga	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Traders												
Linked	-	6.5	-	-	-	6	-	5.7	-	5.3	-	5.9
Unlinked	9	9	9.2	-	8.5	8.2	8	9	8	7	8.6	7.9
Landlords												
Linked	-	5.7	-	-	-	5	-	-	-	6	-	6.6
Unlinked	-	8	-	-	-	7	-	-	-	7.3	-	6.6
SCSs	2.5	2.5	2.5	-	2.3	2.4	2.4	-	2.5	2.5	2.5	-
ROSCAs	-	0	0	-	-	0	-	-	-	0	-	0

Source: Survey data.

rates (6.9% rather than 6%) than do frequent customers. Two rural traders and one urban trader indicated that they normally charge smaller (probably poor) borrowers a higher interest rate than they do larger (probably richer) borrowers. It is also quite clear that, with the exception of ROSCAs and SCSs, informal lenders charge higher interest rates on shorter-term loans (up to 3 months) than they do on loans of a longer duration, since short-term loans tend to be small, granted to very small borrowers (with a higher risk of default), not normally slated for investment, and sometimes do not require collateral. These interest rate structures suggest that the risk of default on unlinked loans is greater than it is on linked loans, and is greater with small, poorer and new clients.

ROSCAs in the survey do not charge any nominal interest rate on loans by member depositors. In 1992, with an inflation rate of 22%, this implied that loans had negative real rates of interest. The SCSs claim to be charging official rates of interest – 31% annually for all types of loans in 1992, or 2.6% monthly for shorter maturity loans. SCSs also pay interest rates on savings of 26% annually to member depositors. In 1992, these rates were competitive with those paid by commercial banks.

Yet these averages mask enormous variation in actual interest rates charged. For example, the minimum and maximum nominal monthly interest rates charged by trader-lenders and landlords on linked loans of up to 1 year ranged from 3% to 10%. An analysis of variance in interest rates raised on an F-statistic revealed significant variations between linked and unlinked loans and among lenders. However, the interest rates charged in rural and urban areas did not differ significantly. A t-test on the mean monthly interest rates by type of lender suggests that the interest rates charged by SCSs differ significantly from those charged by moneylenders. Such evidence has also been found in Ghana (Aryeetey, 1993). A casual glimpse at the interest rates charged by informal moneylenders might give the impression that they are extortionary; in 1992, official rates of interest on most formal loans varied between 21% and 31% annually. However, it should be noted that interest rate setting in the informal sector appears to be an intricate process that involves the following social and market considerations:

- **Social relationship between borrower and lender.** The closer the relationship, the less asymmetric information is a problem, and hence the lower the interest rate. Relatives are much more likely than non-relatives to be charged lower (or no) interest rates.
- **Seasonality.** Borrowing seeds during the planting season (when they are scarce) is likely to be more expensive than borrowing seeds during the harvest season.
- **Nature of commodity.** Loans issued in cash tend to have higher interest charges than do loans issued in kind (money can be used more readily than can commodities, which may take time to be converted into cash).

- **Inflation rates.** About 20% of the lenders indicated that inflation is one of the major determinants of interest rate setting. Higher rates of inflation attract higher interest rates.
- **Likelihood of default.** Linked loans have lower interest charges than do unlinked loans; new and poor clients are sometimes subject to higher interest rates than those that are applied to regular and richer borrowers.
- **Costs of processing, administering and monitoring loans.**
- **Bargaining strength.** Borrowers with disposable wealth can bargain successfully for lower rates of interest.
- **Opportunity cost of capital.** The existence of more profitable alternatives may raise the rate of interest.
- **Time period.** Shorter-term loans (3 to 6 month loans) are charged at higher interest rates than loans of longer than 6 months.

It is difficult to assess the relative importance of each factor in the interest rate setting process. According to respondents' perceptions, however, it appears that social relationships, the inflation rate and default propensity are much more important than the others. One interesting aspect of interest rate setting in this financial sector is flexibility with the costs of borrowing. The interviews clearly suggested that in about 60% of the informal money-lending contracts in rural areas, borrowers did not understand the concept of a percentage interest rate on the loan outstanding. Some lenders indicated that they could easily negotiate a fixed total amount of interest payment to be payable either in a lump sum at the end of the contract or over a flexible period of time. This 'bargaining' process implies a form of credit rationing that would tend to favour borrowers with greater disposable income. Thus, the presence of imperfect information, strong personal relationships, locational proximity and credit linkage, means lenders are more likely to seize upon their discretion by 'creaming' borrowers who are perceived to offer the best credit risk and who require the least supervision. In such circumstances, the scope of competition becomes restricted and some lenders in specific locations may enjoy monopolistic returns. Thus, although access to informal credit is unregulated and initial capital requirements for lenders are relatively low, the informal credit market may exhibit some rigidities that effectively restrict the scope of competition. Another aspect that emerges from this analysis is that small and poor borrowers are not 'put off' by high interest rates. Such behaviour has also been found to characterise microenterprises in Kenya (Keddie, 1992).

6.3 Sorting behaviour: screening costs

As discussed throughout the report, personal ties, market interlinkages and quantity rationing are some of the features peculiar to the process of screening and sorting borrowers by IFIs. Such unique features help IFIs internalise some of the externalities that are inherent in the highly imperfect residual credit market and in the absence of a well-developed market support infrastructure.

One major category of transaction costs pertains to the costs of the process for screening loan applications and applicants. Section 5.2 pointed out that 100% of the ROSCAs, 86% of urban trader-lenders and 63% of rural moneylenders personally knew the people who applied for loans. Consequently, more than 80% of the informal lenders had never tested applicants before granting them the required loans.

In addition, only 3 of the 31 urban trader-lenders (about 10%) and two of the 28 rural moneylenders (7%) employed a person besides themselves to deal with loan screening. Thus, screening costs are likely to be kept low. The most important screening costs to moneylenders are the time spent on the process, transportation costs and stationery expenses (Table 8).

A typical urban trader-lender incurred screening costs equivalent to 1.2% of each loan granted; the proportion in rural areas was 2%. Landlords had relatively higher

Table 8 Average screening costs per average loan by a typical lender by urban and rural area, 1992 (TSh)

Type of lender	Urban			Rural		
	Average loan value	Average screening costs		Average loan value	Average screening costs	
	Value	Value	As %age of loan	Value	Value	As %age of loan
Traders	1,430,000	17,580	1.29	522,000	10,550	2.0
Landlords	—	—	—	12,000	284	2.6
SCSs	30,000	585	1.95	15,000	365	2.4
ROSCAs	162,000	120	*	27,500	125	*

* the proportion is insignificant

Source: Computed from survey data.

costs (0.6% of loan amounts) than did rural traders, because, given that most loans by landlords are tied to land, landlords must visit the mortgaged land physically to check its suitability and productivity. The screening costs of SCSs in urban and rural areas were equivalent to 1.95% and 2.4% of the loan amounts, respectively. SCSs have relatively higher screening costs per average loan because a credit committee (which normally sits quarterly) carries out loan appraisals and some committee members have to make on-site visits to projects. Conversely, ROSCAs have almost zero screening costs. In general, screening costs are generally higher in rural areas than in urban areas, due primarily to high transport costs, which raise the direct cost of communication between transacting parties and indirectly raise the prices of stationery in rural areas.

6.4 Loan monitoring

Project follow-up – regular visits to project sites, auditing and progress reports – is an essential component of formal credit monitoring and administration. This does not seem to be the case with informal credit in Tanzania. Only 2 of the 10 ROSCAs, 2 of the 19 SCSs, and 3 of the 22 traders covered by the survey reported not implementing any form of loan monitoring. Furthermore, only 2 of the 22 trader-lenders and only 3 of the 8 landlords indicated that they visited clients for loan monitoring. It appears that the existence of informal trust-enhancing mechanisms – especially personal and social ties, mutual confidence and market interlinkage – help reduce not only screening costs but also the costs associated with loan monitoring to almost zero.

7. Loan repayment and contract enforcement

7.1 Repayment schedules

A wide variety of repayment terms and schedules exist in the Tanzanian informal credit market. The variety reflects the heterogeneous character of the operators and the complexity of their perceptions about the risk of different types of clients. For example, all SCSs require that interest be repaid monthly. All ROSCAs in urban areas require that all members pay their contributions monthly. While 3 of the 8 ROSCAs require that their members contribute their regular payments monthly, the other 5 usually make their contributions every fortnight.

However, moneylenders prefer flexible repayment mechanisms. One landlord enjoyed usage rights over a pledged land for 18 months, after which the loan was considered repaid in full. Three other landlords had secured undeveloped land as collateral, which they could cultivate for an indefinite period until their client paid the principal and interest. While some trader-lenders prefer bulk payment of principal and interest at the end of the agreed-upon period, others require that regular payments be made at negotiated intervals.

7.2 Contract enforcement

One of the reasons that small (informal) borrowers are normally excluded from the institutional market for credit is that they are perceived to be at high risk of default.⁸

However, the survey results do not corroborate this conventionally perceived notion. During 1990–92, SCSs reported that only 12 cases had failed to repay the principal and interest on loans contracted during the period. ROSCAs reported only 9 such cases of 354 clients (or 2.5%), traders reported 9 such cases of 195 clients (or 4.6%), and landlords reported 8 cases of 196 (or 4%). These figures suggest that the default rate is very low⁹ and that contract enforcement costs are negligible

⁸ They are perceived to be high risk because most formal financial institutions have little knowledge about small, poor borrowers without an established track record, who cannot afford to pledge full collateral, and who may thus require substantially more supervisory costs per shilling of credit.

⁹ These default rates were much lower than those experienced by the National Bank of Commerce in loans to microenterprises – averaging 60% in 1991 (Keddie,

– almost zero on average for most lenders except landlords,¹⁰ whose estimated enforcement costs were about 0.6% of a typical loan granted in 1992.

How can the relatively low default rates among informal borrowers be explained? As pointed out in sections 5.1 and 5.2, contract enforcement in the informal financial sector is normally facilitated by the existence of social ties (and thus social pressure) and market interlinkage. For example, where credit is linked to the sale of output to the lender, it becomes easier for the lender to exercise first claim on proceeds at the disadvantage of other borrowers. Similarly, when credit is tied to land, the pressure to repay is much greater in the fear that valuable property may be lost. Thus, market interlinkage serves as collateral and improves contract enforcement by reducing post contract opportunism.

Thus, it is not surprising that the majority (72%) of landlords and traders preferred output and input control as measures for forestalling default. However, 63% of SCSs and 84% of ROSCAs would prefer to persuade, advise and encourage defaulters to repay. Collateral confiscation and court action are rare, and wherever they were mentioned they were ranked low as procurement mechanisms.

1992).

¹⁰ In case of default, the transfer of land use rights may involve substantial of negotiations and/or legal proceedings.

8. Institutional linkages

One of the major links between IFIs and the formal sector is through banking, primarily for holding deposits. About 97% of urban lenders and 67% of rural lenders held accounts with formal banks. All trader-lenders, landlords and SCSs operated accounts with banks. This pattern contrasts sharply with the pattern of microenterprises in the real informal sector, where a recent survey revealed that 409 of the 546 firms studied (or 75%) did not have a bank account (Bagachwa et al., 1993). About 75% of SCSs in urban areas operated demand deposits. The majority of the other informal lenders operated savings deposits. Thus, it will take awhile before most lenders are able to transact with clients through banks.

Only 7 of 21 traders, 1 landlord and 1 SCS had ever applied for loans from formal financial institutions. The loans to moneylenders went primarily towards expanding their primary activities. ROSCAs sought to boost their lending capacity. About 36% of all lenders indicated that they knew the prevailing official interest rates; about 14% of the traders, 13% of the landlords and most SCSs indicated that they took these rates into consideration in setting their own interest rates. In general, it appears that the IFIs are poorly linked with the formal financial sector.

9. Conclusion

The preceding sections have analysed the complex informal financial institutional arrangements through which various categories of informal lenders (traders, landlords, SCSs and ROSCAs) transact with individual traders, farmers and small firms in both rural and urban Tanzania. The analysis yields four instructive insights not only into why dualism exists in the credit market of Tanzania, but also why the market is fragmented in the informal sector.

Flexibility and adaptability of IFIs. In the absence of a formal institutional and market infrastructure (for example, government regulations, a court system and information networks), IFIs have developed several innovative informal arrangements for internalising the externalities of the highly imperfect residual credit market. The web of interpersonal relationships, market interlinkages, credit layering and custom-tailored small-scale services in which IFIs have a cost advantage has helped many IFIs not only enhance trust and mitigate moral hazard and adverse selection, but also extend credit efficiently beyond the narrow project feasibility and bankability criteria that characterise a rigid and over-regulated formal sector. Thus, informal financial intermediaries exist partly because they are able to adapt to prevailing market conditions. This flexibility and adaptability explains their resilience, as well as their ability to operate with transaction costs that are lower than those in the formal sector. *The policy implication is that if funds are channelled into the formal financial sector and away from IFIs, intermediation costs are likely to rise. Moreover, the presumably higher borrowing costs of any remaining funds would reduce investment.*

Value of IFIs. Significant expansion in the volume of informal credit and in the mobilisation of informal savings is now occurring in a much more liberal environment (which includes the removal of interest rate ceilings). If the informal credit market were strictly a parallel market – in the sense that it reflected solely a disequilibrium in the official credit market due to the government's control over interest rates, which would in turn reduce the flow of funds into banks while also creating excess demand for credit at official rates – then interest rate liberalisation would have eliminated this channel of credit.

The fact that this scenario has not played out suggests that IFIs would exist even in the absence of government-induced financial repression. In credit markets characterised by imperfect information about borrowers, interest rate increases by banks in order to balance supply with demand may give borrowers an incentive to adopt projects that yield higher returns but are also riskier, thus increasing their probability of default. Consequently, as interest rates rise, low-risk borrowers may be forced to drop out altogether, leaving a pool of income-disposable and thus

more desirable clients. In such circumstances, lenders would prefer to ration credit on the basis of a client's perceived risk of default. Since small business owners, traders, poor farmers and households cannot provide acceptable collateral, are not regular bank clients and require small loans (and thus larger administrative costs), they are perceived to be at higher risk and are thus rationed out of the formal credit market. The poor borrowers resort to informal lenders to satisfy their credit demand, even if sometimes at higher rates of interest than in the formal sector. This is another important source of dualism in the credit market.

Inherent dynamics of IFIs. Since entry into the informal credit market is unregulated and start-up capital requirements for lenders are not an important barrier, fragmentation within the informal credit market would not be expected. And, yet, these credit markets exhibit some rigidities – in the form of credit rationing and eligibility criteria (social distance, default risk propensity and so forth). Thus the markets are characterised by asymmetric information. Informal credit is transacted based on information from personal contracts, thus limiting the flow of information to the rest of the market. Indeed, the problem of asymmetric information is one of the determinants of high interest rates. This 'institutional' behaviour reinforces the earlier observation that repressed credit markets are not repressed merely because the government regulates financial intermediaries or intervenes in the credit and capital markets. A larger part of the explanation for financial dualism and fragmentation seems to lie in the inherent differences in credit transactions and institutional infrastructure.

IFIs serve a pool of able borrowers. The dramatic expansion in the mobilisation of informal credit and savings, particularly in view of the fact that informal interest rates generally tend to be higher than formal interest rates, dispels the erroneous belief that small, poor borrowers cannot pay the real cost of credit and that the poor cannot save. In such circumstances, subsidising interest rates to small borrowers is not only distortionary but also cost-ineffective and could rapidly deplete the value of loan funds. The poor should no longer be treated as beneficiaries, but as commercial clients.

9.1 Policy implications

What, then, are the implications of the analysis for policy?

First, policies should be designed on the assumption that both IFIs and the formal financial sector serve different market niches. Seeking to formalise IFIs through registration would certainly be counterproductive. Thus, policy should seek to integrate certain aspects of the two sectors selectively.

For example, one way to alleviate the difficulties faced by formal banks would be to encourage them to employ private lenders as their agents. For example, several

creative policy schemes in the Philippines have entailed using the informal sector as a conduit for government loans or credit extended by the formal sector. The resulting repayment rates have been remarkably high (Yotopoulos and Floro, 1991). Bell (1990) reports on several fairly successful schemes organised by the Agricultural Bank of Malaysia, in which farmer organisations and private traders were appointed as local credit agents of the bank.

Other cases have also demonstrated that formal sector financial institutions (FFIs) can adopt the flexible characteristics of informal sector practices and administer credit and savings services cost-effectively. The Grameen Bank in Bangladesh, the Bank Rakyat Indonesia (BRI)–Unit Desa System in Indonesia and the Podem Programme in Bolivia are prominent examples. All three pursue a strategy that calls for maintaining close proximity to their clients – Grameen, for instance, operate a network of more than 800 branches; the BRI–Unit Desa System operates about 3,600 service locations for clients. Both Grameen and Podem rely primarily on character-based assessment and have a pragmatic and flexible interpretation of the concept of collateral. Rather than individual collateral, group guarantees are made by members, each of whom is jointly liable for each other's debt. Furthermore, at all the three, documentation and repayment terms are simplified to suit the client's repayment ability, and loan approval processes are extremely rapid and decentralised (Jackelen and Rhine, 1991; Rhine, 1993).

In Tanzania, the Presidential Trust Fund for Self Reliance (PTFSR) has attempted to adopt the Grameen Bank model. The PTFSR was established in 1985 to support small groups and individuals, especially the jobless and underemployed youths and women, with small loans administered through the National Bank of Commerce network. Lack of staff forced it initially to use district (government) planning officers for follow-up, project monitoring and debt repayment. Widely scattered projects, poor project follow-up, ineffective project monitoring and high administrative costs yielded very low repayment rates (generally below 50%).

Since 1989, the PTFSR has embarked on a new direction, involving a four-pronged strategy. Firstly, it has adopted a Grameen Bank-type credit programme in which loans are made to groups of individuals, whose members provide a mutual guarantee in a bid to resolve the problem of collateral, cut down costs and reduce the high default rate. The new approach has increased the repayment rate from less than 50% to 95%. Secondly, it has narrowed its focus to a limited target community in a given district (initially Kinondoni District in Dar es Salaam and later Morogoro) so as to develop a replicable working model of group-based loans. Thirdly, it has worked through its own field officers (with a target of 200 clients per credit officer), rather than through regional or district government officers, who had previously performed ineffectively. And, fourthly, it has gradually broadened the target group beyond women and youths and has spread uncollateralised loans to a wide range of activities in different sectors.

The PTFSR lending approach has some built-in advantages. For instance, it allows group members to use their loan shares individually, but it exerts social (group) pressure to ensure repayment; moreover, it facilitates supervising of clients and motivates poor clients to save and to cultivate the habit of doing so. But despite the high repayment rates, the Fund has a low volume of credit and high operating costs. It has been reported that from January to August 1991, the programme made TSh 4.3 million in loans (of between TSh 50,000 and TSh 100,000 for each project) against a cost of TSh 5.6 million; and that as of June 1992, it had made TSh 9.6m in loans, yielding interest income of TSh 0.99m against an operating cost of TSh 7.7m. Savings are reported to have been only TSh 1.01m (Keddie, 1992). This is likely to impair the programme's sustainability in the long run. However, some prospects exist for future cooperation between the Fund and the National Bank of Commerce. The Bank officials expressed interest in lending money to the NGO's programme at commercial interest rates, to be re-lent to informal sector borrowers, provided that the Fund shows strong cost control and recovery rates.

Second, if such policies are to be meaningful and effective they should address the problems facing informal lenders, especially those that raise transaction costs – poor infrastructural support services (feeder roads, telecommunications and cheap and accessible forms of electricity) and the absence of market information. They should also address the problems facing small borrowers, especially those associated with the lack of collateral and creditworthiness.

Third, a structured market must be created to reserve a certain proportion of resources for poor borrowers, especially in rural areas. This could be achieved, for example, by promoting new formal credit institutions with new forms of collateral, such as the group system introduced so effectively by the Grameen Bank in Bangladesh (Bagachwa and Stewart, 1992) and the Podem Programme in Bolivia and the BRI–Unit Desa in Indonesia (Jackelen and Rhine, 1991).

Other successful innovative schemes that should be pursued are those that have attempted to link informal savings and credit groups to local banks in order to bring the beneficiaries into direct contact with the formal credit system. In India and Bangladesh, for example, informal savings and credit institutions are linked to local banks that supply credit based on the amount of savings deposited, which also serve as security. In Peru, programmes involve NGOs to help informal borrowers form joint liability groups that establish guarantee funds. NGOs also help prepare the necessary documentation and assume part of the operational costs. Banks may then provide loans several times the value of guaranteed loans (de Jong and Kleiterp, 1991). Similar attempts are being made by the Tanzania Gatsby Trust – an NGO that provides microenterprise support in three pilot districts in Tanzania (Mwanga, Mtwara and Zanzibar West). It works with grassroots organisations to help form joint liability groups, register these groups and open their bank accounts. The Trust also provides credit to legally registered institutions, at the market interest rate, for on-lending to small operators.

Overall, this study has confirmed the absence of financial integration in the Tanzanian informal financial system. This is reflected in the normally observed and statistically significant differences in interest rates both between segments and between savers and borrowers. Interaction and linkages between the informal and formal financial sectors were also observed to be weak. One important finding is that the various financial market segments may in fact be representing an efficient specialisation for different niches, suggesting that selective integration is the appropriate policy vehicle, rather than simply extending the formal sector's frontier.

Another revelation is that the financial repression hypothesis that explains dualism in terms of restrictive financial policies and controls that shift investible resources from the market to the government may not necessarily be the only reason for fragmentation. Tanzania has experienced repressive financial policies and attempted to liberalise them as part of structural adjustment reforms. However, the study has revealed that the volume of informal credit is expanding significantly and informal savings are being mobilised rapidly in a much more liberalised environment than previously. If the informal credit markets were strictly a parallel market, interest rate liberalisation would have eliminated this channel of credit. Finally, there is evidence that informal financial institutions appear to be operating with low transaction costs.

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